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Henry M. Schwalbenberg

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Class Conflict and Economic Stagnation in the Philippines: 1950-72

HENRY M. SCHWALBENBERG

For the first four years immediately after the Pacific War the Philippine economy grew on average at a rapid 17 percent per capita per annum. But after 1950 the growth rate dropped drastically to under 3 percent per annum for most of the years prior to martial law (see table 1). This poor growth performance occurred when many other nations in the region were achieving economic miracles. In this article we argue that political conflicts among different social classes caused the Philippine economy to stagnate. During the postwar period prior to the imposition of martial law, several Philippine social classes had great success in using their political influence to distort the nation's economy to serve their own economic interests.¹

PHILIPPINE SOCIAL CLASSES

The social classes in the Philippines are linked very closely to the nation's economic structure. The economic structure is dualistic. There exists a traditional agricultural sector in the provinces and a more

This essay represents a nontechnical application to the Philippine experience of chapters 4 and 5 of my doctoral dissertation, "Neoclassical Political Economy Models of Trade and Development," Columbia University, 1988. This article has profited from the comments of Dr. Ellen Palanca, Roberto Yap, S.J. as well as the participants at the graduate seminar at the School of Economics, University of the Philippines where I presented the technical version of this essay. Since I have felt free to use or ignore their comments I alone am responsible for the contents of this article.

1. Richard Baldwin has catalogued this process and its detrimental effects on Philippine economic growth in R. Baldwin, *Foreign Trade Regimes and Economic Development: The Philippines* (New York: Columbia University Press, 1975); and in R. Baldwin, "Political Economy of Industrialization: The Philippine Case," in J. Black and B. Hindley, eds., *Current Issues in Commercial Policy and Diplomacy* (New York: St. Martin's Press, 1980).

Table 1. Average Annual Per Capita Growth Rate of
Philippine Gross National Product

Years	Growth Rate (%)
1946-50	17.1
1951-55	4.9
1956-60	1.9
1961-65	2.1
1966-71	2.9

Source: Baldwin (1980), Table 6.1, p. 114.

modern manufacturing sector in the urban areas, particularly in the metropolitan Manila area. The agricultural sector is led by landowners who employ labor, while the manufacturing sector is led by capitalists who also must employ labor. Since conditions and wages vary so greatly between the rural and urban areas it is perhaps best to divide workers into two classes, namely rural labor and urban labor. Philippine social classes would then consist of landowners, capitalists, urban labor, and rural labor. Each of these social classes has conflicting economic interests as well as differing access to political influence. Although this view of the Philippine political economy is necessarily oversimplified, it does, we believe, contain the most crucial elements of the actual situations.²

ECONOMIC DISTORTIONS

During the postwar period prior to the imposition of martial law, several of these social classes successfully used their political clout to influence the government's economic policy in many diverse areas. But two areas are of critical importance because they could and did effect the prospects for economic growth. These two areas are tariff protection and urban wages.

2. For an overview of the Philippine economy during this period see F. Golay, *The Philippines: Public Policy and National Economic Development* (Ithaca, New York: Cornell University Press, 1961); R. Baldwin, 1975, *Foreign Trade Regimes and Economic Development*; V. Valdepeñas and G. Bautista, *The Emergence of the Philippine Economy* (Manila: Papyrus Press, 1977); and J. Carroll, *The Filipino Manufacturing Entrepreneur: Agent and Product of Change* (Ithaca: Cornell University Press, 1965).

From the war and up to the imposition of martial law we observe that the leaders of local manufacturing firms (capitalists in our terminology) had sought from the government with great success extremely high tariff protection from foreign competition, often under the banner of nationalism. The government, by granting such high tariff protection, artificially raised the price of what these industrialists or capitalists could receive for their products. In many cases manufacturers who were receiving little or no import protection in 1950 were receiving by 1960 prices 300 percent higher than world prices due to tariffs placed on imports (see table 2).

Table 2. Effective Protection Rates (Overall Percentage Difference Between Domestic Philippine Prices and International Prices)

Year	Imported Nonessential Consumer Goods*	Traditional Exports**
1950	5	0
1955	141	-16
1960	349	-27
1965	365	-22
1970	354	-43

* The term "nonessential consumer good" is in general a euphemism for any locally manufactured good that faces international competition.

** The term "traditional exports" is in general equivalent to agricultural exports.

Source: Baldwin (1975), Table 5.10.

This protection led to higher profits for capitalists as well as a diversion of labor and other resources into highly protected and for the most part inefficient industrial activities.³ In effect, resources, human and otherwise, were wasted by being diverted away from activities that would have more likely increased the productive capacity of the nation.

A second but often not noted adverse effect of this protection of manufacturing was an unfortunate undermining of the agricultural sector. In relative terms it depressed agricultural prices below interna-

3. Baldwin, *Foreign Trade Regimes and Economic Development*.

tional prices, made it more difficult to attract resources to agriculture, and most likely hurt the rents received by the landowning class.⁴

Clearly it would have been in the interests of the capitalists to seek tariff protection from the government while landowners should have sought to oppose such efforts.⁵

The economic interests of capitalists not only clashed with landowners over the government's trade policy but also with urban labor over the wage rates prevailing in the more modern manufacturing sector. Clearly we would expect the efforts of capitalists to enlist the government in holding down wages, while at the same time observing the efforts of urban workers to enlist the same government in raising urban wages above what could be gotten in the traditional agricultural sector.⁶

The success of politically active labor organizations in the urban sector may help in part to explain the existence in the Philippine economy of a wide gap between urban and rural incomes.⁷ These attempts to maintain relatively higher urban wages appear to have produced, although with some exceptions, increasing strife between labor and capitalists in the urban sector during the postwar period prior to martial law.⁸

This increasing strife, oddly enough, resulted not in an increasing, but rather in a gradually decreasing urban rural income gap. During the postwar period the average rural income increased from a quarter to a third of the average urban income.⁹ This reduction can not be credited to rising rural wages, but unfortunately to declining urban wages. In the period from 1949 until 1972 real wage rates for both skilled and unskilled laborers in industrial establishments in the

4. Ibid.

5. Baldwin, "Political Economy of Industrialization."

6. For an overview of the labor situation in the Philippines see N. Vasquez, *Mobilizing Surplus Labor Through International Exchange* (Manila: Ateneo de Manila University Center for Social Policy and Public Affairs, 1987).

7. For instance in 1987 the government's mandated legal minimum wage for nonagricultural workers was almost 50 percent higher than the legal minimum wage for nonplantation agricultural workers. The government imposed minimum daily wage rates were ₱69.33 for nonagricultural workers, ₱58.50 for plantation agricultural workers, and ₱47.12 for nonplantation agricultural workers. See Broad, *Unequal Alliance* (Manila: Ateneo de Manila University Press, 1988) for a discussion of the prevalence of violations against Philippine minimum wage laws.

8. See annual strike statistics in *Philippine Yearbook of Labor Statistics*, 1984.

9. See annual data for rural versus urban incomes in *Philippine Statistical Yearbook*, 1984.

metropolitan Manila area declined (see table 3).¹⁰ Apparently capitalists were able to gain the upper hand over urban labor and gradually forced urban labor to accept average wages closer to what prevailed in the country's more stagnant agricultural sector.

Table 3. Real Wage Rate Index of Laborers in Industrial Establishments in Metropolitan Manila Area

Year	Skilled Laborers	Unskilled Laborers
1949	142.2	109.6
1954	140.1	113.4
1959	139.5	112.2
1964	115.1	98.6
1969	123.3	115.2
1970	114.4	111.6
1971	105.1	104.1
1972	100.0	100.0

Source: Central Bank of the Philippines as cited in E. Palanca (1985).

We have described two political conflicts: a conflict over tariff protection between capitalists and landowners and a conflict over urban wage policies between capitalists and urban workers. There are certainly other economic areas where the interests of Philippine social classes could and did clash. One of these was the political conflict between landowners and rural labor over land reform.

During the period under consideration, prior to martial law, the Philippine political system proved incapable of implementing any major changes from the status quo.¹¹ Perhaps the condition of rural labor (it is widely dispersed geographically, poorly educated, with very low incomes, etc.) made it incapable of much influence in government

10. Central Bank of the Philippines as cited in E. Palanca, "Poverty and Inequality: Trends and Causes," *Budhi Papers* 6 (Manila: Ateneo de Manila University, 1985). Similar statistics also cited in Broad, *Unequal Alliance*, p. 120 and Baldwin, "Political Economy of Industrialization," p. 118.

11. Valdepeñas and Bautista, *The Emergence of the Phil. Economy*; A. Ledesma, "Land Reform Programs in East and Southeast Asia: A Comparative Approach," *Philippine Studies* 28 (1980): 305-43, 451-81; and M. Mangahas, et al., *Tenants, Lessees, Owners: Welfare Implications of Tenure Change* (Quezon City: Institute of Philippine Culture, Ateneo de Manila University, 1974).

circles against the interests of the landowners.¹² Without any major changes in agricultural policies, there would not be any significant increase or decrease in the economic distortions emanating from the agricultural sector that might have affected the growth performance of the country over this period.

In summary we are left, therefore, with just two changing political conflicts (tariffs and urban wages) and with three contestants (capitalists, landowners, and urban labor).

INDUSTRIAL GROWTH: ECONOMIC AND POLITICAL CONSEQUENCES

We can now develop an explanation of the pre-martial law experience of the Philippines as a result of these political contests. To do so we must show how these two political conflicts over tariffs and urban wages are consistent with the observed, although stylized, trends in the country. These stylized trends are: (1) increasing protectionism; (2) decreasing urban wages; and (3) increasing strife between capitalists and urban labor over urban wages.

The results of our theory are derived by two simple but important characterizations of the Philippines. The first important characteristic is political, and argues that the Philippine political system was responsive to the entreaties of any social class so long as that class or interest group was capable of devoting resources to influencing the government in either legitimate or illegitimate ways. The second characteristic is economic, and argues that since the war the Philippines have experienced a type of economic growth due to the accumulation of capital geared to industrialization, while the nonlabor resources for agricultural production have remained more or less stagnant.¹³ Of course

12. There is a large literature on the free rider problem and the difficulties of group cooperation. Some of the more important works are: M. Olson, *The Logic of Collective Action* (Cambridge, Ma.: Harvard University Press, 1965); J. Buchanan and G. Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1967); and G. Stigler, "Free Riders and Collective Action: An Appendix to Theories of Economic Regulation," *Bell Journal of Economics* 5 (1974): 359-65.

13. Although capitalists have saved and accumulated more capital to increase the industrial capacity of the nation, it should also be noted that a significant share of capitalists' savings have been invested outside the Philippines. Clearly this represents another significant factor that can explain the poor growth performance of the Philippine economy. However, the reluctance to invest in the Philippines may be due to the same politically induced distortions discussed in this paper. A highly inefficient and distorted economy is not likely to be an attractive investment site even for Filipino investors. For more details see J. Boyce and L. Zarsky, "Capital Flight from the Philippines, 1962-1986," *Journal of Philippine Development* (Second Semester, 1988).

these are simplifications of the actual situation but they correctly characterize the crucial elements.

Based on these two important characteristics of the Philippines we can now see how industrial biased growth changed the economic fortunes of the three social classes and in turn their willingness to devote resources to influence the economic policies of the government. The political configuration changes in such a way that we will be able to explain the rise of protectionism, urban strife, and the relative decline of urban wages.

The accumulation of capital through savings and investment in new industrial capacity for the country affects the incomes of the three political contestants—capitalists, landowners, and urban labor.¹⁴ We begin with the simple assumption that the owners of this capital would not save and accumulate more capital if it did not increase their total profits. Therefore capital accumulation benefits capitalists.

Capital accumulation is the same as an increase in the means or tools of production available to urban labor in the production of manufactured goods. Such an increase in the capital stock makes urban labor more productive and therefore more valuable to capitalists. Capitalists will want to hire more urban workers. Given the Philippine case where labor is abundant, capitalists should be able to get their additional workers without significantly raising wages.¹⁵ But even with a very abundant labor supply the total wage bill received by urban labor as a group would increase, since there would be more workers receiving at least the same wage. Therefore we would also expect capital accumulation to benefit urban labor as a group.

Finally, the accumulation of more industrial capital has a negative effect on the rents received by landowners. Landowners' rents are depressed because now the new capital has created new employment opportunities in the urban sector for workers as well as for other productive inputs to agriculture. In order to compete with the expanding manufacturing sector for workers and other productive inputs, landowners must pay more for them. But since the productivity of land has remained stagnant, these higher costs must necessarily cut into the rents that landowners would normally receive.

14. The explicit economic model behind this section is the Ricardo-Viner sector specific trade model. It is formally given in R. Jones, "A Three Factor Model in Theory, Trade and History," in J. Bhagwati et al., eds., *Trade, Balance of Payments, and Growth* (Amsterdam, North-Holland, 1971).

15. This is the assumption of surplus labor made famous by Nobel Laureate W.A. Lewis. In the technical version of this paper we are able to derive the same results if we drop this surplus labor assumption and assume its opposite full employment, but the reasoning is more complicated and subject to exceptions.

To summarize, the process of industrialization in the Philippines has increased the profits of capitalists and the wage bill of urban labor while decreasing the rents received by landowners.

What would be the likely effect of these changes in income on the ability of these three different social classes to influence the government to distort the economy in their favor? We must consider first the political contest over tariff protection.¹⁶ As the economy grows capitalists get richer while landowners get poorer. We would therefore expect that capitalists would increasingly be in a better position to devote resources to lobbying the government, as well as having more to lose if they do not seek to protect and enhance their income through the political process. On the other hand, poorer landowners would have less resources and incentives to protect their declining incomes.¹⁷ The result would be increasing tariff protection of manufactured goods which we have observed in the Philippines.

Next we consider the political contest over urban wages.¹⁸ The total group incomes of both capitalists and urban labor will increase due to the country's industrial biased growth. Hence both groups will have more to gain by devoting additional resources into influencing the government's labor and wage policies. Such a situation would create increasing strife between the two groups.

Yet how can we explain the fact that the eventual winner has been the capitalists over urban labor? Simply by noting that the Philippines

16. Formally this political contest is modeled as a noncooperative game following the example of R. Findlay and S. Wellisz, "Endogenous Tariffs, the Political Economy of Trade Restrictions, and Welfare" in J. Bhagwati, ed., *Import Competition and Response* (Chicago: University of Chicago Press, 1982). Two classics in this field of modeling political system are: A. Bentley, *The Process of Government* (Chicago: University of Chicago Press, 1908) and A. Downs, *An Economic Theory of Democracy* (New York: Harper and Row, 1957). More recent work has been done by G. Stigler, *The Citizen and the State* (Chicago: University of Chicago Press, 1975) and G. Becker, "A Theory of Competition among Pressure Groups for Political Influence," *Quarterly Journal of Economics* 93 (1983): 371-400.

17. See Schwalbenberg, "Neoclassical Political Economy Models," for the formal derivations of the best reply functions of the different social classes. In essence the competition for political influence here has an exact analogue in the Cournot model of oligopolistic competition commonly used in economic theory.

18. The formal modeling of the wage contest draws on G. Calvo, "Urban Unemployment and Wage Determination in LDC's: Trade Unions in the Harris-Todaro Model," *International Economic Review* 19 (1978): 65-81; R. Findlay and M. Lundahl, "Racial Discrimination, Dualistic Labor Markets and Foreign Investment," Discussion Paper Series No. 308, Department of Economics, Columbia University, 1985; and J. Harris and M. Todaro, "Migration, Unemployment and Development: A Two Sector Analysis," *American Economic Review* 60 (1970): 126-42. For a technical discussion see Schwalbenberg, "Neoclassical Political Economy Models."

is clearly a country with abundant labor and scarce capital. In such a climate increased demands for capital and labor generated by industrialization will benefit the owners of scarce capital much more than the owners of abundant labor. In this way industrialization increases the total incomes of both groups but does so in such a way that it favors capitalists more than urban labor.

Turning back to the political implications, a relatively richer capitalist class would therefore be in stronger position to influence the political system and thus use its political clout to drive down urban wages closer to the wages prevailing in the stagnant agricultural sector.

Clearly we assume that the pre-martial law Philippine political system was more responsive to well financed interest groups than to one-person-one-vote, since urban labor clearly outnumbered capitalists. In such a political system small size may actually be advantageous, since the smaller group, capitalists, would be more likely to organize itself and effectively lobby the government to oppose strikes and hold down urban wages.

By raising the total group resources of both capitalists and urban labor, industrialization foments increased urban strife. But by benefiting capitalists more than urban labor, industrialization also allows capitalists to win out over urban labor. The result is a gradual decline in urban wages toward the rural wage level, amid increasing urban strife as in the Philippines during the pre-martial law period.

WELFARE AND GROWTH EFFECTS

We have shown how an economic, social, and political system similar to the Philippines, experiencing industrial biased growth, will give rise to increasing protectionism, mounting strife over wages in the urban area, and the gradual reduction of urban wages toward the level of rural wages. At this point it is appropriate to consider the normative implications of these results. Simply put were these trends good or bad for the welfare of the country as a whole?

The political system described above allowed the three politically active social classes to distort the economy in three different ways. They were the distortions created by tariff protection, by the divergence between urban and rural wages, and finally by the waste of resources spent on political infighting among the three interest groups.

For the Philippines as a whole, increasing protectionism had the effect of artificially raising the prices of manufactured goods produced by the politically influential capitalist class. These artificially higher prices induced capitalists to divert their investments into manufacturing firms that were highly uncompetitive and inefficient, but extremely

profitable when protected by high tariff walls. As a result, enterprises, particularly in agriculture, that were efficient and competitive which could have induced more technological advancement and growth were ignored.¹⁹

The effects of higher urban wages relative to rural wages could have countered to some extent the production imbalance favoring manufacturing over agriculture created by increasing protectionism. By keeping urban labor expensive relative to rural labor, the wage gap raises the relative costs of manufacturing compared to agriculture, thus reducing to some extent the bias in favor of manufacturing.²⁰ But in the Philippine scenario we observe a declining wage gap between the two sectors. Therefore the ameliorating effect of the wage gap distortion on the tariff distortion declined, thus adding to the overall drag on the economy.

Finally the increasing strife in the urban sector over wages can be thought to simply represent a loss of resources that could have been used more productively.²¹

Combining these three types of distortions we see that the loss of resources going into inefficient or unproductive activities increased as the country industrialized. In effect, as the economy industrialized, an increasing part of the new income generated by this economic growth was eaten up by these expanding distortions, thus undermining the future growth of the country.

Industrial biased economic growth benefited certain social classes which in turn were able to use their increasing political clout to influence Philippine economic policy for their own purposes, but at the expense of the nation's future. In this way class conflict not only transferred income to the politically powerful, but also retarded economic growth in the Philippines.²²

19. Interesting discussions concerning the negative effect of protectionism on the growth performance of developing countries are given in J. Bhagwati, *Dependence and Interdependence* (Cambridge, Ma.: The MIT Press, 1985); R. Findlay, "Trade and Development," *Asian Development Review* 2 (1984): 23-42; and A. Krueger, "Trade Policies in Developing Countries," in R. Jones and P. Kenen, eds., *Handbook of International Economics*, vol. 1 (New York: North-Holland, 1984).

20. For a discussion of how a wage distortion may ameliorate a trade distortion see J. Bhagwati and T.R. Srinivasan, *Lectures on International Trade* (Cambridge, Ma.: The MIT Press, 1983).

21. J. Bhagwati, "Lobbying and Welfare," *Journal of Public Economics* 14 (1980): 355-63.

22. When all new income generated by growth is eaten up by distortions we call this immiserizing growth. Two classic articles on the theory of immiserizing growth are: J. Bhagwati, "Immiserizing Growth: A Geometrical Note," *Review of Economic Studies* 25 (1958): 201-5; and H.G. Johnson, "The Possibility of Income Losses from Increased Efficiency or Factor Accumulation in the Presence of Tariffs," *Economic Journal* 77 (1967): 151-54.

CONCLUSION

We have attempted to explain why the Philippines during the postwar period prior to martial law encountered difficulties in promoting long run economic growth. We have argued that the Philippine social structure exerted political pressures causing the government to distort the economy in such a way that these distortions increasingly ate up the new income generated by industrialization. The crucial components of the explanation are threefold. Society was organized into social classes, such as capitalists, landowners, urban labor, and rural labor, several of which were capable of different degrees of organizing and acting for their common group economic interests. Capital accumulation in a dualistic economic structure was essentially an industrial biased growth strategy that favored certain social classes at the expense of other social classes. Finally, the political system's choice of economic policies responded favorably to the desires of those economically favored and politically organized social classes rather than to the more amorphous concerns of the general public's welfare, thus distorting and undermining the future prospects of the economy.

A change in any one of these three areas— social, economic, or political—will affect the ability of the nation to grow. An eroding of the social stratification of society or a change in the underlying political system in our view are just as important as changes in strictly economic factors in either enhancing or inhibiting a country's long run economic progress.