

PASCN Discussion Paper No. 99-14

**The Social Impact of APEC TILF:
The Philippine Case**

Leonardo A. Lanzona, Jr.



The *PASCN Discussion Paper Series* constitutes studies that are preliminary and subject to further revisions and review. They are being circulated in a limited number of copies only for purposes of soliciting comments and suggestions for further refinements.

The views and opinions expressed are those of the author(s) and do not necessarily reflect those of the Network.

Not for quotation without permission from the author(s) and the Network.

*Working Draft
Please do not quote*

The Social Impact of APEC TILF: The Philippine Case

Leonardo A. Lanzona
Ateneo de Manila University

This paper gives a broad overview, with supporting statistical evidence, of the relationship and interrelationships between trade liberalization and the inflow of foreign direct investment and social development in the Philippines during the late 1980s and the 1990s. The APEC Trade and Investment Liberalization 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 program seemed to have overplayed the short-run, and in the process underplayed its long-term, implications. In particular, in the case of the Philippines, the focus of the program is primarily on expanding investments and freeing financial markets. This emphasis has led to a disproportionate process of liberalization and facilitation that favored capital- and skill-intensive industries, resulting in an increase in poverty incidence and magnitude in the rural areas.

I. Introduction

Globalization 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 globalization are: (1) the growth of foreign direct investments (FDI) due to financial liberalization 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 categorized jointly in terms of financial and trade liberalization.

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 liberalization and facilitation measures, incorporated in the globalization 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 labor 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, liberalization and facilitation are expected to improve the welfare of society. The Hecksher-Ohlin theory maintains that countries export goods that use intensively those goods that are relatively abundant at home and import goods that use intensively those products 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 labor is found and skilled labor is scarce, trade tends to increase unskilled labor wages and lower skilled wages, thereby narrowing the gap between them.

With this perspective, 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 industrialized economies and 2020 for developing economies; (2) expansion and acceleration of trade and investment facilitation programs; 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 globalized. One of the results of this progress however was the huge internal public debt that has been reported to have increased by 1.5 percent to P1.37 trillion as of the end of May last year from P1.35 trillion as of the end of 1997. This development comes also at the heels of the debilitating effects of the Asian financial crisis. This means that on top of the weakening foreign exchange rates, the declining international reserves, and the rising inflation, the government does not have enough resources to restore both external and internal stability.

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 liberalization. The APEC Trade and Investment Liberalization 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 program 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 liberalization and facilitation is primarily on expanding investments and freeing financial markets. This emphasis has led to a disproportionate process of growth that favored 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: Section II discusses the financial and trade liberalization programs as these were implemented in the Philippines in the last 10 years or so. Section III provides data that will then show the consequences of such programs. These two sections will demonstrate the uneven pace of implementation between trade and financial policies, resulting to some deterioration in social welfare. Section III presents the conceptual framework that will explain the adverse consequences of disproportionate policies on trade and capital market liberalization. Section V will make concluding remarks, particularly the policy implications of the paper's findings.

II. Financial and trade liberalization and facilitation in the Philippines

The APEC financial liberalization and facilitation program is based on individual initiatives and action plans of the different economies. Given the diversity of the APEC members, the program 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 liberalization has been approached in a more cautious and generally less thoroughgoing fashion than has trade liberalization, many economies have liberalized 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 condition and development strategies. Unlike other countries in Asia, the Philippines adopted the strategy of import substitution industrialization as a response to severe balance-of-payments. 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 such devices such as tax exemptions, favorable credit terms, and market protection.

The situation changed in 1990 drastically with the implementation of an economic stabilization program 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 Aquino administration. The most important of these was the passage of the Foreign Investment Act of 1991 that liberalized investment by allowing 100 percent 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 percent from the 1990-1992 level of US\$ 2 billion 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 liberalization 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 implemented since 1980, though this has been met with some resistance. So far, there have been four major programs that resulted in substantial reduction in tariffs. The first phase of the Tariff Reform Program (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 percent. 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% and 3% rates of duty, respectively, while intermediate goods were levied at 20% and finished goods at 30%. 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 liberalized 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 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 liberalization in the ASEAN countries. The next tariff adjustments, TRP-IV, provided a structure of 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 clamor for further protection to "assist them compete globally."

In general, the existing efforts of APEC have been very weak to affect the Philippine tariff structure significantly. One way of assessing the likely impact of the APEC TILF program of the Philippine trade liberalization is to compare the effective protection rates (EPRs) of commodities considered in the APEC Early Voluntary Sectoral Liberalization (EVSL) Program 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 jewelry, oilseeds and oilseed products, chemicals, telecommunications mutual recognition arrangement, energy sector, food sector, natural and synthetic rubber, fertilizers, automotive, medical equipment and instruments, and civil aircraft. The problem however is that these sectors are not those that require liberalization the most. Table 1 shows the EPRs of commodities considered to the APEC EVSL Program and the other commodities that possess the highest EPRs.

Three points can be made. First, those highly protected sectors are categorized as sensitive agricultural products which 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 6 times lower than the selected industries, thereby showing the significant difference between the EVSL sectors and those sectors that need to be liberalized 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 liberalizing these heavily protected sectors as well as the discriminatory nature of this type of liberalization.

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 liberalize 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 favored 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 liberalizing 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 characterized both by the lack of understanding of the economic costs of tariff 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 organized labor 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 liberalization has been pursued more vigorously than trade.

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

| | 1996 | 1997 | Percentage |
|---|--------------|--------------|--------------|
| 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 |
| Fertilizer | 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 Jewelry | -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

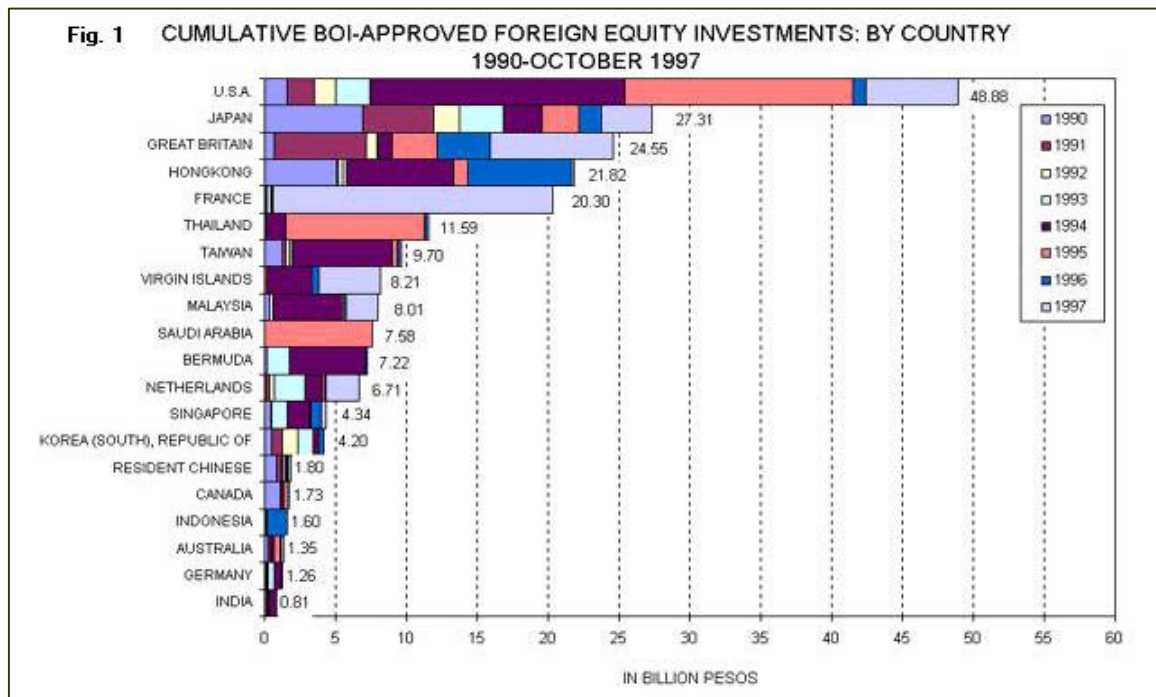
III. The Effects of Trade and Investment Liberalization and Facilitation

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

A. Economic Indicators

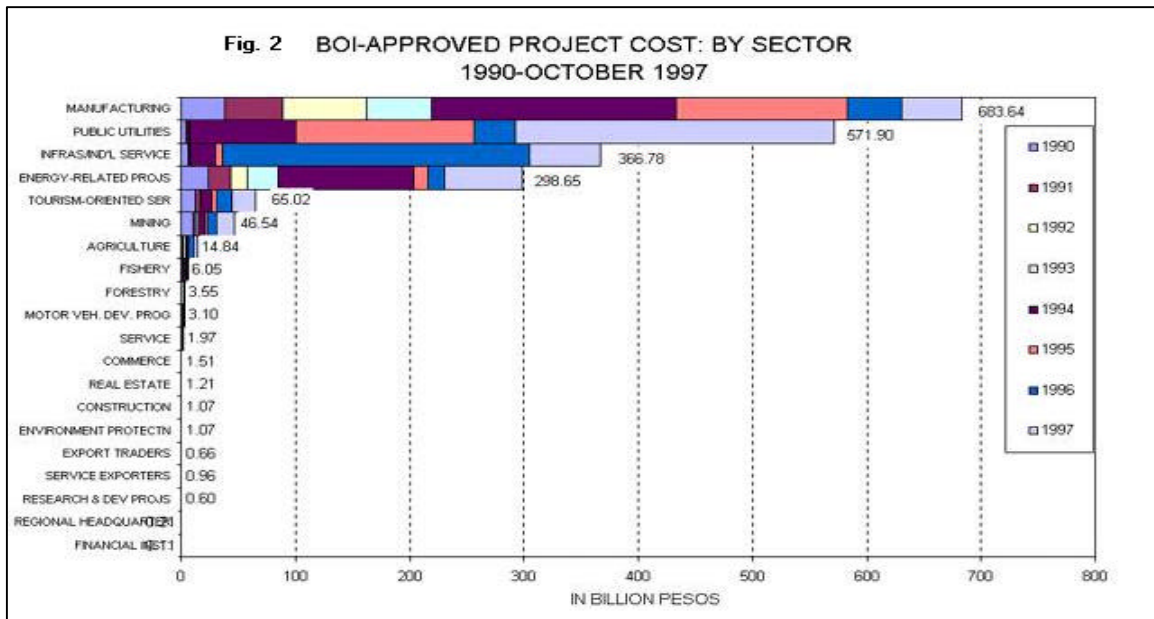
Even before 1992, reforms have already been in place to allow greater foreign goods and investments in the country. The General Agreement of Tariffs and Trade (GATT) and the commitment to currency convertibility under the International Monetary Fund (IMF) have mainly influenced the governments to sweep away most of the restrictions to the international markets. However, this movement towards trade and investment liberalization 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 U.S. and Japan. Certainly, other countries, like France, U.K. and Saudi Arabia have also increased, but these were realized 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 liberalization 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 realized only gradually. Third, while the change in more recent 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.

The economic impact of these developments can further be seen in Table 2, which features selected items from the country's Balance of Payments, as a percentage of the Gross Domestic Product (GDP).

If one uses the ratio of exports to GDP as indicator of openness, the liberalization 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.

Table 2. 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

The country's top exportables are observed to highly capital intensive. Hence, the proportion of current account deficits to the GDP has significantly increased during the said period. Without investment liberalization, trade liberalization would not be favorable for the economy. During the same period, substantial foreign loans and direct investments have also been realized especially in 1993. The tables shows that more of these foreign funds are mainly medium and long-term loans, although for 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 3 which shows selected macroeconomic indicators.

Table 3. Selected Macroeconomic Indicators, 1989-1997

| Year | GDP Growth Rate | Exchange Rate | Growth Rate of Exchange Rate | Per Capita Income | Inflation Rate | Internal Public Debt (in Billion Pesos) | T-bill Rates |
|------|-----------------|---------------|------------------------------|-------------------|----------------|---|--------------|
| 1989 | 6.06 | 21.71 | 3.03 | 11,476 | 10.6 | 237.24 | 18.64 |
| 1990 | 3.04 | 24.31 | 11.84 | 11,727 | 14.17 | 253.80 | 26.67 |
| 1991 | -0.58 | 27.48 | 13.03 | 11,528 | 18.66 | 340.80 | 21.11 |
| 1992 | 0.34 | 25.51 | -7.15 | 11,422 | 8.95 | 253.80 | 16.02 |
| 1993 | 2.14 | 27.12 | 6.30 | 11,450 | 7.61 | 491.92 | 12.45 |
| 1994 | 4.40 | 26.45 | -2.47 | 11,456 | 7.06 | 652.49 | 12.71 |
| 1995 | 4.70 | 25.70 | -2.84 | 11,743 | 8.10 | 603.32 | 11.76 |
| 1996 | 5.80 | 26.21 | 1.98 | 12,261 | 8.50 | 701.14 | 12.34 |
| 1997 | 5.20 | 29.41 | 12.44 | 12,555* | 5.10 | 704.00 | 12.89 |

Sources: NCSB, Bureau of Treasury. Notes: *Refers to third-quarter data.

Note that before 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 liberalization policies. Although 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 accounts deficit, the foreign exchange rate would have slowly depreciated. However, in 1994 and 1995, the exchange rate has even appreciated. 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, such controls, while inducing capital inflows, are inconsistent with the goal of external stability. The trade and investment liberalization 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.

On the other hand, 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.

B. Social Indicators

There are several social indicators that can be considered in the light of globalization. I focus here on the employment and wages since labor 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 labor. Table 4 presents some statistics on the population, the labor force participation rate, the employment, unemployment and underemployment rates, and the real wage rate from 1989 to 1997.

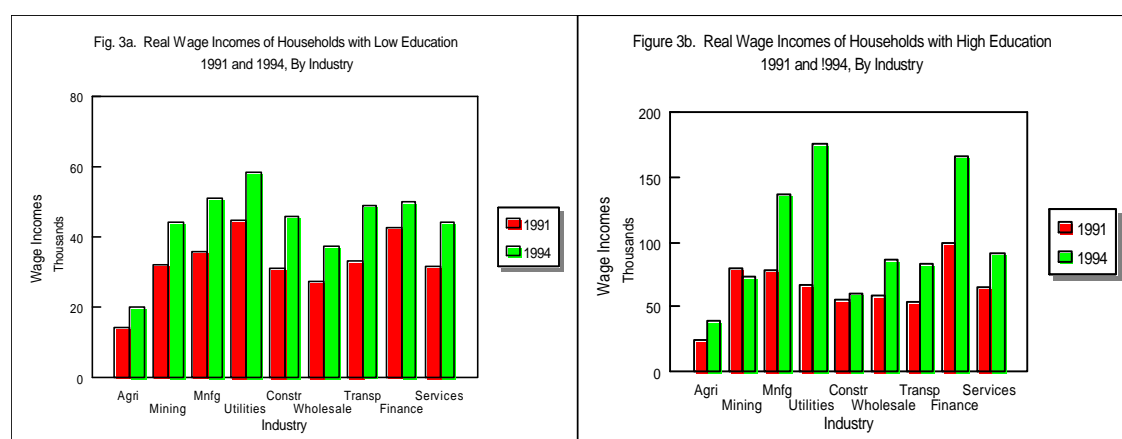
Table 4. Labor Employment Statistics, 1989-1997

| Year | Population 15 years and older | Labor force participation rate % | Employment rate | Unemploy- -ment | Underem- -ployment 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 | n.a. |

Source: Philippine National Coordination Statistical Board

The major observation that can be made from this table is that no perceptible effect can be found in the use of labor. This suggests that the productivity returns to labor have not improved, with the increasing liberalization. While there may have been some slight improvements in the employment and underemployment rates, the changes have not been substantial enough to reduce the unemployment rates, given the increases in the labor force participation rates. Moreover, real wages have substantially decreased from the rate in 1995, a result that is contrary to what is expected from the Stolper-Samuelson theory, assuming that the good that uses the more abundant resource is exported.

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 3a and 3b show the real wage incomes of households across industries and across two levels of educational levels: households with high education or with high school degree or higher; and those with low education or with no high school degrees.



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 labor-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 be found between the more educated and less educated families, suggesting that education is crucial factor in the determination of wage incomes. Second, the improvements from 1991 to 1994, when globalization 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 globalization trends. Moreover, these are industries that are to a certain extent either highly protected (e.g., agriculture), or highly capital-intensive (such manufacturing and utilities). Note also that the financial sector has the highest increase in real wage incomes for the households

These highly skewed movements may have led to some inequality in the distribution of income. Table 5 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 have not yet been experienced.

Table 5. 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 favor 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 globalization 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 labor (at least for particular types of labor), those who have more access to capital should be clearly better off than 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 those from these capital market movements. Table 6 shows the poverty incidence and magnitude for the three periods across several regions.

Table 6. 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 liberalization and globalization 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 suggest 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 has greater access to free capital markets have improved their welfare, the majority who have no access to such benefits were in effect “immiserized” by the policies of liberalization and facilitation.

IV. A Source of “Immiserising” Growth: Disproportionate Trade and Financial Liberalization

Contrary to the standard international trade theory, the inflow of capital into a more liberalized country, such as the Philippines, has evidently been unable to influence the social conditions favorably. 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 “immiserizing” 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 unspecialized. 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 immiserizing growth results from any kind of distortion,

whether locally induced or foreign policy created. An endogenous distortion occurs when an imperfect domestic factor market creates a distortionary wage differential. The distortion may on the other hand be caused by foreign sources if monopoly power in trade is involved or if the country is engaged in optimal tariff policies before trade occurs.

Uzawa (1962) and Brecher and Diaz (1977) independently showed that in a conventional Heckscher-Ohlin model, direct foreign investments (DFIs) necessarily lowers (raises) the host country's social welfare if the import competing sector is capital-intensive and protected by tariff. Given that the Philippines' import-competing industries are capital intensive, this theory suggests that the DFI 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 labor market distortions, export subsidies and trade in intermediate goods, the inflow of DFI, regardless of whether this is pursued in a liberalized economy or not may be welfare worsening. Under these 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, as a result of growth, 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 DFI can be immiserising if the import competing sector is relatively capital intensive and uses these intermediate inputs. Export subsidies can favor 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 as opposed to trade liberalization. Consider the case where the growth in one country is accompanied by further capital liberalization. If we view the change in the scenario as such, there is a distinct possibility that the primary gain in from growth, derived from 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 liberalization. In this case, a reduction in the gains from trade occurs, despite pursuing what the state perceives as "optimal" policies.

The possibility can be seen easily with respect to a country that is neither affected by monopoly power nor domestic distortions. The problem is that capital liberalization without any accompanying change in the international 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 product. However, because trade liberalization does

not progress as quickly, consumers are forced to purchase these products at a relatively higher cost.

This price wedge between goods and factor prices will have three main consequences. First, this reduces the demand for the product, and since the producers do not receive the same price charged to buyers, quantity supplied is reduced. Hence, the uneven implementation of the trade and capital liberalization 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 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 world market, the price of such goods may indefinitely remain high. Thus, producers of these goods are drawn towards them.

Third, for the local producers of goods whose prices have not been rising in the world market, the restricted entry to world markets 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 world trade barriers, the import-competing sectors will be strengthened by easy access to world capital markets. In this way, capital liberalization may run contrary to freer and more open world trade as the domestic non-tradable industries are encouraged.

The interesting point about the above discussion is that the primary cause of immiserization is a shift of the opportunities found in the world market. Hence, even though optimal policies are being implemented by a small country before and after growth, there is no assurance that the intervening policies can avoid such immiserization. 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.

V. Policy Implications

The immiserization 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 a shift in foreign market opportunities that reinforces the gains from trade, or an initial growth that is large enough to absorb the maximum level of reduction in the gains from trade (Bhagwati, 1969). The probability of immiserization 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 liberalization. If capital mobility had been used to complement trade liberalization, 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 emphasized. Thus, the APEC program should concentrate on the disputes relating to trade openness and facilitation.

The second point suggests the importance of economic and technical cooperation cannot be overemphasized. The emphasis 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.

References

Asian Pacific Economic Cooperation (APEC) Economic Committee. 1997. *The Impact of Investment Liberalization in APEC*. Singapore: APEC Secretariat.

Bangko Sentral ng Pilipinas, *Philippines Selected Economic and Financial Indicators, 1991-1998*, Philippines.

Bhagwati, J. 1969. "Optimal Policies and Immiserizing Growth," *American Economic Review*, 59, 967-970.

Bhagwati, J. and T. N. Srinivasan. 1983. *Lectures on International Trade*. Cambridge, MA: MIT Press.

Board of Investments, Planning and Research Department, Philippines.

Brecher, R. and C.F. Diaz. 1977. "Tariffs, Foreign Capital and National Welfare," *Journal of International Economics*, 7, 317-322.

Buffie, E. 1987. "Labor Market Distortions, the Structure of Protection and Direct Foreign Investments," *Journal of Development Economics*, 27, 149-163.

Haggard, S. 1995. *Developing Nations and the Politics of Global Integration*. Washington: The Brookings Institution.

Lairson, T. and D. Skidmore. 1997. *International Political Economy: The Struggle for Power and Wealth (Second Edition)*. Fort Worth, TX: Harcourt Brace College Publishers.

National Statistical Coordination Board, *Economic and Social Statistics, 1984-1997*, Philippines.

National Statistics Office, *Family Income and Expenditure Survey, 1988-1994*, Philippines.

Uzawa, H. 1962. "Production Functions with Constant Elasticities of Substitution," *Review of Economic Studies*, 29, 291-299.