REVIEW OF VOS AND YAP'S
THE PHILIPPINE ECONOMY:
EAST ASIA'S STRAY CAT?

by

Jim Roumasset

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Review of Vos and Yap's, *The Philippine Economy: East Asia's Stray Cat?*
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There is much food for thought in this small volume. Vos and Yap review the political economics history of the Philippines from 1970 thru 1993 and attempt to explain poor economic performance with the aid of extensive statistical and general equilibrium analysis. This is an important study; it shows how foreign aid and multilateral lending can do more harm than good. Because of the authors' neglect of previous literature on the same subject, however, they do not separate what is new in their contribution from what is old. Moreover, because the empirical challenge Vos and Yap set for themselves is beyond what existing methodology can reliably deliver, their simulation results are not conclusive. However, if one complements their analysis with simple theoretical arguments, the more-harm-than-good thesis becomes quite compelling.

But first, let us separate the old from the new. The microeconomics of protectionism and its effects on the Philippine economy during the 60's, 70's, and early 80's are well understood, as are the nature and consequences of cronyism in the second-half of the Marcos regime. Indeed the World Bank's structural adjustment loans (SAL's) during the 1980's were largely motivated by such concerns. The idea behind the SAL's and other World Bank programs was to loan billions of dollars on the condition that the Philippines would reduce some of its tariff and non-tariff barriers. "The Bank" never fully faced up to two outstanding questions about their lending program. One question
was why such large sums were needed to motivate a government to do what was in its country's best interest. The other was why rent-seeking objectives would not subvert Bank "conditionalities," leading to non-compliance with respect to liberalization schedules and increased use of other instruments of protection, especially administrative barriers (e.g. health and safety standards).

Vos and Yap show that the loans were really supply-induced all along. In the early 80's, for example, the international banking community was in the business of recycling petro-dollars generated from the "second oil shock." In this environment, the World Bank was hardly interested in getting the biggest liberalization bang for the buck; indeed it was quite the other way around (buck for bang). The authors document how it was all too easy to lend not only for structural adjustment but for a variety of public white elephants and commercial banking enterprises which were entirely antithetical to the World Bank mantra of "privatize and get the prices right." International bankers, awash in petro-dollars, were anxious to "lend the money and run" and shirked the managerial responsibilities regarding loan performance. Given the rent-seeking climate in the Philippines and elsewhere, political-commercial coalitions would happily "take the money and run." This is hardly the stuff of postmodern conspiracy theories about how capitalists conspire to maintain dependence, but dependency results nonetheless.

The attempt to buttress these arguments with econometric and computable general equilibrium (CGE) analysis should have been qualified with caveats about the difficulties
of econometric estimation of large systems of equations and problems incorporating macro-economic relationships into general equilibrium models. It is well known, that unless duality theory (or some yet-to-be discovered technique) is used to structure the statistical model to make economical use of data, the analyst will either be forced to ignore much of the simultaneity in the economic system or have too few degrees of freedom. And CGE models that simply append macro-economic aggregates on to an otherwise micro-economic structure can generate misleading conclusions. In light of these reservations, it would have been helpful to complement the empirical and simulation analysis with demonstrations of the hypotheses in question as tendencies in simple theoretical models.

Partly because of the unnecessary complexity of their equation systems, Vos and Yap appear to be at somewhat of a loss in deriving clear policy implications. They call, for example, for "unconventional" macro-economic policy based on the pluralism of the country in questions and a "social consensus" for structural reform including income redistribution. This is too vague and too much like social engineering, consensus or not.

Here follows an attempt to describe a simplified version of the syndrome that Vos and Yap have discovered, albeit in a way that makes the underlying theoretical principles more transparent. Begin with an agriculturally-based developing economy with policies that protect against the importation of finished consumer goods. The results in a "cascading" structure of protection with high effective rates of protection on finishing-
stage industries that import large amounts of capital equipment and material inputs at relatively low tariff rates. Now when international bankers push loans, because of an event such as an oil-price shock, the resulting appreciation of the domestic currency induces a further bias towards the finishing stage by simultaneously encouraging importation of intermediate products but discouraging import-substitution. The appreciation of the real exchange rate also causes a contraction of the exportables sector and an expansion of the non-tradeables sector. The increased profitability of non-tradeables attracts rent-seeking entrepreneurship into government production of non-tradeables and regulation of private production (e.g. licenses and quotas).

The government enters into a variety of public enterprises, from energy production to rice storage, in which it has no comparative advantage. The government also expands its own lending to commercial banks. Precisely because of the political environment in which these expenditures and regulations are made, they are not only inefficient in their own right but displace efficient private expenditures. Many of these new rent-seeking opportunities provide ready outlets for international loans, and international bankers do not have to "push" very hard to get their loans accepted. This "Apull" factor is augmented by higher world prices of energy and materials in the face of inelastic demands; loans are needed to finance the higher material input bill.

When the next fiscal crunch hits the economy, as it did in the Philippines during the early 80's, the government is unable to simply contract its expenditures on these
white elephants but must contract more efficient public services (e.g., education) as well.

This is worse than Dutch Disease. Given its similarity with related syndromes in
Mexico and South America, it may be better referred to as "Latin Largesse."

If Vos and Yap were to write a postscript to their book, it might well conclude
that the last four years provide evidence of the more-harm-than-good thesis in reverse.
Now that the World Bank, the U.S. Agency for International Development, and the U.S.
military are reducing their presence, the growth of the Philippine economy appears to
have graduated from its "Stray Cat" status, albeit not by social engineering. It appears
that political stability and infrastructure reliability (most notably electricity) have now
improved to the point that the forces of international convergence motivate foreign
investment to take advantage of low wages and attractive workforce characteristics.
While the Philippines has far to go to become a "tiger", it may be emerging as a more
formidable feline.

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