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# The Economic Theory of Globalization

*Victor S. Venida*

The General Agreement on Tariffs and Trade (GATT) always envisioned development as the ultimate goal. To attain this a liberalized but fair trading of goods and services among countries was regarded as a crucial means. This vision has its basis in classical economic theory and has in many ways been verified by the history of developed countries in Western Europe, principally England. As early as 1817, David Ricardo attempted one of the earliest rigorous approaches to economic analysis to justify the abolition of the Corn Laws which restricted the importation of wheat to England and which he regarded as delaying the expansion of employment and investment in England (Blaug 1976). But equally powerful arguments have also been put forth to emphasize the disagreeable aspects of free trade or globalization. Even after the contentious debates regarding the ratification of the GATT, disagreements over the merits of globalization remain, specially with the ongoing regional economic crisis in East Asia.

This article presents a summary of the implicit theories of development underlying globalization, specifically free trade. It focuses not so much on the relationships among nation-states but the social structure within a society and how it changes as the process of economic development proceeds. A special point is on the social classes and how their interaction in the political and economic sphere can determine a country's economic change. The effect of trade on industrial development is then discussed. And the last section attempts to apply these theories in analyzing the economic structure of the Philippines and to examine what forces would contend in determining the path of development in the future.

## The Dual Economy

Some of the major issues that have emerged in the study of development economics relate to market or structural fragmentation. Developing economies lack a degree of market integration that developed economies take for granted. To be precise, developing economies are said to have a "dualistic" economic system. Dualism here refers to the coexistence of an informal and a modern sector within the structure of the same economy and has become quite popular in the study of the economies of developing countries (Myint 1986; Todaro 1985). From this point of view, development is the process of modernization of a society that starts from a traditional or premodern economy. Thus developed economies are essentially fully modernized societies while developing economies are still in transition to full modernization. Modernity refers to the high degree of specialization of economic functions, monetization of transactions and homogenization of goods and services prevalent in a society.

The modern sector contains five basic units: the household, the firm, financial institutions, government, and the foreign sector. Households supply firms with labor and capital services in return for factor payments which are then spent on the goods produced by the firms. Both households and firms deposit their savings with financial institutions which then supply finance for both consumption and investment purposes. Households, firms and financial institutions pay taxes to the government which then provides the economy with public goods and services (the government also has credit transactions with the banking system). Finally, firms, households and financial institutions deal with the foreign sector in, respectively, the import and export of goods, supply of factor services for factor incomes, and in capital inflows and outflows (see figure 1).

In this stylized picture of the circular flow of income, product, and money, the features of a modern sector emerge. First, the economic units are specialized in their economic functions. Consumption is done by households, production and employment by firms, savings and credit by financial institutions, and peace and order and defense by government. Second, transactions have attained a high degree of monetization because specialization necessitates exchange on a wide scale. Much of the services are already done in exchange for payment. Third, goods and services attain a high degree of homogenization in price

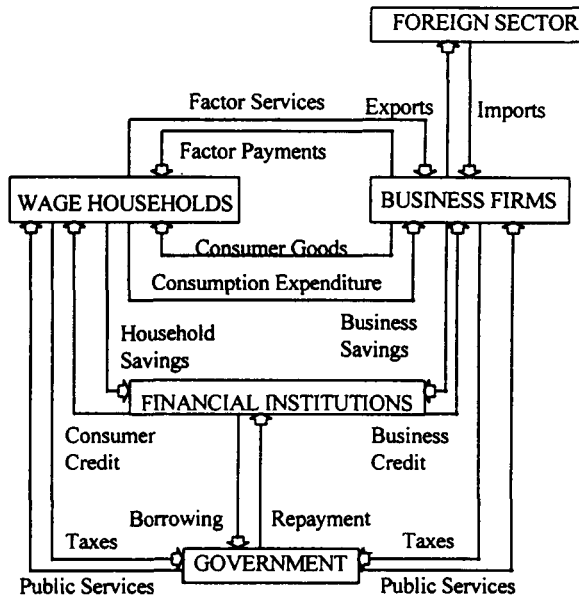
and quality throughout the entire modern sector. These include the homogenization of skills and education required by the entire economic system from among its labor, professional and managerial classes.

This economic structure corresponds to that prevailing among developed economies and the modern sectors of the less developed countries. The costs of transaction and information across borders are quite affordable that they promote a high degree of global economic integration made possible by the availability of infrastructure. Indeed, "infrastructure" (literally beneath the structure) are the systems that make this economic structure function smoothly and efficiently. Five elements comprise the modern infrastructure system: energy, transport, communication, water and sanitation. In fact, the modernized economies of the developed world and the modern sectors in developing countries are closely integrated, made possible by infrastructure linkage. Indeed nearly all of the transactions within the modern sector of a country are easily and similarly undertaken with the foreign sector.

In contrast, the traditional or premodern economy features a low degree of specialization in functions and in integration into the exchange economy. The prevailing economic unit is the peasant household. These undertake subsistence production and possibly production of cash crops and handicrafts and supply of seasonal wage labor, all to earn some money income. In contrast to the modern household which earns money income from its labor to purchase goods and services, the peasant household produces a lot of the goods it consumes and sells some of its produce to earn some money income to purchase some of the goods. There is, moreover, little infrastructure connecting these peasant households which are thus quite isolated from each other. Exchange of goods and services is thus quite minimal. Given this production structure the degree of monetization of transactions and homogenization of goods and services is quite low.

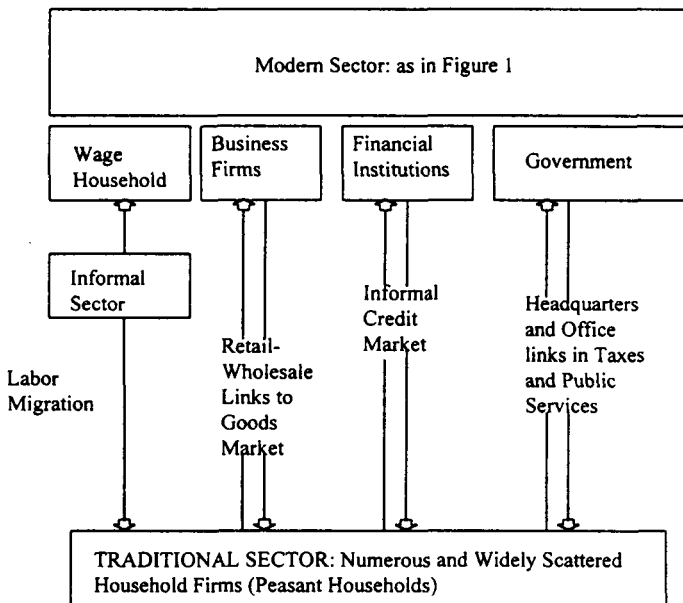
By the theory of dualism, development is the process of modernization, by which a society evolves from the traditional to the modern economic system. A developed economy is one that is fully modernized. A developing economy is one that is still in transition, with the modern sector and a non-modern sector—called the informal—coexisting, thus a dualistic economy. The informal sector emerges as that which is no longer traditional but is not yet fully integrated with the modern or formal sector. The interaction between the modern and informal sectors is assumed to be tenuous so that the national economy is fragmented (see figure 2).

Figure 1. A Fully Organized Economy



Source: Hla Myint, "Organizational Dualism and Economic Development," *Asian Development Review* 2(1): 28.

Figure 2. Organizational Dualism: Structure of a Developing Economy



Source: Hla Myint, "Organizational Dualism and Economic Development," *Asian Development Review* 2 (1): 29.

Because of an undeveloped transportation and communication system throughout the economy particularly in the informal sector, the over-all costs of marketing, information and storage of commodities are quite significant. The mark-up pricing of middlemen in the distribution system reflect both localized monopolistic control (especially over communities of peasant households without access to other markets) and real resource costs of transactions. As a result, there is a wide differential in the price of farm produce and of manufactured goods between the producer and the retailer. Persistent subsistence production among peasant households is then an economically rational decision given the high prices for goods available in the market and supply uncertainties (Wharton 1969). The domestic market for goods in general in a dualistic economy is indeed quite small. This serves as an effective limit to the growth of enterprises that cater largely to the domestic market. It also predisposes the modern sector to monopolistic or oligopolistic control. These considerations explain, for example, the ambivalence of many firms towards export orientation: on the one hand, the domestic market for wage goods and luxury commodities is easily saturated; on the other, oligopoly profits are more attractive than export earnings and the competition that these earnings entail (deJanvry 1981).

In the labor market, wage differentials across sectors are also significant. An added consideration is that labor itself is no longer homogeneous: raw labor for peasant agriculture is vastly different in minimum skills and work orientation from the unskilled labor of the modern sector. The latter sector generally needs workers with basic skills and availability for regular, long-term, supervised employment—in contrast to the seasonality, muscular energy and manual dexterity sufficient for traditional peasant production. The modern sector wage thus reflects a “quality” premium needed to maintain a relatively stable pool of labor available for wage employment.

In the dual model, employment in the informal labor market involves seasonal labor and rather crude, labor-intensive production in shoemaking, carpentry, other artisan crafts and food processing. A major portion of the work force involves services such as peddling, domestic work, messengerial, sanitation, garbage recycling and the like. In effect, the informal sector absorbs the seasonal excess labor from the peasant agriculture sector that is unable to obtain wage employment because of lack of sufficient skills and of job availability. Its large pool of labor explains to some extent the cheapness of personal service in developing countries.

Interest rate differentials characterize the capital market (Sicat 1983). The formal banking system incurs higher administrative costs per unit of loan amount if it transacts with the numerous and widely dispersed peasant and urban informal sector households than if it restricts itself to the large modern sector establishments. The latter are either urban manufacturing enterprises or accessible plantations, and these tend to borrow in large amounts to further reduce monitoring and transactions costs. Moreover these firms have a much lower cost of credit investigation. The interest rate disparity reflects both real costs of administration and differential risk across the sectors (McKinnon 1973).

In the informal credit market, the interest rates are rather higher. This reflects both the local monopoly control of the moneylenders— isolation precludes arbitrage by peasant households across moneylenders—and also there is a genuine capital scarcity in the credit market. The informal sector cannot generate substantial surplus cash, given the prevalence of subsistence production in agriculture and high rates of urban underemployment. And it does not have institutional access to the savings of the organized financial system. Moreover, the informal credit market relies on personalistic (social and economic) relationship among the transacting parties to initiate, consummate and enforce the contractual relationship (Floro 1987; Llanto 1993).

As in the analysis of the labor market, one can see parallels to the role of the informal credit market. Clearly, the latter provides loans needed by the informal sector but one can expect interest rates to be higher, reflecting the real scarcity of funds in this sector. The supply of funds is limited to whatever surplus the moneylender may have and he would have minimal access to the larger pool of funds within the formal banking system. Secondly, the moneylender can exercise real monopoly power over certain borrowers because of their mutual isolation from other markets. Third, the formal banking system, given the high cost of transportation and information-gathering to determine creditworthiness, may not have an incentive to enter the informal credit market even though interest rates are higher than in the modern (Floro 1987).

Finally the administrative machinery of the government is largely concentrated in the modern sector. The high cost of collecting taxes and providing public services among a vast number of widely dispersed peasant and urban informal sector households ensures this concentration. Besides the prevalence of subsistence production imposes a limit on monetary revenues that can be generated from within the

informal sector. Not surprisingly, the bulk of the modern sector revenue derives from income and corporate taxes, sales taxes and taxes on imported and exported goods. The tendency is to rely on indirect taxes which, despite equity problems, are relatively efficient and convenient to collect. Again, the small size of the modern sector constrains its revenue-generating capacity even if one assumes an efficient collection machinery and the absence of political pressure by organized unions, capitalists, landowners and middle classes against high taxation. The ability of these social classes to organize as a pressure group, coupled with the administrative costs of delivery of public goods to the informal sector, also explains why public services (such as public or subsidized private education, health services, and infrastructure facilities) are also concentrated in the modern sector. In a nutshell, the tendency for dualistic economies is towards regressivity in tax and expenditure policy, thus towards inequitable distribution of fiscal resources.

From a historical perspective, the modern sector is actually the capitalist mode of production, the traditional as the feudal or precapitalist mode. The process of modernization or of economic development is the transition from a feudal to a capitalist system. The developed economies therefore are fully capitalistic while the developing are in transition. In a developing economy, capitalism coexists with a mode of production no longer completely feudal but semi-capitalist, or the informal sector (Venida 1996). This approach suggests that feudal practices may persist even though the traditional economic system may have already disintegrated. One can also analyze the political factors that influence the development process itself—in other words, the political economy factors.

Under feudalism the two main classes were the landlords and the peasants who may be serfs or tenants. The latter are organized into communities over which a particular landlord has a domain. The size of the lord's landholding is variable, its boundaries depending upon relative positioning with other landlords. The lord provides protection to a subject peasantry from outside molestation and guarantees their access to land for subsistence production. In return the landlord has the right to extract the surplus output of the peasantry in cash, in kind, and/or in personal service.

Since the surplus is extracted from the peasantry as a matter of right, the power and wealth of the feudal lord is dependent upon the number of people under his direct control as peasants, retainers or



warriors. The collected surplus is spent on his own military for the protection and enlargement of the manor, and for conspicuous consumption. The latter consumption is functional since it reflects and reveals the power of the lord and his serfs and thus serves as an inducement for more peasants to ally with him and request his protection. Moreover, it has a redistributive function to the degree that the peasants participate in the feasting and the entertainment without charge. One can notice this pattern of relationship among many politicians in the Philippines with their large staff of retainers, private army of bodyguards and the constant entertainment and open house necessary for the hospitality of callers (McCoy 1994).

Under capitalism the two basic classes are the capitalists or bourgeoisie, and the proletariat or formal sector laborers. The former own the means of production while the latter are legally free individuals who provide the labor service necessary for production. This service is exchanged for a wage payment. The capitalist utilizes the profit to invest in equipment, land improvements and machinery to increase production capacity, to reduce the cost of production and thus ensure the viability of the firm. Two factors impose regular pressure on profits. Market forces determine output price while the wage cannot in the long-run fall below the level necessary for the subsistence of the worker and his or her family. For the competitive capitalist, conspicuous consumption is not a rational choice. The threat of bankruptcy for the one class is as real as the threat of unemployment for the other. Warfare is useless because it destroys capital and reduces the labor supply.

Economists have tended to describe rentiers and landlords as a sterile class because they do not have the incentive to save and invest their earnings in income generating activities. Their earnings tend to go into political activity which by itself does not generate sustained employment and increased production capacity. In contrast the capitalists are regarded as progressive because by the very nature of their activity, they have to save and invest their earnings in capital, land improvements and skills training because these guarantee their business survival. These also increase employment and production capacity in society (Blaug 1978). The increase in employment is what is necessary to absorb the informal sector labor and the excess labor in agriculture to regular employment and hasten the transition to capitalism.

In a dualistic economic system, the social classes of feudalism and capitalism are all present because the society is still in transition. Ele-

ments of either mode of production, specially the peculiar economic behavior of the social classes, persist. The country's prospects for development will therefore depend on which social class interest dominates, whether that of the feudal landed elite, or that of the capitalist. The role of international trade and economic relations is also crucial since historically capitalism was brought to the developing economies by colonialism. Thus the capitalist sectors worldwide are tightly interwoven. Whether an economy develops towards modernity will depend on the type of transactions it engages in the international market.

In addition to the landed elite as a major class component there are also the international capitalist class (the foreign multinational corporations) and the class of local people, the dependent bourgeoisie, who are employed as managers for multinational corporations. The importance of the latter two classes is due indeed to the strategic role that foreign interests play in the domestic economy. Their substantial profits can either be repatriated to the home countries of the multinational corporations or be reinvested in the host countries. As for the landed elite, their profits and rents are directed towards maintaining their position of power, through the establishment of private armies and/or the expenditure in elections to maintain some control over government decisionmaking.

Because some degree of industrialization has been attained in many developing countries, there is a national bourgeoisie, the equivalent of the capitalist bourgeoisie in the capitalist economies. But also important are the agrarian bourgeoisie, who are engaged in agriculture like the landed elite but are more profit-oriented or capitalistic in nature. A large number of the agrarian bourgeoisie may not even be large landowners and they generally do not engage in politics.

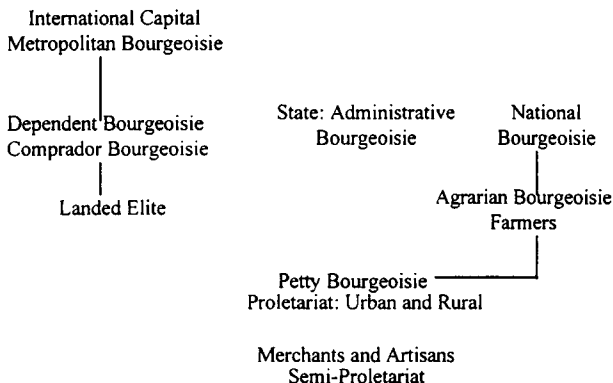
The proletariat are present but in addition, there would also be the informal sector labor, and the peasantry or the traditional sector farm households, and the class of merchants and artisans. Two other important classes are the professionals and students (or the petty bourgeoisie) and the government bureaucrats (or the administrative bourgeoisie).

Given this structure of social classes, the transition to a developed economy may be accelerated when and if dominant social interests happen to be those of the national and agrarian bourgeoisie in political alliance with the peasantry, proletariat, semiproletariat, merchants and artisans, petty and administrative bourgeoisie. Under this alliance, the taxes and savings of society will be invested in machinery, equip-

ment, infrastructure and education and skills training which can expand employment and production. The bourgeoisie will tend to engage in production for export and joint ventures with foreign capitalists because of the substantial profit opportunities in the international market. Even the international bourgeoisie can be enticed to reinvest their profits in the host country because of the expansion in economic activities and opportunities. However, if the landed elite together with the international and dependent bourgeoisie are the dominant class interest, taxes and savings will tend to be utilized in private armies, politics, and for the international bourgeoisie, repatriation of profits to the home country. The increase in production capacity and employment opportunities will be constrained so that the transition to a developed economy will be delayed (see figure 3).

In summary, development is a process of modernization in which a society evolves from a traditional or feudal economic system towards a modern or capitalist economic system. A modern economic system is one with a high degree of specialization of economic functions, monetization of transactions and homogenization of goods and services. Developing economies are in transition to this so that their economies are dualistic, with modern and informal sectors coexisting. The transition will be accelerated if the class interests of capitalists or bourgeoisie dominate over that of the landed elite because the former tends to direct its savings towards investment in infrastructure, plant, equipment, and skill improvements rather than the latter which tend to engage in politics.

Figure 3. Social Class Structure of a Dualistic Economy



Source: Alain deJanvry, *The Agrarian Question and Reformism in Latin America* (1981), p. 42.

## Trade and Development

How international trade contributes to the development is the starting point of understanding the theoretical underpinning of the GATT and globalization. The dualistic approach to the analysis of the development process is generally based on the historical experience of Western European countries. But the modern theories of trade and the process of development tend to be based on the recent history of the East Asian Newly Industrialized Countries (NICs) of Taiwan, South Korea, Hong Kong and Singapore (World Bank 1993).

"Vent-for-surplus" theory argues that the international market, being far bigger than the domestic market in the number of consumers and total purchasing power, provides an outlet for surplus resources and output of any trading country (Myint 1973). A developing economy can utilize its labor, capital and natural resources to increase the production of goods and services over and above what the domestic market can absorb. The surplus can be sustained and increased over time as these can be sold in the wider market abroad. The expanded production can then help increase domestic employment, income and savings.

As a complement, trade also increases and sharpens the productivity of an economy. Since the international market approximates a perfectly competitive market, production has to be efficient to be profitable and this means the improvement of labor skills and technical innovation to enhance productivity. This innovation and constant education and training mutually reinforce an atmosphere of economic dynamism that can generate further investment, innovation, efficiency and productivity. This could then redound to sustained increases in domestic production, employment, income and savings. The spur to all these are the competition and opportunity fostered by participation in international economic transactions and not any form of assistance from government.

Most industrialization programs among developing countries began with import substitution (Balassa 1980). "First stage" import substitution involves the replacement by domestic production of imports of nondurable consumer goods (such as clothing, footwear, processed food and household goods) and of their inputs (textile fabrics, leather, primary goods, among others). "Second stage" import substitution involves the replacement by domestic production of the imports of

intermediate goods, producer and consumer durables (such as machinery, equipment and household appliances).

The first stage generally involves production processes that are intensive in unskilled labor with the efficient scale of output at relatively low levels. Costs per unit of output are not substantially high at low output levels, neither is technology sophisticated. And efficient operations do not require a network of suppliers of parts, components and accessories. The second-stage is generally capital-intensive and subject to economies-of-scale. The efficient plant size could well be higher than the domestic requirements of a developing economy. Moreover, costs per unit of output rise rapidly at low levels of output and may increase further with organizational and technical inefficiencies. This may be the usual case given the lack of adequate infrastructure, the lack of sophisticated technology and the absence of a ready network of suppliers of parts, components and accessories. Thus the first stage is also called the "easy" stage, the second, the "difficult" stage. For the first stage, a measure of tariff and nontariff barriers on imported substitutes can be justified to protect domestic producers since the domestic production of nondurable consumer goods and inputs encourages the training of large pools of labor, and develops entrepreneurship and the spread of technology (Balassa 1980).

But in the second or the difficult stage, economies of scale is an important consideration. This refers not so much to increasing plant size per se but to increasing horizontal and vertical specialization. Horizontal specialization requires the reduction in product variety which would allow longer production runs and reduce production costs through efficiency, savings on expenses incurred by moving from one operation to another (which would be the case if product variety were high), and the use of special purpose machinery. Vertical specialization involves the manufacture of standardized parts, components and accessories and other vital intermediate inputs on an efficient scale in separate plants. Costs are largely reduced through the subdivision of the production process among plants of efficient size.

The limited size of the domestic market among developing countries constrains the possibilities of both horizontal and vertical specialization. Furthermore, skilled labor and sophisticated technology are not readily available but are necessary for precision required in the production of parts, components, and accessories. A measure of outward- rather inward-orientation would thus be necessary for efficient second stage industrialization program.

Outward-orientation strategy pertains to policies that provide similar incentives to production for domestic and for export markets. Inward-orientation strategy biased incentives in favor of production for the domestic market rather than for the export markets (Balassa 1980). Among the East Asian NICs—regarded as generally outward-oriented—exporting establishments could obtain their inputs from domestic or imported sources, avail of exemptions from indirect taxes on outputs and inputs and from duties on imported inputs, and generally enjoyed the same privileges as the domestic producers of inputs to export production. Furthermore, all exported goods were extended equal treatment: the same incentives were granted production for export as for import-substitution, agricultural and non-agricultural exports and activities. The incentive system was automatic (i.e., nondiscretionary) and stable over time. The East Asian NICs guaranteed positive real interest rates (which encouraged domestic savings mobilization), realistic pricing for public utilities (which encouraged investments in) and minimal differences in incentives across industries.

Countries that pursued outward-oriented industrial development strategies had higher sustained growth rates in export, employment and GNP than those that were inward-oriented. Moreover, countries that shifted to outward-orientation improved on their overall economic performance than those that maintained inward-orientation (Balassa 1980; World Bank 1993). The East Asian NICs began the exportation of nondurable goods soon after the first stage which did not last long among them. Besides not all exported nondurable consumer goods first passed through import substitution: South Korean synthetic textiles, Taiwanese plastic shoes and Singaporean fashion clothing were from the outset produced solely for export.

The private sector played a crucial role. This was specially underscored by the need for flexibility to changes and initiative to the possibilities in international market conditions. But with the incentive system not discriminating against exports, the production of exportable commodities largely corresponded to the countries' respective comparative advantage. Comparative advantage in this case also referred to dynamic changes in the countries' factor resources over time. Thus Japan started with commodities intensive in unskilled labor, then with those in skilled labor and capital, and is now in technology-intensive commodities. The East Asian NICs have captured Japan's former niche in products that are intensive in skilled labor and capital. Countries at a lower stage of industrial development (such as the majority of the

member countries of the Association of Southeast Asian Nations [ASEAN] and China) have taken over the production of goods intensive in unskilled labor.

For countries that maintained a largely inward-oriented strategy in second-stage import-substitution, their nondurable goods and inputs faced a price disadvantage in the international market because their inputs were largely sourced from the domestic market and were thus high-priced. Moreover the export of intermediate goods, consumer and producer durables were retarded because the smallness of the domestic markets precluded economies of scale. Small-scale production, inadequate specialization and obsolete machinery and equipment resulted in an internationally obsolete and inert industrial structure as is apparent among the heavy industries of the former Socialist bloc economies.

Thus for an efficient second-stage import-substitution, special attention has to be focused on the need for economies of scale on the plant level for the production of intermediate goods, horizontal specialization for machinery, and vertical specialization in the production of parts, components and accessories. Furthermore, it would be more efficient to simultaneously undertake the manufacture of intermediate goods, producer and consumer durables for both the domestic and export markets, rather than preceding exportation with an import substitution phase. No import substitution preceded the export of South Korean ships, Singaporean photographic equipment, or Taiwanese electronic products.

To summarize the case for free trade and development, a moderate scale of preferential treatment would be needed at the start for manufacturing activities to maintain industrial efficiency and ensure the expansion of agricultural production for both domestic and export markets. Equal treatment in incentives need to be extended to exports and import substitution in manufacturing to ensure resource allocation by comparative advantage and the exploitation of economies of scale. This can also engender efficient production for export and import substitution through vertical and horizontal specialization. Variation in incentives across sectors need to be minimized so that the private sector can best choose the composition of export goods to respond to international market conditions. The stability and automaticity of the incentive system would minimize uncertainties among manufacturers and allow then flexibility in long-term operations. Finally, export promotion needs to consider dynamic comparative advantage over time.

But even in the last century, a number of political thinkers have expressed reservations regarding the supposed benefits of trade and these were echoed this century by many others (Todaro 1985). In brief, the argument is that trade exposes a country to the inevitable fluctuations of international commodity prices and exchange rates. Thus the economy is subjected to instability over which it may have little control and is thus diminished in its ability to shape its own destiny. Moreover a young developing economy is at a disadvantage because its newly emerging industries would be subject to unfair and even ruinous competition from the established, more experienced and consequently more economically powerful industries of the wealthier countries. Several studies have already documented the differential and unsustained impact of international trade on various localities. The thriving textile weaving industry of Iloilo was destroyed by the entry of British cottons in mid-nineteenth century and was replaced by the sugar industry (McCoy 1982). Or hemp exports from Bicol caused income and employment to grow over the nineteenth century but did not encourage industrial development so that when international demand for natural hemp collapsed after the 1920s, Bicol remained to this day the region with the highest poverty incidence (Owen 1982).

For this reason, many developing countries did embark on an import-substitution industrialization program not long after independence and in many instances resolutely persisted in it (Myint 1973). The entire panoply of controls—tariff and nontariff barriers and other disguised restraints—were righteously deployed to protect domestic industries with the valid justification of maintaining national sovereignty and control over their national destiny. But as noted above, a generally inward-oriented industrialization policy has lost much of its attractiveness given that countries that have pursued this policy have lagged behind the outward-oriented ones in terms of GNP per capita growth, employment and foreign exchange earnings. The pressure to open their economies has been great yet so has the pressure to maintain national sovereignty and specially to protect social programs and other sectors that may be adversely affected—whether in the long-run or the short-run—by trade liberalization and globalization.

The GATT has been an attempt to minimize the disadvantages of free trade by setting standards for fair trading among member-countries and developing a mechanism for adjudicating trade disputes among them. The hope is that these facilities will encourage countries to continue to embark on a generally outward-oriented development



program since the GATT mechanisms are available to deal with any form of unfair trading practices or activities that hamper the growth of commerce and industry. Nonetheless, GATT is rather new and its effectiveness still needs to be proved.

Thus regional economic integration—such as ASEAN and the Asia-Pacific Economic Cooperation (APEC)—remains as an attractive option. Historically, the first successful modern experience is the United States of America and this was a subtle point underlying the US Constitution: the destruction of interstate customs barriers and tariffs eventually paved the way for the emergence of the most powerful economy in the twentieth century (Reich 1987). This experience strongly influenced the formation and integration of Western European economies which culminated in the adoption of the Maastricht Treaty that established the European Union or EU (Coppé 1994). Regional integration allows a country a wider market for its goods and services yet reserves a measure of control over elements in the regional market so that a member-country could also manage its own domestic and economic priorities. The costs of industrialization can be reduced by realizing economies of scale within a larger yet still manageable regional market. As explained by Todaro:

Third World countries, at relatively equal stages of industrial development, with similar market sizes, and with a strong interest in coordinating and rationalizing their joint industrial growth patterns stand to benefit most from the combined inward/outward trade policies represented by economic integration. . . . [R]egional groupings of small nations . . . can create the economic conditions (mainly in the form of larger internal markets) for accelerating their joint development efforts. Such groupings can also promote long-run development by enabling nations to block certain forms of trade with the more powerful developed nations and perhaps also to restrict or prohibit the deep penetration of multinational corporations into their industrial sectors. (1985, 426)

Thus regionalism to be successful requires a degree of outward orientation among the member countries. The microeconomic effects can be classified into static and dynamic (Cuyvers et al. 1994). The static effects include the general reduction in average production costs due to the abolition of trade barriers, to economies of scale resulting from the enlargement of the market, and to the increase in competition in the domestic markets of member-countries. Dynamic effects include the further economies of scale and innovation because of the long-term

competition effect resulting from the enlargement of the market. Investment effects, though ambiguous in theory, are also quite attractive. Investment—from within and outside the regional bloc—in import-substituting industries in the second-stage could be spurred by locational advantages, uncertainty in trade and investment policies outside the regional bloc, and by efficiency gains and increased demand within the region as a result of dynamic microeconomic effects of regionalization. Investment to the outside world could also be spurred by increased competitiveness of firms from within the region. The macroeconomic effects cover the general weakening in cost-push factors in inflation—mainly the improvement in infrastructure linkages across the region. This will result in decreases in production cost across the economies, and increases in aggregate demand, capacity utilization and overall and individual GDP. The reduction in cost-push factors will also result in greater competitiveness and improved regional trade balance and reserve position with respect to the rest of the world. These have been experienced by the EU and other regional blocs want to emulate this, like the ASEAN and the APEC.

These are the theoretical benefits that can be derived from outward-oriented industrialization policy. It should also be pointed out though that more than just trade policy, crucial to the success of this trade and industrialization strategy is the stability of macroeconomic policy, mainly the maintenance of low rates of inflation and interest and stable exchange rates (Balassa 1980; Bhattacharya and Linn 1987). It was precisely this macroeconomic stability that allowed the private sector to effectively engage in trade and industrial investment because the stability of these rates reduced the uncertainty in the economic environment and encouraged long-term investment in capital, innovation, training and market development. Governments will thus need to maintain control over the budget deficit by ensuring increasing tax revenue and controlling expenditure. This suggests priority in expenditure towards infrastructure and social services which reduce cost-push factors and therefore enhance a country's competitiveness. Also government will need to control the money supply to control inflation, and liberalize the foreign exchange markets to attract greater foreign exchange deposits to stabilize the supply of foreign exchange.

At this point, it will be worthwhile to consider the implications of outward orientation on a country's social class interaction. It has already been pointed out that historically economic development was spurred by the activities of the capitalist class. For developing econo-

mies with a dual economic structure, the transition to modernization will be accelerated if the dominant social class will be that of the capitalist class in alliance with organized labor, the informal labor sector, the professionals and the bureaucrats. The discussion on outward-oriented industrialization and regional economic integration suggests that these directions in policy favor the economic interest of the capitalist class and undermines that of the landed elite. The next section will sketch the current socio-economic structure of the Philippines and attempts to point out possible directions of interaction among the social classes as far as globalization is concerned.

### **The Philippine Setting**

At independence, sugar, coconut oil, lumber, copper and gold were already the major export commodities. The export of agricultural commodities began as early as the eighteenth century. The export of agricultural commodities created a powerful national elite that would dominate the country's political and economic system. This elite comprised not just the feudal landed elite but the agrarian capitalists, foreign multinational corporation executives (mainly in mining, lumber, banking, and processing of agricultural products) and their local managers, and a capitalist class that initially sourced its wealth from trading before diversifying into landownership (Cullinane 1982; McCoy 1982a, b; Owen 1982).

A certain degree of industrialization was begun on an extensive scale not long afterwards. The underlying philosophy of postwar Philippine industrialization was largely along import substitution (Baldwin 1975; Bautista and Power 1982; Valdepeñas 1970). Industries established during the early 1950s were thus designed to capture the domestic market for manufactured goods away from foreign competitors. Such a program necessarily required a system to protect domestic manufacturers from competition with imports.

The complex foreign exchange control system initiated in 1949 and completely dismantled by 1962 served this purpose effectively at first. The foreign exchange control system was originally intended to ration foreign exchange and stem the outflow of foreign exchange during the first postwar balance of payments crisis in 1949. It was soon found out to be an effective means of controlling importations thus of promoting import-substituting industries as well. With the decontrol of the foreign

exchange market beginning in 1960, the task of protection then fell on the tariff and nontariff barriers which were first implemented in 1957. The transition was relatively smooth so that the domestic economy has been effectively officially protected without interruption from the 1950s until the early 1990s (Alburo et al. 1989; Baldwin 1975; Medalla 1990; Power and Sicat 1971).

The tariff system largely favored the import-substituting manufacturing industries which were generally inward-oriented (Valdepeñas 1970; Power and Sicat 1971; Baldwin 1975; Power and Bautista 1982). This could be readily noted in the steady expansion of the share of manufacturing in Gross Value Added from thirteen percent in 1902 to 28 percent in 1961, and the decline of that of agriculture from 55 percent to 34 percent. Services maintained a relatively steady share. The manufacturing sector also experienced the fastest growth rate during the 1950s to early 1960s, the heyday of import substitution. The agricultural sector (which contributed the bulk of export earnings then) continued to survive due to its inherent efficiency and comparative advantage (Bautista and Power 1982).

This pattern of industrialization moreover was largely capital-intensive and increasingly import-dependent specially for intermediate inputs and capital goods. Thus these industries were largely assembly and packaging operations that relied on imported raw materials and capital equipment which were not imposed any tariff nor nontariff barrier. And they were largely oriented to the domestic market rather than to exports. Their expansion was already retarded by the 1960s because of the slow growth in the domestic market (Bautista and Power 1982; Valdepeñas 1970).

The domestic market could not be expected to grow then as now because of the inequitable distribution of income and the high degree of poverty incidence (see table 1). The income distribution profile does not show any significant change from 1961 to 1997. It is interesting to point out, though, that there was a degree of improvement until 1988. The Gini ratio is the standard measure of equity in the distribution of income; a ratio approaching 0 indicates equitable distribution while a ratio approaching 1 indicates inequitable distribution. From 1961 until 1985, the last year of the Marcos administration and a recession year, the distribution was improving and continued in 1988, when the highest growth rate was attained and the Gini ratio was at its lowest in 1988 at 0.445. But the ratio worsened to 0.468 in 1991, when the Aquino administration was at its last year. It worsened further to 0.496

in 1997, the last year of the Ramos administration. Inequitable distribution of income is indeed a rather persistent problem.

This confirms certain arguments that a number of policies were pursued at the expense of equity, principally the decision to continue the servicing of the national debt owed to foreign and domestic banks (Intal and Bantilan 1994). Debt servicing accounted for 35–40 percent of the national budget during the entire term of President Aquino. The purpose of this policy was to maintain the country's creditworthiness in the international and domestic capital markets and the Philippines also happened to be under IMF monitoring since 1983 when the international debt crisis severely affected the Philippines along with many Latin American countries. And because the tax effort did not increase significantly during the 1980s, this debt policy meant reduction in government expenditures on social services. Also the administration did not pursue any policy at promoting employment by encouraging labor-intensive production processes. Thus when the economy entered into a recession in 1990, unemployment increased substantially from 8.4 percent that year to 10.5 percent in 1991 (Intal and Bantilan 1994).

The import-substitution industrialization process was characterized by a high degree of dependence on imported capital which therefore

Table 1. Income Distribution of Families in the Philippines (%)

| Decile Grp              | 1961 | 1965 | 1971 | 1985  | 1988  | 1991  | 1994  | 1997  |
|-------------------------|------|------|------|-------|-------|-------|-------|-------|
| First                   | 1.5  | 1.1  | 1.2  | 2.0   | 2.0   | 1.8   | 1.9   | 1.7   |
| Second                  | 2.7  | 2.4  | 2.4  | 3.2   | 3.2   | 2.9   | 3.0   | 2.7   |
| Third                   | 3.4  | 3.5  | 3.5  | 4.1   | 4.1   | 3.7   | 3.9   | 3.4   |
| Fourth                  | 4.5  | 4.6  | 4.6  | 5.0   | 5.0   | 4.6   | 4.9   | 4.3   |
| Fifth                   | 5.5  | 5.7  | 5.9  | 6.0   | 6.0   | 5.6   | 6.0   | 5.3   |
| Sixth                   | 6.6  | 7.1  | 7.4  | 7.3   | 7.3   | 6.9   | 7.4   | 6.7   |
| Seventh                 | 8.3  | 8.9  | 9.9  | 8.9   | 9.1   | 8.7   | 9.1   | 8.6   |
| Eighth                  | 11.0 | 11.2 | 11.1 | 11.4  | 11.6  | 11.3  | 11.8  | 11.4  |
| Ninth                   | 15.5 | 15.4 | 16.9 | 15.7  | 16.0  | 16.0  | 16.4  | 16.1  |
| Tenth                   | 41.0 | 40.1 | 37.1 | 36.4  | 35.8  | 38.6  | 35.5  | 39.7  |
| <u>Gini coefficient</u> |      |      |      | 0.447 | 0.445 | 0.468 | 0.451 | 0.496 |

Source: National Statistics Office for the income distribution data. For the Gini coefficients of 1985–91, *Understanding Poverty and Inequality in the Philippines: A Compendium of Policy and Methodological Researches*, by Ponciano Intal and Ma. Cynthia Bantilan (Manila: NEDA, 1994).

did not significantly contribute to the generation of employment opportunities. This would truly be problematic specially in a labor-surplus economy. The unemployment rate has remained quite high hovering around ten percent in the 1982-91 period. A significant measure of

Table 2. Growth Rates of GNP, Rates of Unemployment and Underemployment (%)

| <u>Year</u> | <u>GNP</u> | <u>GNP</u> | <u>Unemployment</u> | <u>Under-<br/>employment</u> |
|-------------|------------|------------|---------------------|------------------------------|
| 1973        | 9.76       | 6.77       | 4.9                 | 11.8                         |
| 1974        | 4.20       | 1.39       | 4.0                 | 9.8                          |
| 1975        | 4.88       | 2.51       | 3.9                 | 11.2                         |
| 1976        | 8.17       | 4.83       | 5.2                 | 10.1                         |
| 1977        | 5.79       | 3.01       | 5.1                 | 18.9                         |
| 1978        | 5.46       | 2.67       | 4.9                 | 15.2                         |
| 1979        | 6.38       | 3.55       | a                   | a                            |
| 1980        | 4.63       | 1.86       | 7.9                 | 20.7                         |
| 1981        | 3.24       | 0.70       | 8.8                 | 22.8                         |
| 1982        | 2.84       | 0.33       | 9.6                 | 25.8                         |
| 1983        | 1.44       | -1.06      | 10.4                | 29.1                         |
| 1984        | -8.72      | -10.92     | 10.4                | 30.5                         |
| 1985        | -7.06      | -9.31      | 12.5                | 20.4                         |
| 1986        | 4.15       | 1.68       | 11.8                | 23.0                         |
| 1987        | 5.10       | 2.61       | 11.2                | 23.1                         |
| 1988        | 7.16       | 4.67       | 8.3                 | 23.3                         |
| 1989        | 5.73       | 3.31       | 8.4                 | 23.3                         |
| 1990        | 4.53       | 2.19       | 8.1                 | 22.1                         |
| 1991        | 0.23       | -1.99      | 9.0                 | 22.1                         |
| 1992        | 0.62       | -1.54      | 8.6                 | 19.9                         |
| 1993        | 2.12       | -0.38      | 8.9                 | 21.4                         |
| 1994        | 5.25       | 2.74       | 8.4                 | 20.9                         |
| 1995        | 4.88       | 2.43       | 8.4                 | 19.8                         |
| 1996        | 7.24       | 4.81       | 7.4                 | 19.4                         |
| 1997        | 5.3        | 2.97       | 7.9                 | 20.8                         |

Unemployment data for 1956-75 and 1980 onward use "past week" reference period while for 1976-78 use "past quarter" reference period. Prior to 1987, underemployed was defined as the number of employed persons wanting additional work. From 1987 onwards, the concept was redefined to number of employed persons wanting more hours of work. No labor force survey was conducted in 1979.

Source: National Statistics Office.

the degree of informal sector or semiproletarian activity is the equally high rates of underemployment during the same time period (see table 2). This averaged about 25 percent, an indicator of the size of the precapitalist sector.

The pattern of import substitution industrialization in a small domestic market has resulted in a high degree of concentration of capital or of monopolistic control over markets (Lindsey 1977). Although Lindsey's results apply to 1970 data, there is no reason to believe that there has been a significant change in this pattern of concentration. Moves to liberalize major sectors of manufacturing and services date only to 1992 with the present administration. Moreover large-scale industrial concentration and centralization of capital occurred during the subsequent martial law regime of Marcos that began in 1972. This era has not yet been systematically studied but available information (Manapat 1992) suggests a continuation and in some sectors, an intensification of concentration or monopoly power.

There has yet to be a rather systematic study of class relationships and structure following the class structure of a socially disarticulated economy along the lines of deJanvry (1981). It would be fascinating to identify members of the landed elite who may well be related to the capitalist class either on a familial or business level. It would be interesting to explore this specially since Lindsey's findings showed a high degree of concentration in the manufacturing sector. Also, it would be instructive to identify members of, say, the bureaucrats who happen to have familial or business roots in some other social class, such as the capitalist class or the landed elite.

The informal sector meantime has been thriving. It is formally defined as comprising income, employment and production generated by activities which are officially unrecorded, unregistered and unregulated (Templo and de Leon 1992). Criminal activities are generally part of this sector in any economy (Quesada 1988) but for developing economies, this sector covers activities which are far from being criminal but cannot simply be registered nor recorded with the government because of the economic structure. Among the activities covered are: small business people engaged in trading and service activities, cottage industry (i.e., production within residential premises) and street and flea market vending and hawking; credit and finance; transportation; household help and domestic service; small-scale utilization of fisheries, mining and logging; and foreign exchange trading. The International Labor Organization defines the informal sector as activities

where "free entry exists, enterprises are small, often family-owned and rely on indigenous resources, workers have limited formal training and markets are highly competitive and unregulated" (Templo and de Leon 1992). From a dualistic perspective, this sector is unregistered, unrecorded and/or unregulated because the lack of infrastructure increases the transactions cost of government.

In general firms in this sector can be described as having low levels of productivity, employment and fixed assets. Hours of work can be longer than those in the formal or modern sector but most workers in the informal sector perceive their occupation as temporary till a more preferred job is available. Because the sector is precisely unregulated, unregistered and unrecorded, conditions of work and terms of employment can often be more severe than in the formal sector (Templo and de Leon 1992).

Based on a special Labor Force Survey that is still not officially published (Templo and de Leon 1992), the informal sector has comprised a substantial majority of the labor force since 1986 (the earliest for which data are available) as shown in table 3. The majority of the informal sector labor—consistently above 65 percent—are concentrated in the agricultural sector. This clearly suggests the degree of transition of the economy from the feudal to the fully capitalistic mode of production. From the available data, the actual level of informal sector employment in agriculture has declined from 1986 to 1991 but that in the services sector has increased. This again seems to suggest that given the low level of skills required in either the services sector or the traditional agricultural sector, the informal labor can only be absorbed in either of these.

Moreover a cursory inspection of the data suggests that the level of employment in the informal sector may be related to the level of overall economic activity as measured by standard measures of national income and output. It must be remembered that in 1986, the Philippines was just recovering from the most severe post-World-War-II recession: real GDP declined by about seven percent in 1984 and in 1985. Unemployment levels went up severely and investment levels declined. The level of informal sector employment declined after 1986 as the economy initially expanded. But it went up even higher than the 1986 level by 1990 on to 1991 when again real GDP declined by 1.5 percent and unemployment surged again due to uncertainties brought about by the Persian Gulf War and the calamities wrought by the eruption of Mount Pinatubo (Templo and de Leon 1992).



The informal sector accounted for about 40 percent of total GDP during the period 1980–90 (see table 4). In general, the formal sector economic growth is inversely related to that of the informal sector with the share of the latter increasing during the negative GDP growth years of 1983–85 and 1990. This suggests that indeed the informal sector absorbs the unemployment and underemployment of the formal sector.

Table 3. Employment in the Informal Sector, 1986–1991(in thousands)

| <u>Sector</u>                     | <u>1986</u> | <u>1987</u> | <u>1988</u> | <u>1989</u> | <u>1990</u> | <u>1991</u> |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total                             |             |             |             |             |             |             |
| Employment                        | 18,855      | 20,050      | 20,205      | 21,908      | 22,211      | 22,915      |
| Total Informal                    |             |             |             |             |             |             |
| Employment                        | 11,320      | 11,001      | 11,075      | 11,149      | 11,387      | 11,708      |
| Share of Informal<br>in Total (%) | 60.00       | 54.87       | 54.81       | 50.89       | 51.27       | 51.09       |
| Agriculture                       | 7,837       | 7,494       | 7,457       | 7,275       | 7,499       | 7,667       |
| Mining &<br>quarrying             | 53          | 30          | 52          | 56          | 49          | 52          |
| Manufacturing                     | 626         | 459         | 625         | 657         | 589         | 617         |
| Construction                      | 49          | 68          | 79          | 97          | 106         | 113         |
| Utilities                         | 3           | 8           | 0           | 8           | 0           | 8           |
| Services                          | 2,752       | 2,386       | 2,862       | 3,056       | 3,144       | 3,251       |

Source: Templo, Ofelia and de Leon, Teresita, 1992, "The Urban Informal Sector in the Philippines: Recent Developments and Future Policy Directions." Paper presented at the Seminar on Employment Policies for the Urban Sector in East and Southeast Asia, Bangkok, 12–16 October.

Table 4. Contribution of the Informal Sector (%)

|                     | <u>Average 1980–85</u> | <u>Average 1986–90</u> | <u>Average 1980–90</u> |
|---------------------|------------------------|------------------------|------------------------|
| <u>Growth Rates</u> |                        |                        |                        |
| GDP                 | 19.38                  | 12.79                  | 16.45                  |
| Formal              | 14.44                  | 13.26                  | 13.91                  |
| Informal            | 27.47                  | 12.30                  | 20.73                  |
| <u>Shares</u>       |                        |                        |                        |
| GDP                 | 100                    | 100                    | 100                    |
| Formal              | 63                     | 57                     | 60                     |
| Informal            | 37                     | 43                     | 40                     |

Source: Templo and de Leon, *op. cit.*, following p. 7.

By industrial origin, agriculture, fishery and forestry contributed the biggest share (about 41 percent) of total informal sector output in 1980 but this has declined to 30 percent by 1990. The services sector increased its share from 31 percent in 1980 to 47 percent in 1990. The share of manufacturing even declined from 27 percent in 1980 to 23 percent (see table 5). Again these suggest that some form of transition may be at work with more and more of the peasantry shifting to semiproletariat status given the low level of skills that they possess. Also the declining share of manufacturing may to some extent be explained by the steady expansion of the formal sector manufacturing which requires level of skills higher than what the semiproletariat may possess and levels of technology and efficiency that can successfully compete with those of the informal sector.

In the trade sector, as table 6 shows, the Philippines has had a chronic balance of trade (BOT) deficit since its independence in 1946. A positive trade balance was attained for 1959 and 1973 only. In 1959 the devaluation then caused a severe contraction of imports. In 1973, the value of Philippine exports (then largely raw materials as will be noted below) surged because of a worldwide increase in the prices of raw materials, specially sugar, coconut oil, lumber and copper concentrates—all major Philippine exports. This worldwide price increase has not been repeated since.

Table 5. Share of the Informal Sector in GDP by Industrial Origin, 1980–90 (%)

| <u>Sector/Industry</u>               | <u>1980</u>  | <u>1985</u>  | <u>1990</u>  |
|--------------------------------------|--------------|--------------|--------------|
| Agriculture, Fishery and Forestry    | <u>40.68</u> | <u>31.78</u> | <u>30.27</u> |
| Industry                             | <u>27.95</u> | <u>23.01</u> | <u>22.68</u> |
| Construction                         | 3.35         | 1.29         | 1.65         |
| Manufacturing                        | 24.60        | 20.61        | 20.54        |
| Mining and Quarrying                 | 0.00         | 1.11         | 0.49         |
| Services                             | <u>31.37</u> | <u>45.21</u> | <u>47.06</u> |
| Transport, Communication & Storage   | 5.22         | 6.57         | 4.77         |
| Trade                                | 7.21         | 18.16        | 21.47        |
| Ownership of Dwellings & Real Estate | 12.76        | 11.37        | 11.08        |
| Finance                              | 0.26         | 0.29         | 0.13         |
| Private Services                     | 5.92         | 8.82         | 9.60         |

Source: Templo and de Leon, *op. cit.*, following p. 8.

Table 6. Historical Trade Statistics Statistics (fob value in USD million)

| <u>Year</u> | <u>Exports</u> | <u>% change</u> | <u>Imports</u> | <u>%change</u> | <u>Balance of Trade</u> |
|-------------|----------------|-----------------|----------------|----------------|-------------------------|
| 1946        | 64.2           | -               | 295.9          | -              | -231.7                  |
| 1947        | 263.4          | 310.28          | 511.1          | 72.73          | -247.7                  |
| 1948        | 309.6          | 17.54           | 584.9          | 14.44          | -275.3                  |
| 1949        | 247.9          | -19.93          | 585.9          | 0.17           | -338.0                  |
| 1950        | 331.0          | 33.52           | 341.9          | -41.65         | -10.9                   |
| 1951        | 422.4          | 27.61           | 489.0          | 43.02          | -66.6                   |
| 1952        | 345.7          | -18.16          | 421.4          | -13.82         | -75.7                   |
| 1953        | 398.3          | 15.22           | 452.4          | 7.36           | -54.1                   |
| 1954        | 400.5          | 0.55            | 478.7          | 5.81           | -78.2                   |
| 1955        | 400.6          | 0.02            | 547.7          | 14.41          | -147.1                  |
| 1956        | 453.2          | 13.13           | 506.2          | -7.58          | -53.0                   |
| 1957        | 431.0          | -4.90           | 613.2          | 21.14          | -182.2                  |
| 1958        | 492.8          | 14.34           | 555.7          | -9.38          | -62.9                   |
| 1959        | 529.5          | 7.45            | 523.6          | -5.78          | 5.9                     |
| 1960        | 560.4          | 5.84            | 603.9          | 15.34          | -43.5                   |
| 1961        | 499.5          | -10.87          | 611.3          | 1.23           | -111.8                  |
| 1962        | 556.0          | 11.31           | 586.7          | -4.02          | -30.7                   |
| 1963        | 727.1          | 30.77           | 618.2          | 5.37           | 108.9                   |
| 1964        | 742.0          | 2.05            | 780.3          | 26.22          | -38.3                   |
| 1965        | 768.5          | 3.57            | 807.6          | 3.50           | -39.1                   |
| 1966        | 828.2          | 7.77            | 852.8          | 5.60           | -24.6                   |
| 1967        | 821.4          | -0.82           | 1062.2         | 24.55          | -240.8                  |
| 1968        | 857.7          | 4.42            | 1150.1         | 8.28           | -292.4                  |
| 1969        | 854.3          | -0.40           | 1131.5         | -1.62          | -277.2                  |
| 1970        | 1061.7         | 24.28           | 1090.1         | -3.66          | -28.4                   |
| 1971        | 1136.3         | 7.03            | 1186.0         | 8.80           | -49.7                   |
| 1972        | 1105.5         | -2.71           | 1229.5         | 3.67           | -124.0                  |
| 1973        | 1885.5         | 70.56           | 1596.6         | 29.86          | 288.9                   |
| 1974        | 2725.0         | 44.52           | 3143.0         | 96.86          | -418.0                  |
| 1975        | 2294.0         | -15.82          | 3459.0         | 10.05          | -1165.0                 |
| 1976        | 2574.0         | 12.21           | 3634.0         | 5.06           | -1060.0                 |
| 1977        | 3151.0         | 22.42           | 3915.0         | 7.73           | -764.0                  |
| 1978        | 3425.0         | 8.70            | 4732.0         | 20.87          | -1307.0                 |
| 1979        | 4601.0         | 34.34           | 6142.0         | 29.80          | -1541.0                 |
| 1980        | 5788.0         | 25.80           | 7727.0         | 25.81          | -1939.0                 |
| 1981        | 5722.0         | -1.14           | 7946.0         | 2.83           | -2224.0                 |
| 1982        | 5021.0         | -12.25          | 7667.0         | -3.51          | -2646.0                 |
| 1983        | 5005.0         | -0.32           | 7487.0         | -2.35          | -2482.0                 |
| 1984        | 5391.0         | 7.71            | 6070.0         | -18.93         | -679.0                  |

*Table 6 continued*

| <u>Year</u> | <u>Exports</u> | <u>% change</u> | <u>Imports</u> | <u>%change</u> | <u>Balance of Trade</u> |
|-------------|----------------|-----------------|----------------|----------------|-------------------------|
| 1985        | 4629.0         | -14.13          | 5111.0         | -15.80         | -482.0                  |
| 1986        | 4824.0         | 4.21            | 5044.0         | -1.31          | -220.0                  |
| 1987        | 5720.0         | 18.57           | 6737.0         | 33.56          | -1017.0                 |
| 1988        | 7074.0         | 23.67           | 8159.0         | 21.11          | -1085.0                 |
| 1989        | 7821.0         | 10.56           | 10419.0        | 27.70          | -2598.0                 |
| 1990        | 8186.0         | 4.67            | 12206.2        | 17.15          | -4020.2                 |
| 1991        | 8839.5         | 7.98            | 12051.4        | -1.27          | -3211.9                 |
| 1992        | 9824.3         | 11.14           | 14519.8        | 20.48          | -4695.5                 |
| 1993        | 11374.8        | 15.78           | 17597.4        | 21.20          | -6222.6                 |
| 1994        | 13482.9        | 18.53           | 21332.6        | 21.26          | -7849.7                 |
| 1995        | 17447.2        | 29.40           | 26537.6        | 24.40          | -9090.4                 |
| 1996        | 20542.6        | 17.74           | 32426.9        | 22.19          | -11884.38               |
| 1997        | 25227.7        | 22.81           | 35933.8        | 10.81          | -10706.12               |
| 1998        | 26976.0        | 6.93            | 27461.0        | -24.46         | -485.0                  |

Source: 1946–1973, Central Bank; 1974–1998, National Statistics Office

Expansion of exports tend to be determined by international market conditions while the movements of imports tend to be determined by domestic market conditions. Imports increase quite fast during periods of sustained increase in GNP and GNP per capita. Imports increased at a high rate from 1973 to 1980 and from 1987 to 1990, both of which were periods of sustained increase in economic activity. Imports declined severely from 1982 to 1986, when the Philippines underwent the most severe recession since 1945.

Eighteen products are regarded as the principal merchandise exports of the Philippines as of 1992. These are classified into traditional and nontraditional:

Traditional

Crude coconut oil  
Copper concentrates  
Centrifugal sugar  
Lumber  
Gold from copper ores  
Dessicated coconut  
Copra oil, cake and meal  
Plywood, ordinary  
Logs

Non-Traditional

Semiconductors, electronic microcircuits  
Garments  
Iron agglomerates  
Banana and plantains  
Canned pineapple  
Prepared tuna  
Coffee, not roasted  
Bars, rods of copper  
Shrimps and prawns

The share of nontraditional products has declined steadily since 1970, as table 7 would show. By 1984, two-thirds of the country's exports were largely nontraditional export commodities, the bulk of which were manufactured goods. And this share has increased even more rapidly since.

Table 7. Export Statistics (fob value in US million)

| <u>Year</u> | <u>Traditional share</u> |       | <u>Nontraditional share</u> |       |
|-------------|--------------------------|-------|-----------------------------|-------|
| 1970        | 972                      | 91.96 | 85                          | 8.04  |
| 1971        | 1027                     | 91.13 | 100                         | 8.87  |
| 1972        | 982                      | 89.19 | 119                         | 10.81 |
| 1973        | 1606                     | 85.65 | 269                         | 14.35 |
| 1974        | 2306                     | 85.00 | 407                         | 15.00 |
| 1975        | 1767                     | 77.81 | 504                         | 22.19 |
| 1976        | 1773                     | 70.30 | 749                         | 29.70 |
| 1977        | 2097                     | 67.19 | 1024                        | 32.81 |
| 1978        | 1985                     | 58.26 | 1422                        | 41.74 |
| 1979        | 2561                     | 56.15 | 2000                        | 43.85 |
| 1980        | 3068                     | 53.66 | 2650                        | 46.34 |
| 1981        | 2742                     | 48.43 | 2920                        | 51.57 |
| 1982        | 2116                     | 42.60 | 2851                        | 57.40 |
| 1983        | 2068                     | 42.08 | 2846                        | 57.92 |
| 1984        | 1828                     | 34.77 | 3430                        | 65.23 |
| 1985        | 1302                     | 28.45 | 3275                        | 71.55 |
| 1986        | 1275                     | 27.00 | 3447                        | 73.00 |
| 1987        | 1367                     | 24.57 | 4197                        | 75.43 |
| 1988        | 1382                     | 17.66 | 6442                        | 82.34 |
| 1989        | 1316                     | 16.96 | 6442                        | 83.04 |
| 1990        | 1157                     | 14.27 | 6949                        | 85.73 |
| 1991        | 1129                     | 12.77 | 7711                        | 87.23 |
| 1992        | 1542                     | 15.91 | 8152                        | 84.09 |
| 1993        | 1395                     | 12.49 | 9777                        | 87.51 |
| 1994        | 1505                     | 11.38 | 11723                       | 88.62 |
| 1995        | 1970                     | 11.54 | 15096                       | 88.46 |
| 1996        | 1831                     | 9.13  | 18213                       | 90.87 |
| 1997        | 1913                     | 7.83  | 22514                       | 92.17 |

Source: For 1970–91, Department of Trade and Industry; for 1992–97, National Statistics Office

This suggests that the Philippines is no longer a predominantly agricultural country but is already in a transition stage towards industrialization. But of these manufactured goods exports, 35 percent of total export earnings are largely accounted for by garments and semi-conductors and electronic microcircuits, products which import the bulk of their intermediate inputs. In fact, their main domestic value-added is largely labor since these products utilize largely labor-intensive and low-skill-level technology.

As table 8 shows, the top ten export markets of the Philippines as of 1996 are the USA, Japan, Singapore, Germany, Hong Kong, the United Kingdom, the Netherlands, Taiwan, Thailand and Korea (South). The USA accounts for about 45 percent of the total value of export earnings with Japan, a distant second at about 18 percent of the total. The others account for less than ten percent each so that export market is not widely diversified.

Table 8. Top Ten Export Markets (Value in US million)

| <u>Country</u>  | <u>1994</u>  |                  | <u>1996</u>  |                  |
|-----------------|--------------|------------------|--------------|------------------|
|                 | <u>Value</u> | <u>Share (%)</u> | <u>Value</u> | <u>Share (%)</u> |
| USA             | 5128         | 44.9             | 6655         | 32.4             |
| Japan           | 2020         | 17.7             | 3671         | 17.9             |
| Singapore       | 707          | 6.2              | 1224         | 6.0              |
| The Netherlands | 515          | 4.5              | 1115         | 5.4              |
| United Kingdom  | 637          | 5.6              | 936          | 4.6              |
| Hong Kong       | 651          | 5.7              | 868          | 4.2              |
| Germany         | 664          | 5.8              | 847          | 4.1              |
| Thailand        | 364          | 3.2              | 780          | 3.8              |
| Taiwan          | 452          | 4.0              | 661          | 3.2              |
| Korea (South)   | 291          | 2.5              | 371          | 1.8              |
| Total Exports   | 11429        |                  | 20,543       |                  |

Source: Board of Investments

Of the country's imports, consumer goods comprise a minimal share, never more than nine percent since 1974. As table 9 shows, the bulk of these consumer goods imports are largely dairy products and cereal and cereal products (mainly wheat-based)—products which the Philippines cannot produce given the country's climate and soil conditions. The rest of the country's imports are largely capital goods, raw materials and intermediate goods, manufactured and semifinished items. The main such imported items are:

|  |                                       |
|--|---------------------------------------|
| Mineral fuels, lubricants, related materials | Textile yarns                         |
| Machinery, except electrical                 | Artificial resins & plastic materials |
| Base metals                                  | Textile fibers                        |
| Electrical machinery, apparatus, appliances  | Fertilizers manufacture               |
| Transport equipment                          | Feeding stuff                         |
| Chemical elements and compounds              | Paper products                        |
| Manufactured items of metals                 |                                       |

Table 9. Import Shares (in percent)

| <u>Year</u> | <u>Capital<br/>Goods</u> | <u>Raw Materials<br/>Intermediate Goods</u> | <u>Manufactured<br/>Semi-Finished</u> | <u>Consumer<br/>Goods</u> |
|-------------|--------------------------|---|---------------------------------------|---------------------------|
| 1971        | 38.4                     | 37.1  | 11.9                                  | 12.1                      |
| 1972        | 35.3                     | 38.3  | 12.1                                  | 13.6                      |
| 1973        | 30.8                     | 45.4  | 11.8                                  | 11.6                      |
| 1974        | 26.2                     | 42.7  | 20.8                                  | 8.9                       |
| 1975        | 33.2                     | 33.7  | 22.3                                  | 8.4                       |
| 1976        | 31.0                     | 35.0  | 24.5                                  | 7.3                       |
| 1977        | 27.5                     | 37.3  | 25.4                                  | 7.8                       |
| 1978        | 29.6                     | 39.8  | 21.8                                  | 6.6                       |
| 1979        | 29.1                     | 40.3  | 22.5                                  | 5.9                       |
| 1980        | 25.7                     | 36.9  | 29.1                                  | 6.0                       |
| 1981        | 24.2                     | 36.3  | 30.9                                  | 6.8                       |
| 1982        | 23.3                     | 39.7  | 27.4                                  | 8.3                       |
| 1983        | 22.7                     | 35.2  | 28.4                                  | 7.2                       |
| 1984        | 18.9                     | 43.4  | 27.2                                  | 6.0                       |
| 1985        | 15.4                     | 43.0  | 28.4                                  | 8.6                       |
| 1986        | 17.1                     | 52.9  | 17.2                                  | 7.9                       |
| 1987        | 18.0                     | 50.8  | 18.5                                  | 8.1                       |
| 1988        | 20.0                     | 54.1  | 13.4                                  | 7.3                       |
| 1989        | 23.0                     | 51.7  | 13.4                                  | 8.6                       |
| 1990        | 25.6                     | 47.6  | 15.1                                  | 8.7                       |
| 1991        | 24.5                     | 48.6  | 14.8                                  | 8.2                       |
| 1992        | 27.7                     | 46.6  | 14.7                                  | 8.5                       |
| 1993        | 31.9                     | 44.6  | 14.7                                  | 9.0                       |
| 1994        | 32.2                     | 45.0  | 13.6                                  | 9.9                       |
| 1995        | 30.4                     | 46.1  | 13.5                                  | 10.5                      |
| 1996        | 32.8                     | 44.1  | 12.4                                  | 10.4                      |
| 1997        | 39.5                     | 40.2  | 11.0                                  | 8.5                       |

Source: Department of Trade and Industry

The import picture does suggest the same as the export data. The Philippines is already in transition to industrialization since the bulk of its imported items are capital goods, raw materials, intermediate goods, and manufactured and semifinished goods which are necessary for industrialization. And as Table 10 shows, of the top ten import markets as of 1996, seven are also among the top ten export markets with the USA and Japan again dominating. The other five are Singapore, Taiwan, South Korea, Hong Kong and Germany. The remaining import markets are Saudi Arabia, Australia and Malaysia. But in contrast to the export picture, Japan accounts for the biggest share of imports at around 30 percent of the total, with the USA at second with an average share of about 25 percent. The rest account for less than ten percent each. As with the export market, the import sources are also not widely diversified.

Table 10. Top Ten Import Markets (Value in USD million)

| <u>Country</u> | <u>1994</u>  |                  | <u>1996</u>  |                  |
|----------------|--------------|------------------|--------------|------------------|
|                | <u>Value</u> | <u>Share (%)</u> | <u>Value</u> | <u>Share (%)</u> |
| Japan          | 5205         | 31.2             | 7129         | 22.0             |
| USA            | 3918         | 23.5             | 6361         | 19.6             |
| Singapore      | 1434         | 8.6              | 1740         | 5.4              |
| Korea (South)  | 1103         | 6.6              | 1673         | 5.2              |
| Saudi Arabia   | 945          | 5.7              | 1671         | 5.2              |
| Taiwan         | 1221         | 7.3              | 1598         | 5.0              |
| Hong Kong      | 1094         | 6.6              | 1360         | 4.2              |
| Germany        | 761          | 4.6              | 1209         | 3.7              |
| Australia      | 581          | 3.5              | 808          | 2.5              |
| Malaysia       | 429          | 2.6              | 801          | 2.5              |
| Total Imports  | 16691        |                  | 32,427       |                  |

Source: Board of Investments

## Conclusion

To summarize, the Philippines is definitely in a transition stage towards development or modernization. It already has the unassailable features of an economy beyond the first stage of industrialization. The manufacturing sector has been the major source of employment and



output. Manufactured goods dominate the export sector. And the largest portion of imports cover capital and intermediate goods which are necessary for second-stage industrial expansion.

In the absence of comprehensive research on the country's social class configuration, the economic data and historical research suggest that the class configuration of a developing economy may well be persisting. The country has a substantial informal sector labor force. Unemployment and underemployment has persisted and the distribution of income has by and large remained inequitable. The landed elite is a force to reckon with. They may well be engaged in industrial enterprises already. The country's capitalist class emerged also from the inward-oriented import-substituting industrialization program of the postwar era. They have tended to monopolize their markets. And many of these industrial enterprises have had their start-up from foreign investors and multinational corporations. Inward-oriented industrialization has reigned supreme for decades and this has retarded the country's industrial expansion. But outward-oriented policies have begun to be implemented, including the ratification of the GATT. And a capitalist class has already emerged and figure prominently among the export sector. Manufactured goods exports happen to be those in the more competitive markets and the fact that Philippine exporters are thriving suggest that these enterprises are directed by efficient capitalists.

GATT has been intended as a means to realize the benefits of outward-oriented industrialization for many developing economies. The theoretical underpinning of the GATT and globalization in general has been based upon the proved experience of the EU and then of the East Asian NICs. Globalization, the continued interaction with the international economy promoted an efficient and sustainable pattern of industrial and economic development among these countries.

But the theory also suggests that the development process is spurred by domestic circumstances, not just external transactions. The country's social class configuration is a major factor in a country's ability to respond to the challenges of outward-oriented industrial development. Whichever class dominates will determine whether a country's progress towards modernization and industrial development will be accelerated or not.

As pointed out, crucial also to the development process was the maintenance of a favorable macroeconomic environment, of low inflation and interest rates and stable exchange rate. These imply policies

such as increasing the efficiency of tax collection, controlling government expenditure with emphasis on infrastructure and basic social services, liberalizing the banking system to attract more savings and foreign exchange deposits. Many of these policies will not sit well with some social classes. The landed elite have traditionally used patronage specially in government appropriations to maintain their position of power. Moreover, they and the bourgeoisie are the one class capable of providing the resources of income taxation. At the same time, many among the low-income classes—whether among the proletariat, semi-proletariat and the farmworkers—do benefit from direct subsidies from government. These will make control of the fiscal process a point of conflict between these classes and those promoting a controlled budget directed towards modernization.

It is worthwhile to remember that among the East Asian NICs, the landed class has ceased to be a major force before their industrialization (King 1977). The landed aristocracy of Japan lost its power after World War II, the Nationalist regime neutralized the native landowning class of Taiwan, and the Japanese occupation of South Korea at the turn of the century destroyed the landed elite of the peninsula. Therefore it was possible for these countries to embark on a land reform program and a capitalist and bureaucrat class could later emerge and not be encumbered by the interest of a landed elite class.

This is not quite the case in the Philippines. The landed elite has remained a strong even resilient force in government and politics (McCoy 1994). A capitalist class has already emerged and it may be spurred on by the opportunities of a world market. But a substantial segment of the manufacturing and industrial sector remain protected and are loathe to engage in greater competition with the international market. Large numbers of the country's professional and academic class—the petit bourgeoisie—are divided over the merits of globalization. At the same time, the ability of the economy to generate sufficient employment has been unsatisfactory so that large numbers of the informal labor force remain along with substantial unemployment. The attraction to globalization has been severely dented by the recent crisis in the East Asian economies.

Nonetheless, globalization has strong advocates and has been entrenched by the policies of the Aquino but specially the Ramos administrations. A strong class of export-oriented manufacturers and an articulate group of intellectuals have steadily prodded the government and the business classes towards liberalization. The interaction of these

contending classes in the country's political arena will certainly determine the response of the Philippines to the opportunities of a global market. The one thing certain is that given the class structure and the current economic structure, the path will be slow and quite tortuous compared to other countries in East Asia.

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