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Social Development and Globalisation:
The Philippine Case

Leonardo A. Lanzona

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This paper gives a broad overview, with supporting statistical evidence, of the relationship and interrelationships between trade liberalisation and the inflow of foreign direct investment and social development in the Philippines during the late 1980s and the 1990s. With its membership to the Asia-Pacific Economic Cooperation (APEC) and its commitment to the APEC Trade and Investment Liberalisation and Facilitation (TILF) agenda, the Philippines has committed itself to programs with greater outward orientation, a development that has overshadowed as well as influenced economic and social conditions in the country. However, this program seemed to have overplayed the short-run, and in the process underplayed its long-term, implications. In particular, the focus of the program is primarily on expanding investments and freeing financial markets. This emphasis has led to a disproportionate process of liberalisation and facilitation that favored capital- and skill-intensive industries, resulting in an increase in poverty incidence and magnitude in the rural areas.

1. Introduction

Globalisation refers to the rising levels of involvement in the world economy, increasing interdependence, the establishment of global markets, prices and production, and the diffusion of technology and ideas (Lairson and Skidmore 1997). Three main components of globalisation are: (1) the growth of foreign direct investments (FDI) due to financial liberalisation and relatively costless international financial transactions; (2) the growth of trade due to the emergence of global markets and the reduction of trade barriers; and (3) the diffusion of global technology and innovation due to easier communication. These changes can be categorised jointly in terms of financial and trade liberalisation.

In this context, tariffs and non-tariff measures are considered to be market distortions that impede trade and cause trade and welfare losses to the economies. The trade liberalisation and facilitation measures, incorporated in the globalisation process, are then understood as the removal as well as the reduction of these distortions. Such measures reduce import barriers, which lower import prices to the domestic market and increase imports. Less expensive imports, in turn, lead to lower production costs for other domestic industries. The improvement in the general world economy ultimately leads to a relocation of labour and capital to other more efficient sectors, away from the protected sectors. Moreover, the improved efficiency of the export goods industries is expected to accelerate the exports of the economy. If trade accounts tend to be balanced in the long run, then the exports of the economy will increase until balanced trade is eventually recovered.

On the social aspect, liberalisation and facilitation are expected to improve the welfare of society. The Hecksher-Ohlin theory maintains that countries export goods that use intensively those production factors that are relatively abundant at home and import goods that use intensively those factors of production that are scarce. Trade therefore increases the demand for the abundant factors, assuming the expansion of the export sector, and reduces the demand for scarce factors, assuming the contraction of the import-competing sectors. In low-income developing countries, where abundant unskilled labour is found and skilled labour is scarce, trade tends to increase unskilled labour wages and lower skilled wages, thereby narrowing the gap between them.

With this perspective, the Philippines was in the forefront of the Asia-Pacific Economic Cooperation (APEC), an organisation incorporating the Association of Southeast Asian Nations (ASEAN) members and other developed nations in the Pacific, including Japan, the United States and China. The APEC Economic Leaders at their meeting in Bogor in November 1994 set a number of specific goals and objectives, including (1) free and open trade and investment in the Asia-Pacific region no later than 2010 for industrialised economies and 2020 for developing economies; (2) expansion and acceleration of trade and investment facilitation programmes; and (3) intensified development cooperation. In Osaka in November 1995, APEC adopted the Osaka Action Agenda (OAA), which has become the guide for future APEC work toward the common goals. In November 1996, APEC released the Manila Action Plan for APEC (MAPA), which is the first action plan toward the goals set in the Bogor Declaration and the OAA. MAPA consists of individual action plans (IAPs), collective action plans (CAPs) and other joint activities in various APEC fora.

In this paper, I will consider more closely the recent performance of the Philippine economy, a period that is marked by substantial economic growth, as the country has become more open and globalised. One of the results of this progress however was the huge internal public debt that has been reported to have reached PHP1.37 trillion (roughly US$39.1 billion) as of the end of May 1998 compared to PHP1.35 trillion (US$45.90 billion) as of the end of 1997. This development comes also at the heels of the debilitating effects of the Asian financial crisis, including a substantial depreciation. Hence, despite the recent gains, the government still faces both external and internal uncertainties.

This paper then will examine the reasons for the apparent weakness of the Philippine economy to sustain its growth and to improve its social conditions despite the promotion of trade and investment liberalisation. The APEC Trade and Investment Liberalisation and Facilitation (TILF) agenda is seen as the major event that has overshadowed as well as influenced economic and social conditions in the Philippines. However, this programme seemed to have overplayed the short-run concerns, and in the process underplayed its long-term implications. In particular, at least in the case of the Philippines, the focus of liberalisation and facilitation is primarily on expanding investments and freeing financial markets. This emphasis has led to a disproportionate process of growth that favoured capital- and skill-intensive industries, resulting in an increase in poverty incidence and magnitude in the rural areas.

The rest of the paper is divided into the following parts: the first section discusses the financial and trade liberalisation programmes as these were implemented in the Philippines in the last ten years or so. The next section provides data that will then show the consequences of such programmes. These two sections will demonstrate the uneven pace of implementation between trade and financial policies, resulting to some deterioration in social welfare. Next, we present the conceptual framework that will explain the adverse consequences of disproportionate policies on trade and capital market liberalisation. Finally, we will make concluding remarks, particularly the policy implications of the paper's findings.

2. Financial and trade liberalisation and facilitation in the Philippines

The Philippine programme of financial and trade liberalisation and facilitation foreshadowed its membership to the APEC. The APEC financial liberalisation and facilitation programme is based on individual initiatives and action plans of the different economies. Given the diversity of the APEC members, the programme then has been implemented in varied ways. Despite this diversity, however, two general trends are clear from the experience of the past decade. First, APEC member economies across the spectrum of stages of development have gradually moved toward more open investment regimes. Second, though investment liberalisation has been approached in a more cautious and generally less thoroughgoing fashion than has trade liberalisation, many economies have liberalised their investment regimes, resulting in substantial increases in FDI inflows.

The investment policies of the Philippines have changed substantially along with the Philippine's economic conditions and development strategies. Unlike other countries in Asia, the Philippines adopted the strategy of import substitution industrialisation as a response to severe balance-of-payments problems. Because of the shortage of government resources and domestic savings, foreign direct

investment (FDI) was considered desirable. However, in line with the protectionist and political strategy of the time, the import substituting industries were the only ones that gained from these inflows through devices such as tax exemptions, favourable credit terms, and market protection.

The situation changed in 1990 drastically with the implementation of an economic stabilisation programme spurred primarily by a stand-by credit facility from the International Monetary Fund. This paved the way for reforms in trade and investment that were subsequently expanded in the Ramos administration although important measures were made just before the end of the Aquino administration. The most important of these was the passage of the Foreign Investment Act of 1991 that liberalised investment by allowing 100 per cent foreign equity in a domestic or export enterprise as long as its activity did not fall under a negative list. Furthermore, this law simplified the procedure for the entry of foreign investments by requiring foreign investors to register only with the Securities and Exchange Commission (SEC), unless incentives from the Board of Investments (BOI) are sought.

Since 1992, a more comprehensive market-oriented approach to economic structural reform has been followed. Under this approach, many key sectors, including the downstream oil, shipping, domestic and international aviation, telecommunications, and mining industries, as well as infrastructure, have been opened to the private sector, including to foreign investors. Ten foreign banks also were initially allowed to open branches.

As a result of this, foreign equity investment in the Philippines grew by 136 per cent from US$2 billion in 1990-92 to US$4.7 billion in 1993-95. As a matter of fact, almost two-thirds of the total foreign investment that had been accumulated since 1968 came in during the last five years. In addition, BOI-approved investments have accumulated to about US$66.3 billion as of the first half of 1996. The surge of FDI in the 1990s cannot however be attributed solely to the FDI liberalisation policies, since the investment procedures were only one of the packages of the general economic reform (APEC, 1997).

Trade policies on the other hand have been implemented since 1980, though this has been met with some resistance. So far, there have been four major programmes that resulted in a substantial reduction in tariffs. The first phase of the Tariff Reform Programme (TRP-I) was implemented in 1981 covering a five-year period, aimed at leveling-off protection rates across industries and at achieving effective protection rates (EPRs) within the range of 30-80 per cent. The second phase of TRP became effective on August 1991. Under TRP-II, locally produced and imported raw materials would have a tax of 10 per cent and 3 per cent rates of duty, respectively, while intermediate goods were levied at 20 per cent and finished goods at 30 per cent. TRP-II (EO 470) was supposed to end by December 1995, but was overtaken by the third phase of TRP in August 1995. TRP-III liberalised further the trade environment by reducing the level and spread of tariffs towards a uniform level of EPRs across all sectors, in order to promote global competitiveness and simplify the tariff structure for ease of customs administration, and providing a level playing field for local manufacturers vis-à-vis foreign competitors. Finally, because TRP-III led to a number of objections from the business sector, the government considered a tariff calibration scheme to serve as a framework for TRP-IV vis-à-vis the pace of liberalisation in the ASEAN countries. The next tariff adjustments, TRP-IV, provided a structure of a

30-25-20-15-10-7-5-3 tariff reduction scheme, instead of the previous 30-20-10-3 structure to respond to the business sector's clamour for further protection to 'assist them compete globally.'

In general, the existing efforts of the APEC have been very weak to affect the Philippine tariff structure significantly. One way of assessing the likely impact of the APEC TILF programme of the Philippine trade liberalisation is to compare the effective protection rates (EPRs) of commodities considered in the APEC Early Voluntary Sectoral Liberalisation (EVSL) Programme and the other commodities. The APEC Economic Leaders endorsed the EVSL of the fifteen sectors in their Fifth Meeting (AELM) in Canada in November 1997. These sectors were identified to have likely positive impacts on trade, investments and economic growth in the respective economies and the whole APEC region. These sectors are: environmental goods, services, toys, fish and fish products, forest products, gems and jewellery, oilseeds and oilseed products, chemicals, the telecommunications mutual recognition arrangement, the energy sector, the food sector, natural and synthetic rubber, fertilisers, automotive, medical equipment and instruments, and civil aircraft. The problem however is that these sectors are not those that require liberalisation the most. Table 1 shows the EPRs of commodities considered to the APEC EVSL Programme and the other commodities that possess the highest EPRs.

Table 1: Estimated effective protection rate (EPR) of EVSL products and selected sectors with the highest rates, 1996-1997 (in per cent)

	1996	1997	% Change
EVSL Products			
Civil Aircraft	2.30	2.47	7.28
Energy	3.44	2.61	-24.15
Environmental Goods	15.81	12.44	-21.33
Chemicals	13.72	10.68	-22.18
Fertiliser	2.30	2.33	1.68
Fish and Fish Products	10.63	9.97	-6.20
Forest Products	15.67	15.80	0.84
Food	17.43	9.05	-48.08
Gems and Jewellery	-1.09	-1.04	-3.77
Medical Equipment and Instruments	19.40	17.23	-11.19
Oilseeds and Oilseed Products	14.83	13.29	-10.35
Toys	11.26	12.25	8.79
Natural and Synthetic Rubber	15.96	15.30	-4.11
Average	*11.20*	*10.12*	*-9.68*
Selected sectors with the highest EPRs			
Coffee Roasting and Processing	210.28	166.94	-20.61
Sugar Milling and Refining	105.92	84.72	-20.02
Meat and Meat Processing	93.09	86.30	-7.29
Manufacture of structural concrete products	80.52	50.73	-37.00
Coffee	64.60	51.64	-20.06
Manufacture of soap and detergents	62.07	62.35	0.46
Rice and Corn Milling	60.22	58.23	-3.30
Slaughtering and Meat Packing	58.07	36.84	-36.55
Manufacture of wire nails	55.54	56.45	1.66
Palay	53.14	53.15	0.02
Manufacture of metal containers	46.83	47.03	0.43
Manufacture of hardboard and particle board	45.48	45.54	0.13
Manufacture and repair of other furniture and fixtures	42.83	45.56	6.39
Sawmills and planing mills	42.55	42.58	0.05
Manufacture of flat glass	38.67	38.72	0.13
Manufacture of other fabricated wire and cable products	38.32	35.64	-6.99
Manufacture and repair of metal furniture and fixtures	37.50	39.48	5.29
Other agricultural production, n.e.c.	36.55	30.19	-17.40
Manufacture of Animal Feeds	35.44	34.07	-3.88
Noodles Manufacturing	34.19	35.79	4.68
Average	*62.09*	*55.10*	*-7.69*

Source of basic data: Philippine Tariff Commission

Three points can be made. First, those highly protected sectors are categorised as sensitive agricultural products that in some cases are also the inefficient ones (e.g., sugar milling and refining). Second, the average protection rate to the EVSL sectors is roughly six times lower than the selected industries, thereby showing the significant difference between the EVSL sectors and those sectors that need to be liberalised the most. Third, while these selected sectors on the average have experienced reduced protection rates in 1997, the rate of decline for the EVSL sectors is greater. This suggests the difficulty of liberalising these heavily protected sectors as well as the discriminatory nature of this type of liberalisation.

This discussion suggests that certain industries for a long period of time have received some protection from the government. Because trade restrictions have been in place for a significant period of time, it is particularly difficult to remove them within a short period and almost impossible for all countries to remove such distortions simultaneously. Moreover, in face of the Asian crisis, the countries may be hard-pressed to liberalise multilaterally those activities that are deemed strategic to the development. This is particularly true in the present crisis and especially so for Asian nations - except the Philippines - where trade with countries outside the APEC is as important as trade within the bloc (see e.g., Haggard 1995). Because of the potential free-rider problem of the most favoured nation (MFN) principle, the option to limit tariff reductions to member countries may be a sensible response. Thus, strong opposition within Asia to create a trading arrangement within the MFN mould as designed in APEC can be expected.

What this discussion demonstrates is the greater difficulty in liberalising trade in goods relative to the opening of capital markets. While it is clear that protection is harmful to the economy, the present industrial sector is characterised both by the lack of understanding of the economic costs of tariffs and the presence of powerful political-social forces that strongly oppose any change in the status quo. This system of protection creates substantial rents to the producers of import-competing goods, to the importers that benefit from the allocation of (non-marketed) import rights, to organised labour that is sharing part of the monopoly rents resulting from the protection, and to the government bureaucracy that was administering the restrictive trade policies. Since goods markets affect a greater number of the sectors in society, it is not surprising that investment liberalisation has been pursued more vigorously than trade.

3. The effects of trade and investment liberalisation and facilitation

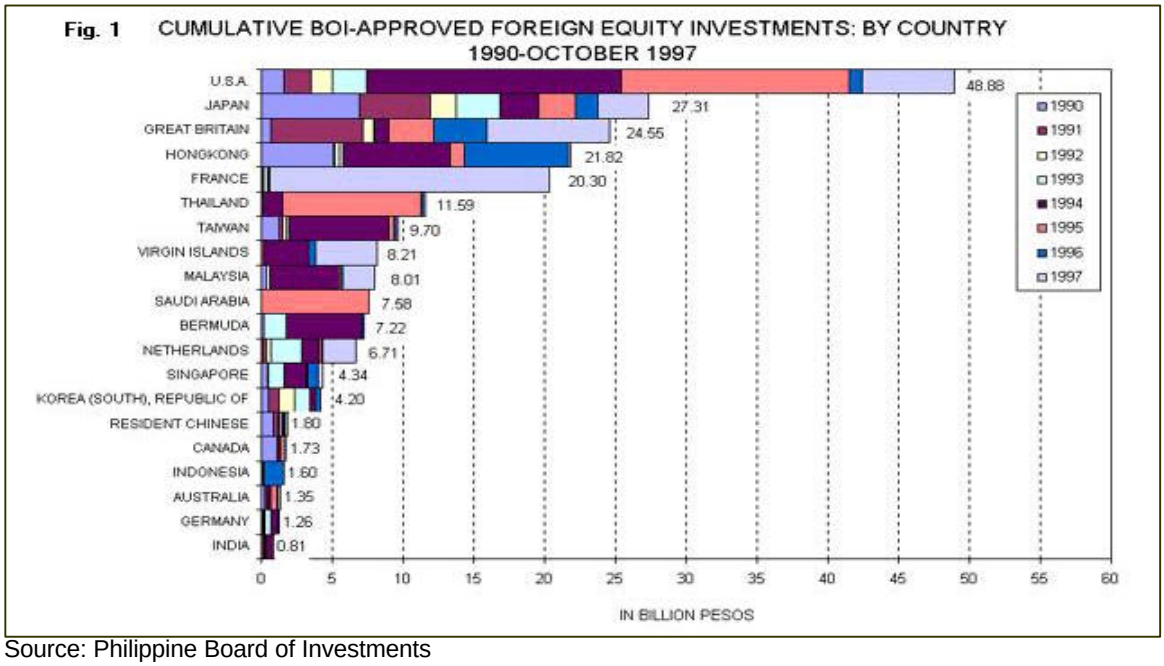
The effects of the existing combination of trade and investment programmes can be divided into two main components: the economic effects and the social effects. Such changes can be noted from the following indicators.

3.1 Economic indicators

Even before 1992, reforms have already been in place to allow greater foreign goods and investments in the country. The General Agreement on Tariffs and Trade (GATT) and the commitment to currency convertibility under the International Monetary Fund (IMF) have mainly influenced the governments to

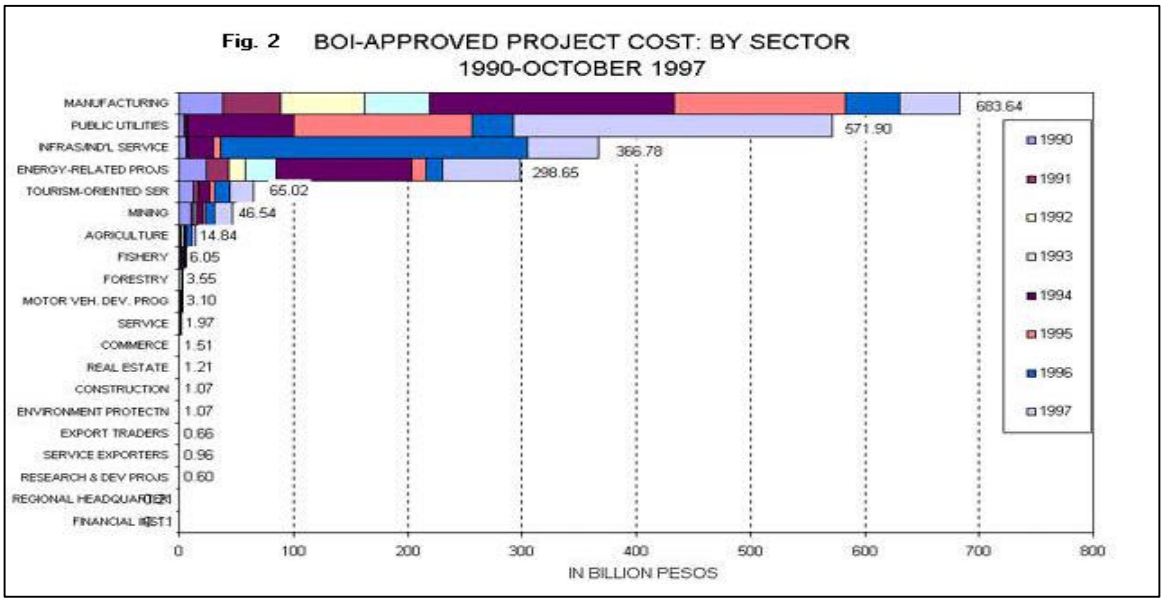
sweep away most of the restrictions to the international markets. However, this movement towards trade and investment liberalisation has been intensified during the last ten years.

Figure 1 shows the cumulative foreign equity investments approved by the Philippine Board of Investments from 1990 to 1997, by country origin. Note that the APEC member countries have started to play a prominent role in the Philippine investment structure starting in 1995. Thailand, Hong Kong, Singapore, Korea, Canada, Indonesia and Australia began to increase their investments in the country along with the US and Japan. Certainly, other countries, like France, the UK and Saudi Arabia have also increased, but these were realised mostly after the APEC member countries have taken the lead.



Source: Philippine Board of Investments

The direct effect of these capital inflows on the country's industries can be found in Figure 2 which shows the foreign equity investments approved by the Philippine Board of Investments (BOI), by sector from 1990 to October 1997.



Source: Philippine Board of Investments

Several key points can be made about this figure. First, the effects of the investment liberalisation have been felt more in the manufacturing sector than in any other sector. This may suggest that the returns to capital are greater in the manufacturing sector primarily because the country's main exports, such as microcircuits, are produced in this sector. Second, the increases in the later years for the top investment receiving sectors have more than doubled. This indicates that the efficacy of many trade and investment policies can be realised only gradually. Third, while the change in more recent years has been significant, the increases have become gradual for those sectors that had peaked earlier. This may to some extent denote some uncertainty in the sustainability of these increases in investments. By the end of 1997, much of these investments have diminished.

Table 2 provides the average effective protection rate (EPRs) of selected industries and their average share of the foreign direct investment from 1988 to 1998. The FDI share of each industry is defined in terms of Central Bank (CB)-registered FDI and BOI-approved FDI. The CB-registered investments are those that actually have flowed into the country while the BOI investments have been merely committed. The discrepancy between the two can be explained in the following: First, committed investments may have already been in the pipeline, but the projects may have been delayed for a number of transaction costs, including possibly huge transportation expenses and bureaucratic delays. Second, the projects may have actually been called off before the end of the project. In any case, the investments approved by the BOI would seem to indicate the real interests and motivation of the investors. However, the investments that have a greater impact on society are those registered in the CB, and generally reflect the priorities of the government.

There are also two measures for effective protection rates. The first is based on only tariff barriers and the second that is considered more meaningful is based on price comparisons and captures the effects of both tariff and non-tariff barriers on imports.

Table 2: Average effective protection rates and industry share to total FDI, 1988-1998

Industries/Sectors	% Share in total CB-registered FDI	% Share in total BOI approved projects	EPR (based on tariffs)	EPR (based on price comparisons)
Mining	19.8273 (5.89)	2.5336 (2.48)	7.8900 (9.90)	7.6755 (10.06)
Agriculture	1.1645 (0.39)	2.1864 (1.98)	29.2691 (11.04)	33.1973 (11.79)
Manufacturing				
Chemical	11.2618 (2.21)	5.9082 (8.51)	32.1264 (25.49)	49.0336 (44.88)
Food	7.5836 (1.95)	1.5736 (1.50)	49.1718 (9.33)	43.4382 (5.02)
Basic Metals	4.5282 (0.81)	3.4218 (5.91)	38.3709 (30.48)	38.2155 (30.59)
Textile and Garments	2.2427 (0.41)	4.6055 (6.14)	47.8155 (45.24)	47.6955 (45.31)
Transport Equipment, Machinery and Appliance	4.8882 (2.16)	16.2218 (17.31)	24.7055 (15.20)	30.9346 (23.08)
Petroleum and Coal	6.9918 (4.86)	8.5182 (15.17)	21.8127 (16.63)	72.7655 (79.59)
Other Manufacturing	41.5118 (3.50)	46.26818 (21.87)	39.378 (16.76)	45.0100 (23.03)

Note: Figures in parentheses refer to standard deviation.
Source: Manasan and Querubim, 1998; Board of Investments

The following points are noteworthy. First, as expected, there is a difference between the two FDI share measures. Moreover, more than half of the investments goes to the manufacturing sector which is generally regarded as capital-intensive. Second, while the two EPR measures are roughly the same, wide swings can be found for chemical, transport equipment and petroleum industries, suggesting significant non-tariff protection for these industries. Third, with the opening of the mining industry to foreigners, it had the lowest effective protection rate, although the standard deviation is higher than the mean. This reflects the substantial amount of movement in the degree of protection for this industry. Other industries on the other hand recorded higher EPRs, with lower standard deviations, indicating more stable but higher rates of protection. Fourth, while there is some evidence of a positive relationship between the EPRs and the industry share of the FDI, this does not seem to be significant. In particular, the mining sector that has the lowest protection also has the highest share at least in the CB-registered FDI, and slightly higher than agriculture in the BOI figures. This implies that other industry-specific factors, mainly those relating to the availability of natural resources and efficiency, may be affecting these shares.

One way of isolating the EPR effects on the FDI share from the industry factors is to do a regression of these factors, using the fixed-effects model to indicate the unobserved qualitative industry-specific effects. Table 3 shows the results of fixed effects regression, using the BOI-approved FDI share and the CB-registered FDI share as the dependent variables to indicate investment concentration particularly in manufacturing. The fixed effects model is generally seen to be a reasonable approach to take account of differences between industries over time that are viewed as parametric shifts in the regression function (see Greene 1990). These effects can then be interpreted as applying only to the cross-sectional units of the study, or the included industries, and no longer to other industries outside of the sample.

Table 3: Fixed effects estimates on industry FDI shares

Variables	% Share in total BOI approved projects	% Share in total CB-registered FDI
EPR based on Tariff	0.2669 (1.11)	0.2969** (4.85)
(EPR based on Tariff) Squared	-0.0017 (0.96)	-0.0018** (3.80)
EPR based on Price Comparison	0.0305 (0.52)	-0.0829** (5.52)
Real Effective Exchange Rate	-0.2630* (1.69)	-0.0181 (0.46)
Constant	23.2863* (1.66)	10.2656** (2.88)
F-test	5.57**	8.87**
Hausman test	0.13	0.01
No. of observations	99	99

Notes: Figures in parentheses are absolute value of asymptotic t-values. **,* indicate significance at the 5% and 10% levels, respectively. Hausman test is used to determine whether there are systematic differences between the fixed effects and random effects models.

For the independent variables, I use the two EPR measures, one based on tariffs alone and the other based on non-tariff barriers. Hypothetically, tariff-based protection may have initially a positive influence, but is expected to have diminishing effects on investments. Hence, the square of this variable is included to capture this non-linear feature. One other variable included in the specification is the real

effective exchange rate (REER) that measures the competitiveness or non-competitiveness of the currency. Assuming that the government does control the effective exchange rate, either directly or indirectly (through interest rate policies), a higher REER increases total FDI and reduces the FDI share per industry if the total capital inflows are distributed equally. Conditional on the distribution of the investments, an increase in REER and conceivably an increase in total FDI (mainly through a significant depreciation relative to the inflation rate) may reduce the concentration of the investments in one industry.

This regression experiment produces the following results. First, both the EPR measures were insignificant only for the BOI-approved projects, but the REER is observed to be significant. This seems to suggest that the investor motivation is influenced more by the interest returns instead of these various types of protection. A higher REER leads to a higher total committed foreign direct investment and will eventually result in a more equal distribution of investments, causing a lower average FDI share. One also has to consider that a higher real foreign exchange rate makes imports expensive for the capital-intensive industries, leading possibly in a lower investment level in these industries, and a greater level in the more labour-intensive industries.

Second, for the CB-registered investments, the opposite pattern is found. The effects of the tariff-based and price-based EPRs are more important in this case. Notice that tariff-based protection is able to attract more investments into an industry, although it reduces total investment. This then supports the view that industries with tariff protection generally receive a greater share of the investments. Nevertheless, increasing this degree of protection ultimately restricts industry concentration, causing these inefficient industries to get a lower share. Similarly, increasing the more general and more effectual price-based protection reduces investments. The latter seems to suggest that eventually more protection particularly through non-tariff barriers, eventually serve as a disincentive for the concentration of investment in particular industries, despite the limitation of foreign competition.

To appreciate these results, consider the economic developments at the period before the Asian financial crisis. Table 4 features selected items from the country's balance of payments, as a percentage of the Gross Domestic Product (GDP).

Table 4: Selected balance of payments Items, as percentage of GDP

Year	Exports	Imports	Current account	Medium and long-term loans, Net	Foreign investments, Net	Net portfolio investments
1989	24.30	32.38	-4.55	1.17	2.65	-0.28
1990	18.47	27.55	-5.79	1.52	1.08	-0.11
1991	19.46	26.53	-1.91	1.84	1.44	0.28
1992	18.54	27.41	-1.62	1.19	1.39	0.12
1993	20.92	32.37	-5.55	4.52	1.49	-0.10
1994	21.04	33.29	-4.60	2.05	2.43	0.42
1995	24.45	36.98	-4.62	1.79	2.25	0.35
1996	24.52	38.05	-4.67	3.21	1.39	-0.20
1996 (Jan.-Sept.)	23.75	37.69	-4.37	3.44	2.04	0.11
1997 (Jan.-Sept.)	29.42	42.65	-5.07	5.28	-3.71	-5.34

Source of basic data: Bangko Sentral ng Pilipinas

If one uses the ratio of exports to GDP as indicator of openness, the liberalisation process can be seen to have accelerated in the period from 1992 to the third quarter of 1997. At the same time, a growing dependence of goods (including exports) on imports can also be noted. From this table, the country's top exportables can be inferred to be highly capital intensive. Hence, the proportion of current account deficits to the GDP has significantly increased during the said period. Without investment liberalisation, trade liberalisation would not be favourable for the economy.

During the same period, substantial foreign loans and direct investments have also been realised especially in 1993. The table shows that more of these foreign funds are mainly medium and long-term loans, although foreign investments have began to move up, particularly in 1994 and 1995. Despite the low share to GDP, portfolio investments are also seen to increase in this period, showing the close integration of the country's financial markets with the rest of the world. Note that, by the time the Asian financial crisis has struck, the outflows of these investments exceeded the inflows. The consequences of these changes on the general economic situation can be gleaned from Table 5 that features selected macroeconomic indicators.

Table 5: Selected macroeconomic indicators, 1989-1997

Year	GDP Growth Rate	Nominal exchange rate (p/$)	Growth rate of exchange rate	Per capita gnp (in 1985 peso price)	Inflation rate	Internal public debt (in billion pesos)	T-bill rates	Real exchange Rate (p/$)
1989	6.06	21.71	3.03	11,386	12.20	237.24	18.64	70.71
1990	3.04	24.31	11.84	11,554	14.17	253.80	26.67	69.20
1991	-0.58	27.48	13.03	11,306	18.66	340.80	21.11	68.12
1992	0.34	25.51	-7.15	11,194	8.95	253.80	16.02	76.37
1993	2.14	27.12	6.30	11,151	7.61	491.92	12.45	74.65
1994	4.40	26.45	-2.47	11,456	7.06	652.49	12.71	79.57
1995	4.70	25.70	-2.84	11,743	8.10	603.32	11.76	84.30
1996	5.80	26.21	1.98	12,275	8.50	701.14	12.34	91.54
1997	5.20	29.41	12.44	12,593	5.10	704.00	12.89	88.49

Sources: NCSB, Bureau of Treasury and Bangko Sentral ng Pilipinas

Note that before nominal devaluations were made and the huge internal public debt was incurred, as a result of the crisis, the economy has benefited from the trade and liberalisation policies. Although the GDP growth rate appears higher in 1989 and lower in 1997, the inflation rate has been substantially reduced, thus raising the real value of production. The country's per capita income had also been improved significantly. Furthermore, the t-bill rates, an indicator of domestic interest rates, have been lower than the levels before 1992, although these indices have shown signs of weakening in the wake of the financial crisis.

Two major areas of concern however are the management of the foreign exchange rate and the public debt. One would have expected that with the growing current account deficit, the real exchange rate would have depreciated dramatically. However, in 1990, 1993 and 1997, the real exchange rate has even appreciated when the current account has actually increased in all instances. This may have been significant in reducing inflation since an overvalued currency will reduce the costs of import. However, as clearly shown by the data and as evident by the crisis that still affects us, these foreign exchange controls, while inducing capital inflows, are inconsistent with the goal of external stability and greater dispersion of investments. The trade and investment liberalisation policies espoused by

the previous governments have made such controls veritable sources of instability and speculation by investors. The only reason for adopting such policies has been the lack of domestic savings and hence the need to attract foreign capital.

At the same time, the internal debt that has already been increasing, had risen significantly more recently, especially in 1998 when the full impact of the economic slowdown due to the Asian crisis and the El Nino weather have been felt. However, it can be noted that the t-bill rates have not been affected notably by the increases in public debt. This can mean that the government has other sources of funding than the domestic market. Another interesting note is that inflation has hardly been affected by the government's debt during the years internal public debt has risen.

All these indicators suggest that although some trade liberalisation was being undertaken, a few sectors were still being protected through higher EPR, and the government at the same time was inducing a fairly overvalued currency with its high internal debt. This could have meant that FDI shares increased for particular industries even as total investments were declining.

3.2 Social Indicators

There are several social indicators that can be considered in the light of globalisation. I focus here on the employment and wages since labour continues to be the more abundant resource in the country. Conceptually, increasing trade and financial openness would have led to improvements in the use and returns to labour. Table 6 presents some statistics on the population, the labour force participation rate, the employment, unemployment and underemployment rates, and the real wage rate from 1989 to 1997.

Table 6. Labour employment and real wage statistics, 1989-1997

Year	Population 15 years and older	Labour force participation rate %	Employment rate	Unemployment	Under-employment rate (%)	Real Wage (1985=100)
1989	36,916	64.6	91.4	8.60	23.2	137.0
1990	37,636	64.5	91.9	9.53	22.1	135.7
1991	39,114	64.5	91.0	10.50	22.1	119.8
1992	40,265	65.0	91.4	9.82	19.8	121.8
1993	41,453	64.7	91.1	9.27	21.4	116.6
1994	42,670	64.4	91.6	9.48	20.9	112.0
1995	42,770	65.6	91.6	9.52	19.8	117.7
1996	45,034	65.8	92.6	8.58	19.4	115.4
1997	46,214	65.5	92.1	8.70	20.8	114.1

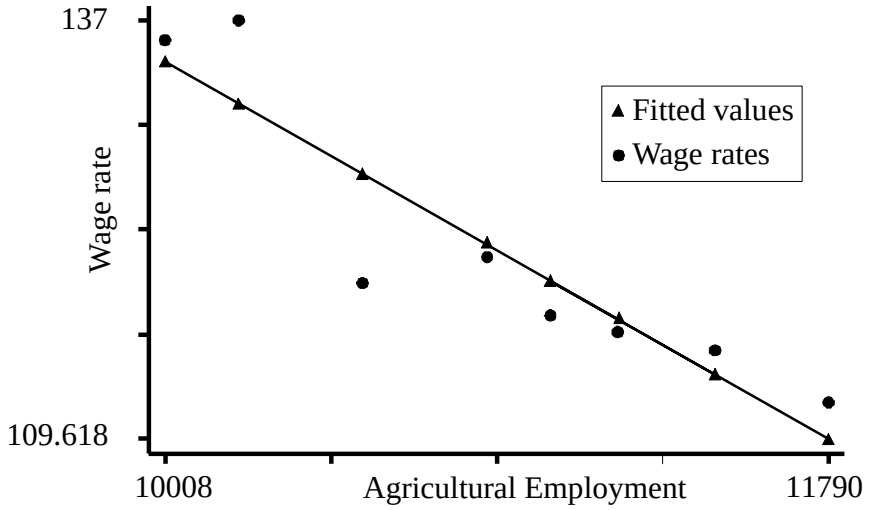
Source: Philippine National Coordination Statistical Board, National Statistical office

The major observation that can be made from this table is that no perceptible effect from liberalisation can be found in the use of labour. This suggests that the productivity returns to labour have not improved with the increasing liberalisation. While there may have been some improvements in the employment and underemployment rates, the changes have not been substantial enough to reduce the unemployment rates along with the increases in the labour force participation rates.

Furthermore, real wages have substantially decreased since 1995, a result that is contrary to what is expected from the Stolper-Samuelson theory, which assumes that the good that uses the more abundant resource is exported. These normalised real wage rates based on 1985 wages have been computed using the recorded wages (net of indirect non-wage compensation, social insurance contributions, etc.) in the labour force surveys in all sectors. The decline in the recorded wage rates can be attributed however mainly to the increased labour supply especially in the agricultural sector. Figure 3 shows the relationship between the wage rates and the total employment in the agricultural sector, and the trend using fitted values.

The figure suggests that the globalisation trends have not been effective in agricultural, particularly labour demand. At the same time, nominal minimum wages have not been raised by the government which could have limited the decline in real wages. Recently, minimum wages were no longer set by legislation but by regional wage boards instituted across the country. This means that minimum wages will be established differently in varied areas in the country. In the absence of any safety-net system, even after the outbreak of the crisis, and the failure of the liberalisation policies to affect the agricultural sector, the lower real wage rates are closely associated with higher labour supply, in which case, the poor working conditions can be seen more in the rural areas.

Figure 3. Relationship between wage rates and agricultural employment, 1989-1996



Source: National Statistics Office

Nevertheless, despite the steady decrease in real wages, industrial relations especially in the manufacturing, urban sectors surprisingly did not deteriorate and in fact indicated signs of improvement. Table 7 provides a general picture of the working conditions in the industries during the period of globalisation before the financial crisis, showing the number of recorded strikes/lockouts filed and actually executed, the number of existing labour unions and the average number of weekly hours worked.

Table 7: Filed and actual strikes/lockouts and number of labour unions

Year	Strike/Lockouts Notices Filed	Actual Strikes/Lockouts	Number of Labour Unions	Average Weekly Hours Worked
1991	1,345	182	5,236	42.9
1992	1,209	136	5,710	42.5
1993	1,146	122	6,340	42.0
1994	1,089	93	7,274	42.2
1995	904	94	7,882	42.0
1996	833	89	8,250	41.2

Source: Bureau of Labour and Employment Statistics, 1996

The decline in the number of lockouts and strikes, both filed and actual, can be attributed to the number of cases resolved through voluntary arbitration, indicating a preference for less confrontational and more legalistic conflict resolutions on the part of labour and management. The marked increase in the number of labour unions also reveals the general acceptance by management and the state of the importance of giving workers more voice. Finally, the fall in average hours worked in a week is consistent with a growing flexibility in the labour market. What needs to be emphasised here however is that these improved labour conditions are recorded mostly in the urban, manufacturing sector, where workers are generally skilled.

The total effect of these real wage movements on social welfare however can be more clearly seen if we consider the changes in real incomes by industries and by educational attainments of workers. Figures 4a and 4b show the real wage incomes of households across industries and across two educational levels: households with high education or with high school degree or higher; and those with low education or with no high school degrees. Education is seen here as an indicator of skilled labour, found mostly in urban and manufacturing industries.

Figure 4a: Real wage incomes of households with low education 1991 and 1994, by industry

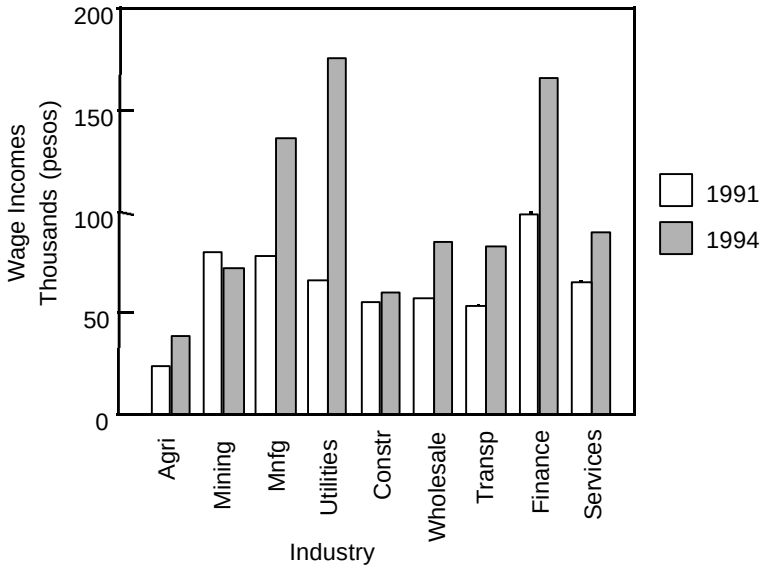
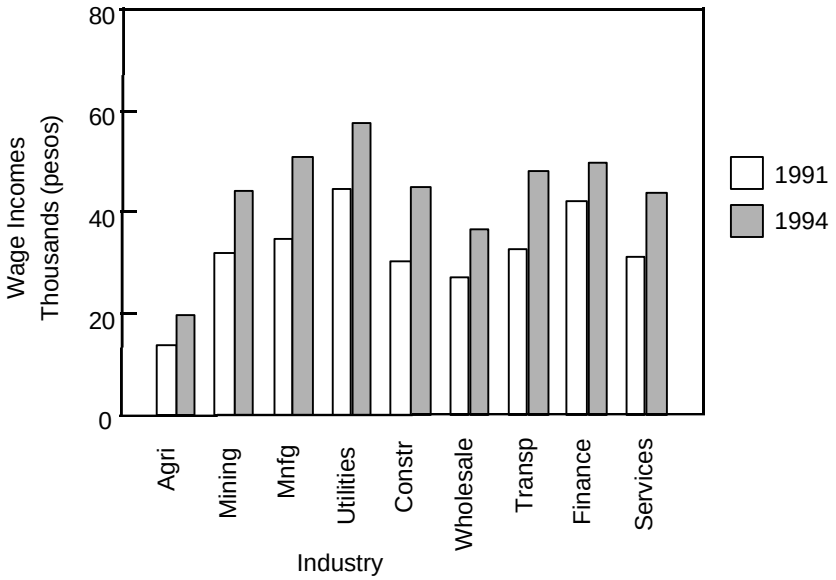


Figure 4b: Real wage incomes of households with high education 1991 and 1994, by industry



Source: Family Income and Expenditure Survey, 1991 and 1994. Note: Real wage incomes are based on the average wage incomes reported,

Three points are important. First, despite the fall in the real wage rates, real wage incomes are nonetheless higher in 1994, suggesting perhaps that production may have been more labour-intensive at least in terms of physical number or hours. Second, although there were increases in real incomes found for both households, a noticeable difference in the wages can found between the more educated and less educated families, suggesting that education is a crucial factor in the determination of wage incomes. Third, the improvements from 1991 to 1994, when globalisation and APEC were operative, are seen to be greater for the highly educated families than their counterparts. This is particularly so for such industries such as agriculture, manufacturing, utilities, wholesale and finance. This suggests the high premium placed on education by much of these globalisation trends. Moreover, these are industries that are to a certain extent either highly protected (e.g., agriculture) or highly capital-intensive (such as manufacturing and utilities). Note also that the financial sector has the highest increase in real wage incomes for the households. As already mentioned, because of inappropriate domestic policies, these are also the same sectors that seemed to have benefited the most from the financial liberalisation.

These highly skewed movements may have led to some inequality in the distribution of income. Table 8 presents the percentage distribution of total family income by income decile for the years 1988, 1991 and 1994. The year 1988 is used as reference since this was the period when the influx of foreign capital has not yet been experienced.

Table 8: Percentage distribution of total family income by income decile

Income Decile	1988	1991	1994
Total	100.0	100.0	100.0
First Decile	2.0	1.8	1.9
Second Decile	3.2	2.9	3.0
Third Decile	4.1	3.8	3.9
Fourth Decile	5.0	4.7	4.9
Fifth Decile	6.0	5.7	6.0
Sixth Decile	7.3	7.0	7.4
Seventh Decile	9.1	8.8	9.1
Eighth Decile	11.6	11.4	11.8
Ninth Decile	16.0	16.1	16.4
Tenth Decile	35.8	37.8	35.6

Source: Family Income and Expenditure Survey, National Statistics Office, 1988, 1991, and 1994.

There are two key points in this table. First, there was no significant shift in the distribution in the succeeding years after 1988, suggesting that capital market movements are hardly evident in affecting equity. Nevertheless, recall that the real wage incomes were highly skewed in favour of the educated households. This may then indicate that, to a certain extent, the less educated households may have benefited from the foreign capital inflows, particularly in 1994 when most of these capital resources were being invested. Second, despite the seeming stability found in income distribution, the trend towards greater globalisation has resulted in some downward shifts for the eight poorest deciles in 1991. Although these deciles were able to recover their previous 1988 share in 1994, these policy changes appear to have made them more vulnerable to capital market movements. The last three deciles, on the other hand seemed to have consolidated their share in income distribution.

Assuming that the social returns to capital are greater than the returns to labour (at least for particular types of labour), those who have more access to capital should be clearly better off than those who have less. One way of determining this is to examine the poverty incidence and magnitude for these three periods for different residents. Presumably, those residing in the urban areas, particularly in the National Capital Region (NCR), should benefit from these capital market movements. Table 9 shows the poverty incidence and magnitude for the three periods across several regions.

Table 9: Poverty incidence and magnitude, 1988, 1991 and 1994

Areas/Regions	1988		1991		1994	
	Poverty incidence	Poverty magnitude	Poverty incidence	Poverty magnitude	Poverty incidence	Poverty magnitude
Philippines	45.5	25,005,345	45.3	28,119,758	40.6	27,274,205
Urban	34.3	7,154,196	35.6	11,037,596	28.0	9,367,263
Rural	52.3	17,841,149	55.1	17,082,163	53.1	17,906,942
NCR	25.2	1,909,886	16.7	1,439,613	10.5	975,263
Outside NCR	48.7	23,095,459	49.9	26,608,145	45.5	26,298,942

Source of basic data: National Statistical Coordination Board. Notes: Poverty incidence refers to the proportion of individuals whose annual income falls below the annual per capita. Poverty magnitude measures the number of people whose annual income falls below the annual per capita poverty threshold.

The following points are noteworthy. First, while the poverty incidence has been reduced, the total number of poor families has increased in 1991 and settled to a level in 1994 that is still higher than the level in 1988. The declining poverty incidence merely suggests that the increase in the number of people receiving an income less than average per capita is not as much as the increase in the number

of people. The liberalisation and globalisation policies then have not solved the age-old Philippine problem of poverty. Second, the poverty incidence increased in the rural areas, as the number of poor people in the urban areas decreased substantially in 1994, the year when the capital inflows were growing. Third, the reduction in poverty incidence has even been more pronounced in the National Capital Region than in the other regions, indicating the people are receiving higher incomes, above the average per capita. This suggests that the decline in poverty incidence is primarily an urban and an NCR phenomenon since the poverty incidence increased in the rural areas and the number of poor persons increased in the areas outside NCR. In summary, the data suggest that while those who have greater access to free capital markets have improved their welfare, the majority who have no access to such benefits were in effect 'immiserised' by the policies of liberalisation and facilitation.

4. A source of "immiserising" growth: disproportionate trade and financial liberalisation

Contrary to the standard international trade theory, the inflow of capital into a more liberalised country such as the Philippines, has evidently been unable to influence the social conditions favourably. A number of authors in fact have indicated that, under certain conditions, there is some connection between capital inflows and government trade policy. Bhagwati and Srinivasan (1983) explained how 'immiserising' growth can be caused by a tariff-induced inflow of foreign capital, given that the country is small and continues to import capital-intensive inputs while remaining unspecialised. The decline in welfare may be attributed to three factors: (1) the usual tariff-created distortions in consumption and production, given only the initial factor endowments; (2) the probable loss that would result even from an increase in nationally owned capital in the presence of a tariff; and (3) the loss arising from the subtraction of foreign capital profits in the determination of national income. The basic idea is that immiserising growth results from any kind of distortion, whether locally induced or foreign policy created. The endogenous distortion occurs when an imperfect factor market creates a distortionary wage differential. The distortion may however be caused by foreign sources if monopoly power in trade is involved even when the country is engaged in optimal tariff policies before trade occurs.

Uzawa (1962) and Brecher and Diaz (1977) independently showed that in a conventional Hecksher-Ohlin model, foreign direct investments (FDIs) necessarily lowers the host country's social welfare if the import-competing sector is capital-intensive and protected by tariffs. Given that the Philippines' import-competing industries are capital-intensive, this theory suggests that the FDI will be welfare worsening if inward protectionist policies are not modified. Many authors have suggested that this may be one particular reason why countries that have pursued outward-oriented policies have been successful.

Buffie (1987) however claims that given domestic labour market distortions, export subsidies and trade in intermediate goods, the inflow of FDI, regardless of whether this is pursued in a liberalised economy or not may be welfare worsening. Under static conditions, welfare worsens as the capital inflows lower trade revenues. If some part of the capital stock is foreign owned, the domestic economy can run a trade surplus only to pay for the foreign capital service and interest payments. In effect, a negative

income effect may be felt as a result of capital expenses because export earnings may not be large enough to service the capital payments. A larger foreign investment increases naturally the required debt service and acts as a drain on the net trade revenues, when export subsidies are greater than tariffs. Moreover, if trade in intermediate goods is present, the increase in FDI can be immiserising if the import-competing sector is relatively capital intensive and uses these intermediate inputs. Export subsidies can favour unduly other industries and the inflow of capital investments can further reinforce such bias, bringing about unbalanced revenue effects and overall decline in welfare. In these cases, restrictive quotas on consumer imports may be welfare-improving.

Other than these issues already raised, another source of immiserising growth is the uneven and disproportionate implementation of capital in relation to trade liberalisation. Consider the case where the growth in one country is accompanied by further capital liberalisation. If we view the change in the scenario as such, there is a distinct possibility that the primary gain from economic growth given an assumed fixed foreign offer curve facing one country can be offset by a reduction in trade gains due to a shift in the foreign offer curve facing the country as a result of the capital liberalisation.

The possibility can be seen easily with respect to a country that is affected by monopoly power and significant domestic distortions. The problem is that capital liberalisation without any accompanying change in the domestic tariff structure creates a wedge between the selling price of output and the buying price of the output. The reduction in the costs of borrowings reduces the marginal cost of output, particularly for capital-intensive products. However, because trade liberalisation does not progress as quickly, consumers are forced to purchase these products at a relatively higher cost.
This wedge between goods and factor prices will have three main consequences. First, this reduces the demand for the products and since the international producers effectively receive a lower net price (after tax or tariffs), the quantity supplied is reduced. Hence, the uneven implementation of the trade and capital liberalisation and facilitation results in a quantity distortion, leading to deadweight losses.

Second, with the availability of more capital, local producers will be induced to produce more capital-intensive goods. It is generally expected that the price of such goods in the world market will also decrease, given the additional supply of these goods. However, because of the distortions in the domestic market, the price of such goods may indefinitely remain high, even as the marginal costs of producing them are lower. Thus, producers of these goods are drawn towards them.

Third, for the local producers of tradable goods whose prices have decreased in the international market, the restricted entry to imports and the inflow of foreign capital can induce them to shift their production into non-tradables. This may have contributed to increased investments in real estate and non-traded services that were observed before the crisis. Moreover, as production is restricted by numerous trade barriers, the continued presence of import-competing sectors will be strengthened by easy access to world capital markets. In this way, capital liberalisation may run contrary to freer and more open world trade.

The interesting point about the above discussion is that the primary cause of immiserisation is a shift of the opportunities found in the world market. Hence, as long as domestically inoptimal policies are

being implemented by a small country before and after growth, there is no assurance that the intervening policies can avoid such immiserisation. Given the overemphasis placed on capital markets, which are beneficial in the short-run, and the dereliction of trade policies, which would have been more productive over the long-term, the country is made more susceptible to drastic changes in demand for capital and production structures abroad.

5. Policy implications

The immiserisation process described in the previous section results from the assumption that the primary gain from growth is outweighed by the reduced gains from trade. This means that such an eventuality can be addressed either by (1) a shift in foreign market opportunities that reinforces the gains from trade, or (2) an initial growth that is large enough to absorb the maximum level of reduction in the gains from trade (Bhagwati 1969). The probability of immiserisation then increases only in so far as the growth is unable to counteract the offsetting forces introduced by free capital markets.

The first point then indicates the precedence of trade over investment liberalisation. If capital mobility had been used to complement trade liberalisation, the influx of short-term investments would have been limited as the investments in non-tradables would not have been profitable. Moreover, the shift towards more capital-intensive and skill-intensive goods would also have not occurred the way it did, as the country's comparative advantage would have been emphasised. Thus, the liberalisation programme should concentrate on the disputes relating to trade openness and facilitation.

The second point suggests the importance of economic and technical cooperation among the different nations cannot be overemphasised. The heavy stress placed on the short-term returns of capital account convertibility, particularly in this period of crisis, should be replaced by greater focus on freeing international trade barriers and an internal restructuring of financial institutions that will encourage investments leading to the transfer of skills and technology.

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