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Export Promotion Policy and Economic Growth in the Philippines A Comparative Context

by

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Export Promotion Policy and Economic Growth in the Philippines A Comparative Context

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Abstract

This paper argues that, in any review of export promotion policy of the Philippines, it is more fruitful if a comparative context (relative to countries in its similar stage) is used. We broadly trace export promotions policies of 3 illustrative tiger economies (South Korea, Singapore, and Taiwan) and 3 emerging economies (Indonesia, Malaysia, and Thailand). The Philippines went through the entire process of export promotion and development in the same way as these economies did. Three critical factors influenced exports in all these countries and for which the Philippines either hardly paid attention to or took on a different policy tack. The first is infrastructure and related facilities and how these defined the overall environment for domestic production and international trade. The second is the importance of foreign direct investments (FDI) in the country's export strategy. The third is the use of exchange rate policies to enhance other export promotion policies.

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Export Promotion Policy and Economic Growth in the Philippines A Comparative Context

Florian A. Alburo

1. Introduction

This paper argues that, in any review of export promotion policy of the Philippines, it is more fruitful if a comparative context (relative to countries in its similar stage) is used. This is especially true in international economic relations – trade, foreign investments, tourism, tradable stocks – where the Philippines is an integral part of the world market in these transactions. While it can always be said that it is inappropriate to compare the Philippine economic performance relative to other countries, there are a number of reasons why this comparative context is taken. The first is because the Philippines “competes” with other countries for product markets in which the country is not the only producer¹. Thus our ability to sell our products abroad may also mean there could be other countries unable to sell similar products. In terms of the evolution of our export industries there is a lot in common with other countries be they general and specific policies, institutional arrangements, behavior of economic agents, and other factors. It is also true that the country’s attractiveness in drawing in foreign investments and tourists is also a function of other countries’ degree of attractiveness. Finally, comparative analysis often always yields reasons why varying performance happens and suggests how it can be attained.

This paper shows that in the immediate post-war decade, the Philippines experienced one of the highest economic growth rates when compared with a selected number of Asian tigers Singapore, South Korea (Korea), and Taiwan, and from among some advanced Asian economies Indonesia, Malaysia, and Thailand. The Philippines also experienced one of the highest exports of goods even as late as 1970 particularly in terms of non-traditional manufactured products. Yet the country actually saw a deterioration of its economic growth and exports thereafter. Indeed Philippine exports (aggregately and in specific sectors such as agriculture) lost their steam relative to the selected countries and even with the war-ravaged countries of Indo-China. This paper hypothesizes that while it would require a more thorough and rigorous technical analysis to examine causally the Philippines failure to attain a comparable and sustainable economic growth similar to the economies it started out with in development, there are some policy-related factors it can be linked to. More pointedly, the inability of the country to achieve a higher growth orbit in the last several decades is associated with a prolonged policy of import-substitution, an export policy diluted by continued protection to the domestic sector, an exchange rate policy that penalized exports and rewarded imports, extremely skewed wealth and income distribution, a domestic economy with limited markets for (and often hostile to) foreign investments, poor infrastructure facilities especially those that support exports and trade, lack of constituency for openness and opposition to outward-looking vision, weak institutions that are unable to maintain fairness and transparency, and feeble political system that engenders narrow and vested interests, among others. Admittedly, this list is long (and not even exhaustive) and it would be difficult to disentangle them much more posit their varying degrees of importance in explaining Philippine economic growth. But some of the contours of the explanation are attempted in this paper.

¹ As Krugman (1991) has argued, nations do not really compete with each other in international trade in the same way as firms do. See also Hawkins (2006).

Accordingly, the next part of this paper describes and quantifies Philippine economic growth since 1960 – the record over the past 4 decades and the more recent experience. The point of this part is to show that although the country has had respectable growth rates it had seen more bouts of a cyclical type of growth and one that simply oscillates around a “low-level equilibrium” trap instead of seeing it oscillating into a higher orbit. This is evident when the country’s per capita growth rates are compared with the two groups of economies in the region. It can also be observed that the country’s high population growth rate during the same period put a drag into its growth performance.

Part 3 in turn describes and quantifies Philippine exports of goods since 1970 in comparison to the same group of economies with a memorandum on the export earnings of China and Viet Nam over the same period where feasible. The messages here are that (a) exports are capable of accelerating irrespective of whether the economy is large or small, (b) potential exports based on natural resources have been missed by the country and being exploited by neighbors, and (c) climbing up the export (diversification) ladder sustains its growth. The burst of non-traditional manufactured exports unfortunately sputtered denying the country a sustainable economic growth path.

Part 4 tries to explain why exports and economic growth have eluded the Philippines compared to the other economies first by laying out the underlying theory behind such relationship and then focusing on the policy instruments that have been used to promote exports. Among those that have been used across the comparable economies include transition from import substitution to export promotion, fiscal and non-fiscal incentives for exporters, creation of processing zones, exchange rate policy, and foreign investments (linked to exports). Although all of the economies in the sample did begin their development processes with import substitution, most abandoned this policy much earlier than the Philippines, and switched to export-oriented industrialization strategy. And all established (with the exception of Singapore where the whole economy was considered a processing zone²) export processing zones where packages of incentives were provided exporters. And to top it all (again with the exception of the Philippines), most pursued undervalued exchange rate policies. The combined array of export promotion policies probably had a strong force in stimulating exports and leading to high economic growth rates.

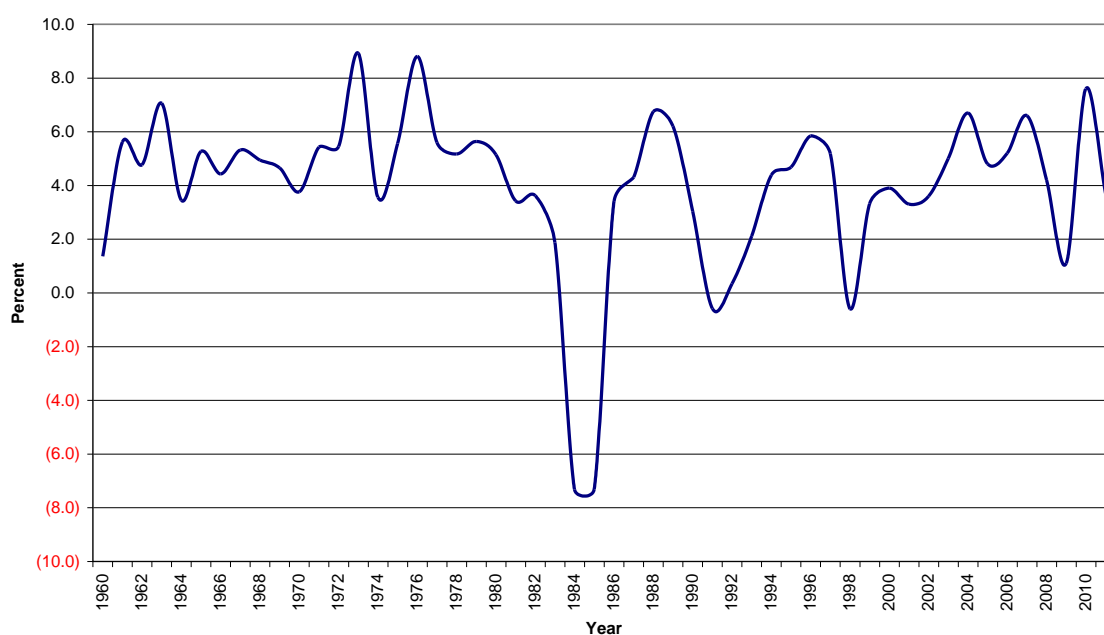
In the last part we conclude the paper with 2 important points – the Philippines had a previous episode in its economic history of a liberal trade regime but was hobbled by political changes and some technical and intellectual vacuum that had critical policy implication. The country then is not new to the outcomes of a liberal economy in terms of efficiency and raising economic growth. Even if it remains difficult to sort out the right combination of policies related to trade and exports that would contribute to the achievement of sustained economic growth, these are known, there is enough research and knowledge base with which they can be pursued, outcomes and consequences are identifiable and the number of countries and economies that have hurdled the tasks of promoting exports and reaping growth keep on increasing. What is needed is perhaps the social and political system to carry out the technical parts of the tasks – the agenda the Philippines has to come to grips with.

² Singapore did have EPZs (its first [1951] even ante-dating Taiwan’s) implying it did pursue import-substitution early on. But for all intents and purposes the other zones merely reinforce the country’s export-orientation and meant to provide a targeted package to put the economy ahead of the curve. Singapore pioneers in an Innovation District (one-North Singapore) began in 2001 and clusters the academe, science parks, and mixed facilities to foster knowledge and innovation.

2. Comparative Philippine Economic Growth

The long-term economic growth rate of the Philippines can best be described as “wobbling” while other economies in the Asia region were creating the “Asian miracle” of rapid growth, poverty alleviation and modernization. While others were experiencing high growth orbits, the Philippines was struggling in bouts of growth spurts and declines. If we are to picture the country’s real GDP growth rate in the last 40 years it would show cyclical patterns around an average of 4 percent per year. As Figure 1 below shows the country’s growth path seems to oscillate around what can be hypothesized as an “equilibrium” growth rate – call it a “low-level equilibrium” trap.

Figure 1
Real GDP Growth Rate
Philippines: 1960-2011



While the few years of high growth rates are respectable (e.g. 1976, 1988, 1996, 2004, 2010), they came after previous periods of lower growth rates masking the performance. Indeed the average for the more than 50 years of growth has been around 4 percent per year. Much of this growth has only been chipped by a high population growth rate leaving per capita rates even lower. And if one were to discount the uneven distribution of incomes the incidence on the lower income classes of this low-level growth rates would be more disconcerting.

If one were to look further backward in the period immediately after the end of World War II when most Asian economies were recovering from its ravages, the Philippines had in fact one of the highest growth rates in the region. We compare the country with 3 economies that are part of the “Asian Miracle” or tigers (Singapore, Korea, Taiwan) and 3 economies that may be considered as emerging tigers (Indonesia, Malaysia, Thailand) in order to have different perspectives from these 2 groups. We compare the per capita real GDP for these economies with the Philippines. It must be remembered that all of these economies were not only recovering but were also plotting their economic growth trajectories.

Table 1
Annual Growth Rate
Real Per Capita GDP
 (Percent)

	1950-60	1960-70	1970-80	1981-90	1990-2000*	2000-10
S. Korea	3.1	6.0	8.0	9.9	9.1	4.6
Singapore	1.3a	6.7	7.7	6.3	8.7	7.0
Taiwan	4.0	6.3	6.7	8.5	6.6	4.7
Indonesia	1.9	2.3	5.7	5.5	8.6	5.2
Malaysia	1.0	3.3	5.3	5.2	9.4	5.5
Philippines	3.6	2.2	3.4	1.2	3.8	4.7
Thailand	2.8	4.7	5.1	7.8	10.2	4.6

a -1956-61

*Ave: 1990-95

Sources: Oshima (1982)
 ADB KI

What Table 1 above shows is that in the decade of the fifties at the start of post World War II reconstruction, Philippine economic growth was one of the highest (bested only by Taiwan at 4 percent per year). The table also reveals that after this initial decade the Philippines started to decline in relative growth rates highlighted by the “lost” decade of the eighties when its annual growth rate was merely 1.2 percent per year. In fact during the entire period (6 decades in Table 1) the country was in the cellar of economic growth except for the initial and ending decades. What is not so apparent from the table is that since it reports *per capita* GDP, the higher the population growth rate the lower would be the per capita growth rate. And even if we presume similar growth rates as the rest, a Philippine population growth rate higher than the others would put a drag in its per capita performance. For example, the Philippines has always been compared with Thailand given its similarity in resource endowments, size, location, etc. Indeed as late as 1965 Thailand had a slightly higher population growth rate than the Philippines so that by 1975 the two countries had about the same population size. Yet by 2000 Thailand had almost a quarter population less than the Philippines which meant it had a higher per capita growth rate, all other things being equal.

These growth rates when translated into absolute values provide even sharper contrasts. In 1990 the Philippines Gross National Income (GNI) in current US dollars was \$ 920 compared to Singapore’s \$ 12,050 and Korea’s \$ 6,000 or Taiwan’s \$ 8,339³. In 2000, the country’s GNI reached \$ 970 compared to Singapore’s \$ 23,350, Korea’s \$ 10,890, Taiwan’s \$ 14,908. This GNI for the Philippines in 2000 was 67 percent higher than Indonesia’s \$ 580. However by 2010, Indonesia’s GNI of \$ 2,580 was now higher than the Philippines \$ 2,050 (by 26 percent) reversing the 2000 figures⁴. Of course, Singapore, Korea and Taiwan continued their high income march despite some slowdown between 2000 and 2010 (e.g. Taiwan at 2.5 percent per year). These comparisons are however quite late to really appreciate the relative economic growth of the Philippines. If we work backwards into 1950 and examine long-run (50-year) comparisons until 2000, the contrasts are sharpest. For example, the real per capita GDP

³ The data here were culled from ADB Key Indicators (various years)

⁴ With the Philippines recent growth streak the country managed to best Indonesia in 2017 by 3 percent.

of the Philippines was higher than that of Korea between 1950 and 1965, yet by 1970 Korea's real GDP accelerated and left the Philippines behind permanently.

3. Comparative Philippine Exports

How much trade in general and exports in particular contribute to economic growth is not a completely settled issue. This is even more so when it comes to the question of trade and exports causing economic growth (instead of the other way around). But the theoretical literature from Adam Smith's seminal treatise to Paul Samuelson's recent critique of classical trade theory remains unassailable⁵. Countries which engage in trade are likely to grow faster since liberal trade allows comparative advantages to prevail, efficiencies enhanced and gains accumulated. But the growth that takes place does not guarantee everyone gaining – gains may neither be equal but distribution is a separate issue requiring a separate policy. What we show here is the record of exports of the same group of economies in Table 1. Table 2 below reports these values (in current US dollars) of merchandise exports for the comparable economies.

Table 2

	Merchandise Exports (In US \$ B)												
Country	1970	1980	1985	1990	1995	2000	2005	2007	2009	2010	2015	2017	
S. Korea	0.8	17.5	26.4	64.0	125.0	172.6	284.4	371.5	363.5	466.4	526.7	573.7	
Singapore	0.8	18.2	21.5	49.3	118.3	137.9	229.8	299.0	268.9	351.2	357.7	372.9	
Taiwan	1.4	19.8	30.5	66.2	111.6	151.5	198.2	246.3	202.7	273.5	283.5	317.3	
Indonesia	1.1	21.9	18.5	25.7	45.4	62.1	85.7	114.1	116.5	157.8	150.4	168.8	
Malaysia	1.6	12.9	15.1	28.7	74.0	98.2	140.9	175.8	156.8	198.5	199.0	217.5	
Philippines	1.1	5.7	4.6	8.2	17.5	38.1	41.2	50.5	38.4	51.4	58.8	62.9	
Thailand	0.7	6.5	7.1	23.4	56.4	68.1	109.5	151.0	150.3	193.2	214.1	234.8	
PRC	2.3*	18.1*	27.3*	62.1*	148.8*	249.2	761.9	1217.8	1201.6	1577.9	2273.5	2263.5	
Viet Nam				2.5	5.6	14.5	32.4	48.6	57.1	72.2	162.0	214.0	

Source: IMF IFS, ADB KI
*Chinability (China Statistical Yearbook)

Notice that as late as 1970 Philippine merchandise exports were among the highest in value except for Taiwan and Malaysia. Its export earnings of USD \$1.1B were definitely higher than Korea and Singapore. Exports started to sputter thereafter and by 1980 the country registered the lowest export earnings among the 7 economies in the table. This has been the ranking all the way in the time period until 2010. What the table also shows is that not only have exports been accelerating through more than 3 decades for these economies but that this (acceleration) held for both large and small economies illustrated by Singapore and (partly) Taiwan. The memorandum item in the table pertaining to China and Viet Nam holds as well.

⁵ Smith (1776) began this idea of why nations trade but it was Ricardo who completed it (Krugman1991); Samuelson (2004) later questions the theoretical foundation of trade.

For the Philippines 1970 was when non-traditional manufactured exports started to become significant in overall exports – electronics, garments, footwear, processed food/beverages, furniture and parts, and wood manufactures, among others (Alburo 1994). Of course, a comparable transformation was taking place in the other economies as they moved out of traditional primary products exports (e.g. copra, logs, and sugar in the case of the Philippines). The relevant question to ask and to be answered is why the country failed to take-off in new exports in the same way as the others did in the table (and reflected in the numbers).

Even in the recent resurgence of agricultural food and seafood products, the Philippines has also been behind next-door neighbors in terms of the country's resource endowments. But these have sprouted in the country for some time, and for some products, the Philippines pioneered in their exports (e.g., mango, banana, asparagus)⁶. Indeed, agriculture trade of the country remains far behind. See Tables 3 and 4 below for its agriculture trade balance and the record of selected seafood products, respectively⁷. Notice the relatively low export per farm area in Table 3 and the low export per kilometer of coast line in the Philippines. The relevant question, again, is why a poor performance?

Table 3
Philippine Agriculture Trade
2007

Economy	Exports (\$ B)	Imports (\$ B)	Balance (\$ B)	Export/ Farm Area (\$)
Indonesia	23.4	10.5	+12.9	710
Malaysia	20.5	10.6	+9.9	2,710
Thailand	25.0	8.4	+16.6	1,420
Vietnam	11.7	6.1	+5.6	1,500
Philippines	3.2	4.3	-1.1	300

Source: Dy (2010)

⁶ The initial market for these resource-intensive agricultural products was Japan but this later expanded even to the United States.

⁷ The economies in which these comparisons are made are not the same as in other tables – they include Viet Nam but exclude Korea, Singapore and Taiwan, economies which are no longer dominantly exporting agricultural products and are in fact importing them.

Table 4
Seafood Exports^a
2007

	Export value (\$ Mln)	Coast-line (Km)	Export/ Km coast-line (\$)
Indonesia	1,949	57,716	34,000
Malaysia	640	4,675	137,000
Philippines	391	36,289	11,000
Thailand	6,173	3,219	1,918,000
Vietnam	3,064	3,444	890,000

^aHS 03 and 16

Source: Dy (2010)

4. Comparative Export Promotion Policies

Without imputing causality (for lack of rigorous technical analysis) of exports to economic growth, it so happens that most if not all of the economies in the previous tables made conscious policies promoting exports at about the same time. They also started their development processes along the same time frame i.e. beginning after the end of WWII. And they also went through similar development stages that are often used to describe economic growth. Developing countries including those in the previous tables began their reconstruction with import substitution as an immediate way to restore domestic industries – which was pursued through protection. Those industries did recover and so did other (new) industries (e.g. automotive assembly) evolve. Some economies, however, realizing domestic market limitations shifted to export-oriented industrialization and moving the policy levers towards export promotion. The arsenal these economies used included the creation of export-processing zones (EPZ) or some variants (free-trade zones, bonded/licensed warehouses) and various fiscal and non-fiscal incentives to exporting industries and firms. For example, all of them started their EPZs around the early part of the seventies (with the exception of Taiwan which established the Kaoshiung EPZ in 1966) with similar incentives to locators (Madani 1999, UNIDO 2015). The fiscal and non-fiscal incentives went with the creation of these zones and extended to those licensed to operate as bonded warehouses. It is important to realize that these EPZs provided incentives to exporting firms that were effectively over and above an environment promoting exports reinforcing the strength of the direction.

For most economies the fifties were the period of import substitution, the sixties of export promotion (early stages of simple assembly), the seventies and eighties of climbing the export ladder, and then onto participation and integration in the globalization processes including

financial liberalization. The Philippines provides the difference in the practices of these export promotion measures. For one, while a number truly abandoned import substitution in favor of export-oriented industrialization – illustrated by Singapore and Taiwan – the Philippines actually enacted export promotion policies while maintaining a protection system for import substitution. It initiated an industrial incentive system for domestic-oriented industries in 1967 and then an export incentives law in 1970 to complement its EPZ⁸. In effect the two incentive systems offset each other, diminished potential backward linkages among industries, and gave confusing signals to economic agents. For another, in the early part of its export drive the government instituted a complex web of mechanics and schemes (e.g. duty-rebates, exchange rate margins, licensing and permits) giving different signals to producers, investors and traders⁹. Finally, the combined impacts of varying incentives and protection invariably took their toll on the country's ability to enter export markets and capture benefits from early movers¹⁰. It is not that the other economies did not have protection systems that distorted incentives and even lingered for some time before finally abolishing them. Indeed the wide variation of effective protection rates across industries and product groups in the Philippines were far more virulent than in other economies – recently emergent Viet Nam did also give protection but with such low average rates and standard deviations (Athukorala 2006). An endemic protection is not likely to be corrected with a soft export promotion.

There are 3 critical factors that influenced exports in all these countries and for which the Philippines either hardly paid attention to or took on a different policy tack. The first is infrastructure and related facilities and how these defined the overall environment for domestic production and international trade. Consider roads which are essentially neutral conduits for goods. While the Philippines has one of the highest road densities in the region, its proportion of paved roads remains one of the lowest. Its first EPZ, the Bataan Export Processing Zone, suffered from poor infrastructure linking the enclave from the nearest port. Consider telecommunications which while ubiquitous today mattered critically during the early stages of pursuing export promotion. For exporters efficient communication systems are the lifeblood of trade for sending and receiving documents (e.g. invoices, certificates), negotiating terms and conditions, and exchanging messages with buyers and suppliers. The Philippines had one of the longest waiting time for telephone connection in the region discouraging would-be investors and domestic businesses from engaging in exports with telecommunications service provider monopolized.

The second is the importance of foreign direct investments (FDI) in the country's export strategy. The overall country economic environment is perhaps the prime barometer foreign investors examine when contemplating on entering a country. FDI in the Philippines has been plagued by intricate rules and regulations, lack of support for the entire process of registration, and other non-economic factors (ADB/NEDA 2011). The relative FDI drought in the Philippines has a salient implication (ADB 2007). While volumes of FDI contribute to a country's development, it is technology transfer with firms at the cutting edge of industries, knowledge that indigenous workers acquire, and strong networks with other firms that loom large and helps the country climb up the export ladder¹¹. The country can graduate faster from simple

⁸ Republic Act 5186 or the Investment Incentives Act to promote domestic industries and Republic Act 6135 or the Export Incentives Act.

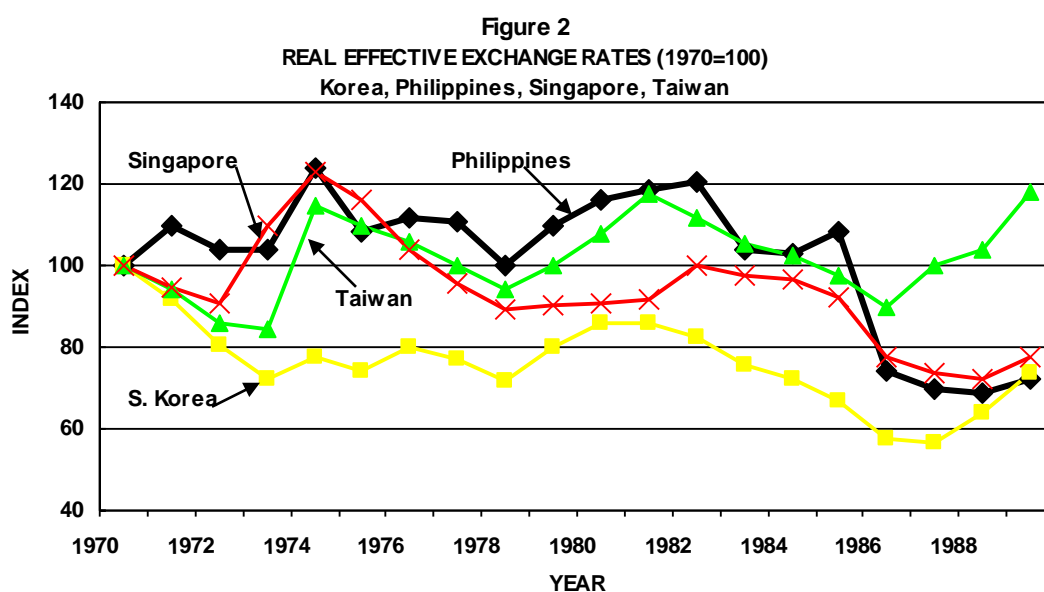
⁹ There is extensive literature on this e.g. Bautista and others (1979)

¹⁰ Estimates of effective protection rates across industries showed wide variations of incentives in large part against exports. See Bautista and others (1979)

¹¹ A notable exception to these FDI inflows would be Korea relative to flows into Singapore and Taiwan. But it is common knowledge that Korea imported cutting edge technologies through other means including reverse engineering.

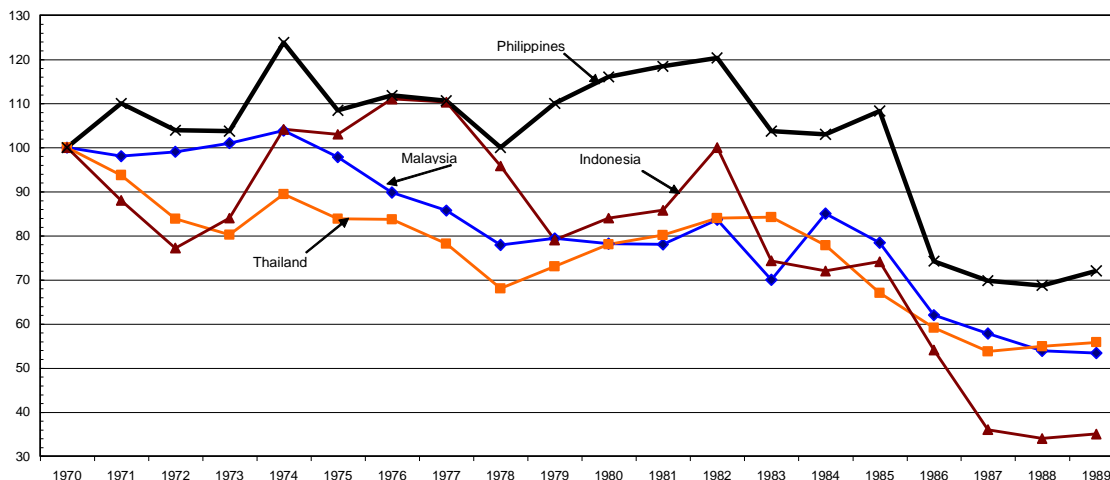
semiconductor and integrated circuit assembly to electronic design with more collaboration that FDI engenders. The average inflows of FDI into the country have remained low in comparison to the other economies in the table.

The third is the use of exchange rate policies to enhance other export promotion policies. Exchange rates affect exports and imports simultaneously. To the extent that an exchange rate is overvalued (relative to what it would be in undistorted markets) exports tend to be penalized and imports rewarded. On the other hand an undervalued exchange rate means there is a social value to exports and social price to imports. And countries that practice active exchange rate policy over time eventually shape its trade and likely growth. Indeed one can argue that exchange rate policy may even have a stronger impact on exports and imports than any other incentives individually. Looking at the real effective exchange rate of the Philippines relative to the other economies reveal that the country had actually an overvalued currency for so long – see Figures 2 and 3 for the period 1970-1990.



Source of Basic Data: IMF IFS; Author's calculation; Above 100=Overvaluation

Figure 3
REAL EFFECTIVE EXCHANGE RATE (1970=100)
Indonesia, Malaysia, Philippines, Thailand



Source: See Figure 2

5. Concluding Remarks

The Philippines went through the entire process of export promotion and development in the same way as other developing economies did. The apparent significant differences between the country's experiences in the process may partly explain why its economic growth has not followed the rest although more rigorous analysis would be essential. The country stayed too long in import substitution long after the rest had abandoned that state. In fact Philippine policies to promote exports came on top of existing import-substitution protection policies – negating any export-oriented bias that promotion policies are supposed to impact, and failing at the very least to keep incentive systems neutral. Indeed even as late as 2005 protection policies were used to shield domestic producers from competition. These vestiges of import-substitution had damaging effects on the economy – for example downstream industries with export potentials are unable to compete given high input costs. Moreover the prolonged import substitution phase created strong vested-interest groups that eventually capture the political process and ensure continued policy biases. Korea did shift away from export promotion to industrial targeting (and not so apparent in the Tables 1 and 2 but evident in Figure 2 above). But the country abandoned that policy as an admitted mistake and moved to more neutrality and export promotion thereafter (Yoo 1994).

From the vast array of controls on international transactions reflecting its import-substitution stage shortly after the end of the WWII, the Philippines completely abandoned that with decontrols and liberalized regime. However the ensuing tariff changes to provide the transparent basis for trade eventually kept the incentive system basically anti-export. And with the absence of necessary supporting measures particularly land reform (which the other economies had earlier instituted) and infrastructure, the abandonment of import-substitution was basically cosmetic. Neither did the frequent policy reversals associated with political changes help the drag of a prolonged period of protection.

Of course the long-term overvaluation of the Philippine currency created even more disincentive to exports in general. Even if we presume measurement errors in estimating real

effective exchange rates, the fact that the other economies deliberately pursued undervalued currencies doubly inflicted on the Philippines' export sectors. Limited FDI inflows also hindered the country from climbing up the export ladder and further diversification. In short, while there are obviously export products that the country have sufficient strength, are outstanding, and will continue to be of comparative advantage, the general types of exports that can absorb the un- and under-employed (in the theoretical sense at least) remain short. And this includes even services exports touted to draw in export earnings and employment (e.g. business-process-outsourcing industries).

Neither has been the policy of exporting labor (the bodies instead of the products they produce) yielded the kind of economic growth that we see in the other economies. It is true that these workers' remittances have almost reached half of the country's exports of goods. The counter-factual question is what the Philippines exports would have been if we had the same pattern of economic policies as the others have followed. The answer can partly be appreciated by the fact that 3 of the economies (Korea, Malaysia, and Thailand) also took a route of sending workers (especially in the mid- to late-seventies) but their exports accelerated absorbing the labor that would have been sent as overseas workers. Now that the length of this particular "export-promotion policy" of the Philippines has reached a generation, it is becoming analogous to the country's prolonged import substitution phase. As the Koreans (and the Singaporeans and the Taiwanese) travel to the rest of the world (and to the Philippines) as tourists given their high incomes, many of the Filipinos still eke out living in other countries as domestic workers or increasingly highly skilled workers who could have produced exportable products to global markets.

A long-term comparison of Philippine export promotion policies with other economies in similar stages of its development is both didactic and revealing. There are enough lessons to draw from these to indicate not iron-clad directions but paths that others have followed with economic growth to show for. Comparisons also reveal where the Philippines may have been short of and thus fashion an appropriate policy apparatus.

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