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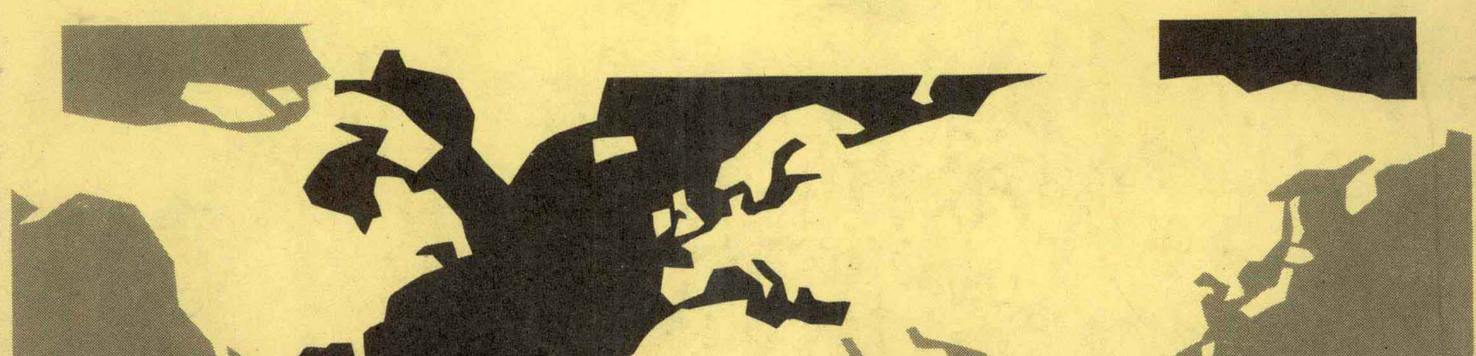

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Abstract

Economic progress as measured by real gross national product (GNP) per capita declined steadily in the Philippines between 1960 and 1985, thus helping to set the stage for the forced abdication of long-time president Ferdinand Marcos in 1986.

Like many of the other developing countries examined in this series of comparative studies, the Philippines during this period sought to build up its industrial sector. As a consequence, the net result of the trade and sectoral policies adopted during the period was an undermining of the agricultural sector, an outcome reinforced by the significant changes in the world economy in the 1970s and first half of the 1980s. The country's fuel bill, for example, rose from 11 percent of the cost of imports in 1972 to about 25 percent in 1981.

This study concentrates on measuring and analyzing the effects of trade and agricultural pricing policies on the agricultural sector up until 1985, with particular attention to rice and corn, the main food grains, and sugar and coconuts, the chief export crops. Although agricultural product exports as a share of all exports dropped from about 80 percent in the early 1960s to about 30 percent in the mid-1980s, about half the population still lived in the countryside and agrarian reform continued to be a matter of intense controversy.

Among the principal findings of the study is that the various types of direct and indirect price intervention resulted in substantial reductions in sugar and coconut production, a very small negative effect on rice output, and a notable increase in corn output. Another significant finding is that direct intervention by the government in the producer prices of sugar and coconuts had net negative effects that were exacerbated by indirect intervention (e.g., manipulation of exchange rates). This appears to account for the shift in political dissension from the rice-growing regions of Luzon to the Visayas, Bicol, and Mindanao, traditional sugar and coconut-producing regions. A characteristic of domestic politics during the period was emphasis on patron/client relations and personal loyalties rather than on the economic interests of larger groups.

The study also reports on the effects of agricultural price intervention on such things as food consumption, foreign exchange earnings, and income distribution.

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Introduction

The February 1986 revolution in the Philippines which led to the exile of President Marcos after 20 years in office powerfully underscores the role of economic factors in shaping political events. The only Philippine president to be re-elected, thanks to a 1969 campaign which emphasized the success of his "rice and roads program," Marcos was also the only Philippine president ever to be forcibly ousted from office.

The 1986 revolution was fundamentally a reaction to the failure of Marcos' economic policies to realize the promises made at the outset of his so-called "New Society" following the declaration of martial law in 1972. Instead of manifesting vigorous industrialization and a "countryside transformed" (Marcos, 1976), the Philippine economy remained excessively dependent on primary exports and became increasingly dependent on external borrowing, both of which contributed to the economic crisis of the 1980s. Indeed, the February 1986 revolution came on the heels of rapid inflation (1984) and declines in output and income (in 1984 and 1985), the only instances of negative growth in the Philippines during the post-World War II period.

Moreover, a large percentage of the rural population suffered significant income losses from government interventions in agriculture that were both inept and prejudicial to farmers. The growth of insurgency during the late 1970s and early 1980s and the geographical shift of its center from the predominantly rice-growing Central Luzon area toward the coconut, sugar, and plantation regions south of Manila corresponded with the pattern of bias in Philippine agricultural policy during the 1970s. At this time, agricultural policy generally favored irrigated rice farmers, disfavored coconut and sugarcane farmers, and largely ignored the land tenure problems in coconut, sugar, and plantation agriculture.

While economic factors have influenced political developments in the Philippines, political events and attitudes, in turn, have helped to shape economic policy. In particular, the attainment of political independence and the spirit of nationalism which accompanied it were instrumental in the adoption of two policies that have most strongly affected agricultural incentives and interests -- namely, the industrial protection system in the 1950s and government interventions in the marketing of agricultural products in the 1970s.

Political independence from the United States, which served the nationalist interest, also meant the gradual disappearance of the Philippines' favored position in the protected American market. This, together with a stubborn bias against correcting a greatly overvalued peso, made Philippine policymakers believe it was time to move away from the colonial dependence on primary exports and focus instead on an industrialization geared to the domestic market. At the same time, the import control system that was adopted to effect this transformation also served a nationalist purpose by introducing a discriminatory Filipinization on the import trade.

Similarly, the government's direct interventions in coconut and sugar trading during the 1970s were in part attempts to reduce the perceived domination by non-Filipinos of agricultural trading and processing. However, instead of being useful, the interventions actually aggravated the structural adjustment problems facing coconut and sugar producers. International prices of coconut and sugar became more volatile and the world use of substitutes continued to grow.

The present study examines agricultural pricing policies in the Philippines between 1960 and 1986 and their effects on agricultural incentives, output, and incomes. The study looks at both specific measures directed at particular crops and the constellation of policies affecting the real exchange rate. Thus, the "direct effects" are essentially the partial equilibrium impacts of taxes, subsidies, customs duties, price controls, and quantitative restrictions. The "indirect effects" on the real exchange rate stem from the industrial protection system and the management of fiscal, monetary, and exchange rate policies. As the study shows, the latter account for a large part of the policy bias against agriculture in the Philippines over the entire period since 1950. Thus, the effects of government policies regarding agriculture were strongly influenced by the overall development strategy that was adopted.

Chapter 1 of this report gives an overview of the Philippine economy and the agricultural sector. Chapter 2 describes the macroeconomic and agricultural policy regime affecting the performance of the agricultural sector. Chapter 3 presents the measures of government interventions in agriculture; and Chapter 4 through 7 present the estimated effects of these interventions on output, consumption, foreign exchange, budgetary transfers, and income distribution. Chapter 8 presents measures of price variability, and Chapter 9 presents price intervention regressions. Finally, Chapter 10 discusses the political economy of direct and indirect government interventions in the agricultural sector.

Chapter 1

An Overview of the Economy

The Economy

The Philippines, located in Southeast Asia, is an archipelago of about 7,107 islands and a number of islets with a history of alternate exposure and submersion. The country has a total land area of nearly 300,000 square kilometers; 45 islands account for 98 percent of the land area. The islands of Luzon (which measures 104,688 square kilometers) and Mindanao (with 94,630 square kilometers) account for two-thirds of the total land area. The country can be subdivided into three broad island groupings: Luzon in the north, Mindanao and the Sulu group in the south, and the intermediate-sized Visayan islands in the middle (primarily Samar, Leyte, Bohol, Cebu, Negros, and Panay).

Table 1.1 presents the population of the Philippines in selected years. The total population grew from 19.2 million in 1948 to 48.1 million in 1980, and 55 million in 1985. The rate of population growth was 3.1 percent a year during the 1950s, 3.0 percent during the 1960s, and 2.7 percent during the 1970s.

Table 1.1 breaks the population into rural and urban categories, with two definitions given for urban. The table shows that the Philippines is primarily rural. Even most of the so-called urban municipalities function as agricultural service centers revolving around agriculture.

Metro Manila is the country's largest city. In 1980, its population of nearly 6 million people represented one-third of the country's 17.9 million urban inhabitants. (In 1960, the city's population accounted for three-tenths of the total urban population.) Metro Cebu is the country's second largest metropolitan area. However, its population in 1980 was only 13 percent of that of Metro Manila.

Table 1.1 shows that the primacy index (i.e., the ratio of the population of the largest city to the combined populations of the second, third, fourth, and fifth largest cities) has been rising for the first time since World War II. The growing primacy of Metro Manila is a result not only of urbanization but also of the post-World War II government policies which have favored the establishment of import-substituting industries in and around Manila.

The population density in the Philippines has risen from about 64 persons per square kilometers in 1948 to 160 persons per square kilometer in 1980. This density varies substantially within the country, however. The most densely populated area is the Central Luzon-Metro Manila Southern Tagalog corridor. In 1980, the population density in the country ranged from 9,317 persons per square kilometer in Metro Manila to 2.5 persons per square kilometer in the island of Palawan. The Philippines currently has the highest national population density among the (agricultural) Southeast Asian countries.

The growth in population has reduced the agricultural land/worker ratio (i.e., the amount of arable land per person employed in agriculture) from about one hectare during the 1950s to about one-half hectare during the early 1980s. This seems to suggest a near closing of the land frontier brought about by the rising population against the land constraint (see Hayami, et al., 1976). However, land classification by topographic maps suggests there is still a large amount of land that is suitable for agriculture (ILO, 1974, p. 83, footnote no. 1). More data and analysis of the cost of land settlement are needed before the trend can be assessed with greater accuracy. Nonetheless, it can be argued that some of the decline in the land/worker ratio is due to the development strategy of the post-World War II period. First, the policy bias against agriculture reduced the returns from investments in land settlement -- investments which increase arable land. Second, the failure of the industrial manufacturing sector to absorb proportionately more labor meant that agriculture and services had to provide employment for the growing labor force.

Changes in the population base of the labor force make it difficult to obtain a uniform time series on labor supply and labor force participation rates. Before 1976, labor force surveys were taken on a population base more than ten years old. Since then the surveys have been conducted using a population base more than 15 years old. The labor force figures given in Table 1.1 have not been adjusted for differences in population base (the 10-14 year-olds constituted 12.37 percent of the total population in 1980). The labor force participation rates were around 56-57 percent during the late 1950s to mid-1960s, 50 percent during 1970-75, 58-62 percent during 1976-82, and 64 percent during 1983 and 1984.

The Philippines has been less trade-oriented than other Southeast Asian countries. In 1982, imports and exports as a percentage of GNP in the Philippines were 32 percent, compared with 40 percent in Thailand, 44 percent in Indonesia, 90 percent in Malaysia, and 331 percent in Singapore (Hill and Jayasuriya, 1985). The small size of Malaysia's and Singapore's populations explains their focus on trade. On the other hand, Thailand has a population size comparable to the Philippines and Indonesia has a much larger population than the Philippines; both of these countries also have higher rates of foreign trade participation. Some trade in the Philippines may have been inhibited by the physical fragmentation of the country and inadequate port and transportation facilities around Mindanao. However, the major obstacle to trade appears to be the predominantly inward-looking development approach engendered by the incentive structure of the post-World War II period.

Overall Economic Performance

Since the 1950s, the growth performance of the Philippine economy has been less than satisfactory compared with other East Asian countries. Between 1950 and 1956 the economy grew at an average rate of 8 percent a year. The growth rate declined to 5 percent a year between 1957 and 1972. The economy picked up slightly between 1973 and 1979, when real GNP increased by 6.8 percent a year. However, growth fell off again between 1980 and 1983 and actually turned negative in 1984 and 1985 (see Table 1.2). Furthermore, alleged flaws in the methodology and data used to estimate the national income accounts may have overstated the growth rate of national income during the 1970s by as much as 100 percent (Oshima, et al., 1986). The average rate of growth in real GNP per capita between 1960 and 1984 was the lowest among the Southeast Asian countries; it also was lower than the average growth rate of lower middle-income countries and individual growth rates of middle-income countries during 1960-82 (World Bank, 1984, pp. 218-19).

During the post-World War II period, the Philippine economy has experienced intermittent balance of payments crises. The first one occurred during 1949-50 and ushered in the foreign exchange and trade controls of the 1950s. The second one occurred at the turn of the 1960s and led to the de facto peso devaluation in 1962. The third crisis took place in 1969; and led to another devaluation in early 1970. The most recent and most serious crisis took place between 1983 and 1986; it again required a major devaluation.

It is difficult to come up with a satisfactory explanation for the disappointing economic performance and balance of payments crises in the Philippines between 1950 and 1986. Although the international economic environment facing the Philippines needs to be considered, several studies and papers (e.g., Baldwin, 1975; Bautista and Power, 1979; David, 1983; Intal, David and Nelson, 1985; Sicat, 1985) point to the nature and extent of government intervention in the economy as causal factors. The various studies suggest that government policies have led the Philippines away from the areas where it has a comparative economic advantage, resulting in a misallocation and underutilization of the country's scarce capital resources. Macroeconomic pricing policies have resulted in low to negative real interest rates and an overvalued peso; the structure of protection for industries has been highly uneven and strongly biased against exportables; government interventions, particularly during the 1970s, have tended to reduce the role of the market mechanism in favor of government regulation -- a process which has enhanced the monopoly power of public and private enterprises.

The international economic environment for the Philippines turned from very favorable during the 1950s to very unfavorable during the early 1980s. The country enjoyed tariff preferences in the United States during the 1950s and, to a lesser extent, during the 1960s under the Bell Trade Act and the Laurel-Langley Agreement. At the time, however, the Philippines did not fully exploit this position because of its focus on import substitution. The 1960s were the boom years in international trade, and, compared with the 1970s, world commodity markets then were reasonably stable. In hindsight, the 1950s and 1960s may be described as the decades of lost opportunities for the Philippines.

During the 1970s and early 1980s, the international economic environment for the Philippines worsened. The 1970s were punctuated by the two oil price shocks of 1973 and 1979, the ensuing world recessions, and large swings in export prices. Because the Philippines relied on imported oil to satisfy much of its energy needs during the early 1970s, the oil price increases drastically raised the share of the oil bill in total merchandise import payments. This share rose from less than 11 percent before 1974, to around 20 percent during 1974-79, and 25 percent during 1980-82. The deterioration in the external terms of trade which began in the 1950s accelerated during the 1970s and early 1980s. This deterioration is comparable in extent only to that of the late 1920s to the early 1930s during the Great Depression. Finally, world interest rates rose substantially during 1979-82, adding to the payment the Philippines had to pay on its external debt, which has variable interest rate terms.

Table 1.2 presents the percentage shares of imports and exports to gross national product during 1950-83. Exports as a share of real GNP averaged about 22 percent during the first half of the 1950s, but declined to about 17.8 percent between 1956 and 1983. The only time when exports reached 20 percent of GNP was between 1963 and 1966, right after the 1962 devaluation of the peso. Note that the export share dropped during the few years before the devaluations in 1962 and 1970; this may reflect the under-reporting of exports as a form of "dollar salting" in anticipation of the peso devaluation and/or the inhibiting effect on exports of an increasingly overvalued peso. The share of imports to GNP averaged 26.2 percent during 1950-55 and 20.3 percent during 1956-83. Imports were quite a bit higher than exports except during 1963-66.

Table 1.2 also presents the shares of gross domestic investment and savings to GNP. The most noteworthy point is the much higher rate of investment during the 1970s and early 1980s compared with the 1950s and 1960s. The share of gross savings--here defined as the sum of capital consumption allowance, personal savings, government savings, and corporate savings--also increased during the 1970s but not as much as the rate of investment. The investment-savings gap reflects the current account deficits and external borrowing, especially during the 1970s and early 1980s. Ironically, the sharp increase in investment rates during the 1970s failed to generate self-sustaining growth in the Philippine economy. One reason is that the overall incentive structure encouraged inefficient utilization of domestic and foreign capital resources. Another reason is the increasing dependence on external financing of investment--a policy which contributed to the debt crisis of the 1980s.

The Relative Importance of Agriculture

Agriculture is an important sector in the Philippine economy, although its importance has been declining in recent years. Agricultural crops and livestock account for about one-fifth of the gross national product; agriculture, fishery, and forestry together account for about one quarter of GNP (see Table 1.3). These shares do not completely capture the importance of agriculture in the economy because they do not include gross value added from the processing of agricultural products and from the marketing and exporting of processed and unprocessed agricultural products. These activities are assigned to other sectors of the economy in the national income accounts.

Philippine agriculture has been dominated by rice, corn, coconut, sugar, banana, tobacco, abaca and pineapple production. Rice and corn are the main foodgrains; coconut and sugar are the main traditional export crops. Tobacco and abaca (manila hemp) were important exports during the late 19th and early 20th centuries but are now minor traditional exports. Banana and pineapple are the major non-traditional export crops. Other crops include coffee and mango (the two newly emerging agricultural exports), rootcrops (primarily cassava and sweet potato), a large variety of fruits and vegetables, and minor commercial crops like rubber, ramie, and maguey. Hog and poultry production are the major livestock industries; carabaos are used primarily as draft animals.