INTRODUCTION

> *Economic ideas can matter; they can shape reality. But ideas are like seeds that must fall on fertile ground to germinate. Attention to the political economy of policy reform can help discover the fertile ground. If development economists are to exercise more influence, they will have to achieve greater understanding of pressing problems that are less amenable to technical analysis, more politicized, involve issues of constitutive rationality, and require institutional change. They will then better understand the causes of differences in development performance and how to institute policy reform.* [1]

The debate over the role of various political economy variables that determine the trade policy continue to prevail in this era. Theoretical and empirical literature on the political economy of trade policy is well documented. The idea rests on the assumption that sub-optimal policies are chosen not to maximize economic efficiency but are formulated in the political contexts where the objectives of the policymakers are different from that of aggregate welfare maximization.

In the Philippines, like any other developing nations, trade policies have been the major tools for industrialization. The country is among the first to embark in an import substitution industrialization drive among Asian countries. It has undergone different stages of trade policy reforms as part of a broader structural adjustment program initiated by the World Bank.

The post-war era period up to 1970s can be characterized as highly trade-restrictive and protectionist. Recognizing the effects it brought in the economy, the government

[1] Charles C. Soludo et. al. 2004, "*The Politics of Trade and Industrial Policy in Africa: Forced Consensus?*" African World Press.

initiated continuous trade reforms beginning 1980s. The country initiated trade restructuring by means of Tariff Reform Programs and Import Liberalization. The main objective of the trade reform program is to rationalize the protection structure by reducing the over-all level of protection and distribute the protection within and across industries.

The trade policy formulation is the result of various interplay of different sector. As Rodrick (1994) points out that in principle, a political economy model of trade must have four elements namely: individual preferences and interest groups which comprise the “demand” side of the trade policy and the policymaker preferences and institutional structure of the government which represents the “supply side”. The “demand side” acts as “pressure” elements to the “supply side” which on the other hand has their own interests and agenda. The interplay between both sides resulted in policy outcomes.

In the country which is vulnerable to all the pressure and sector interplay, policy formulation is often described as “satisficing”. In lieu of this, it is interesting to know and identify the “political economy” that brought about the changes in trade policy.

The author will use the theoretical framework of Rodrick (1994) to present the elements or circumstances that brought about the trade policy. Using this framework as the background, the historical overview of trade policy will first be presented, specifically from 1946-2004. Then, the demand side and supply side of the trade policy will follow as to understand why such policy emerge and was created. The policy implication on the trading system will also be analyzed.

In particular, it hopes to answer the following questions:

a.) Given the political institutional framework, how does it affect the trade policy outcomes?

b.) What are the major issues that played an important role in trade policy formulation?

c.) How does the interest group affected the policy formulation?

d.) What are the policy implications on the trading system?

Finally, the concluding section will provide the summary of the findings of the study and hopefully recommend future trade policy in the Philippines.

A. Methods and Strategies

Qualitative methods will be applied in making the analysis. Primary and secondary sources in describing and analyzing the political economy of trade policy formulation will be used. Relevant documents such as annual reports, statistics, official correspondence, books, newspapers, journals and other types of publications will also be used. Review of literature will be made to substantially validate the claims. Interview of high-ranking officials from the Department of Trade and Industry (DTI), the government institution handling trade relations; the Central Bank of the Philippines, the main monetary policy making institution; and the National Economic Development Authority (NEDA), the policy making body, will be conducted.

II. REVIEW OF LITERATURE

In the neoclassical Hecksher-Ohlin-Samuelson (HOS) model, firms are supposed to compete based on static comparative advantages, and free trade maximizes both national and international welfare. Perfect competition is assumed, market failures do not exist, and trade serves no other purpose other than that of efficient exchange of goods and services to maximize individual and collective welfare. In this world, the pattern of trade would be determined entirely by comparative costs whereby the most efficient producers would supply the world's requirements and the market mechanism would be the sole determinant of prices. If free trade economists ruled the world, there would be no trade policy. This is because autonomous trade liberalization is unequivocally good for the liberalizing country leading ultimately to global free trade. In this world there would be no trade treaties, no trade negotiations and no World Trade Organization. In addition, government intervention through trade policy must therefore be distortionary and harmful to distributional and allocative efficiency (Soludo and Ogbu, 2004).

However, in the real world, things are not that easy and simple. Trade policy is negotiated and other factors other than comparative costs should be considered. Under the political economy framework, comparative advantages and disadvantages can be purposely created as to whom or what sectors of the economy has the authority.

According to Suranovic (1997), political economy is a term that reflects the interaction between the economic system and the political system. Many traditional models of the economy make simplifying assumptions about the behavior of governments. Keeping the model simple is one reason for the assumption of a benevolent dictator. Political economy models attempt to explain, more carefully, the

decision-making process of governments. Today, most governments can be described as representative democracies. This means that government officials elected, through some voting procedure, to “represent” the interests of their constituents in making government decisions.

He added that the key issue in political economy and trade models is to explain how political features in democratic economies affect the choice of trade policy. Among the key questions are:

1) Why do countries choose protection so often, especially given that economists have been emphasizing the advantages of free trade for 300 or more years? In other words if free trade is as good as economists say, then why do nations choose to protect?

2) In discussions of trade policy, why is so much attention seemingly given to the policy effects on businesses or firms, and so little attention given to the effects on consumers?

3) Why do political discussions, even today, have a mercantilist spirit, wherein exports are hailed as beneficial while imports are treated as harmful to the country?

Economists in the industrialized nations as well as developing countries recognized the significant role of trade liberalization on economic growth. Historical and economic analysis indicates that protectionism is associated with poor economic performance and balance-of-payments crises. Then, how do we explain why governments adopted these policy as well as discrimination in certain industries?

Economists attribute it to lack of political will on the part of government, that while governments may know that liberal trade policies are best for promoting long-run

economic welfare, they lack the resolve to forego the political support of narrow special-interest groups who may lose in the short run from liberalization. Empirical work in the political economy of trade policy such that of Cheh (1974), Caves (1976), Lavergne (1983), Baldwin (1985), and Anderson and Baldwin (1987), supports the view that public officials support protectionism not only because of political pressures from special groups but also out of concern for equity and adjustment problems workers face as a result of industry-injuring shocks, perceived unfair trade practices by other countries, and the need to maintain a strong domestic industrial base. Consequently, to understand better how liberal trade policies can be implemented, economists must analyze the economic and political forces that shape the pressure for protection (Baldwin 1989).

As Meier (1991) argues, whether society-based interest groups or a state-centered interest, the central prediction of the model is that policies are beholden to special interests. It is based on a model of a pluralist society in which policy is the result of the pressures exerted upon policy-makers by large numbers of competing groups in society. The state merely provides a more or less neutral institutional and procedural framework in which conflicting groups form coalitions, and policy change occurs because different coalitions of interests manage to gain power and impose their preferred solution on society.

During the last two decades, economics has witnessed a remarkable upsurge in theoretical as well as empirical studies of the behavior and political influence of interest groups. Recent books by Sloof (1998), Drazen (2000), Person and Tabellinin (2000), and Grossman and Helpman (2001) refer to a wealth of evidence of the

significance of organized interests in the political arena, besides presenting surveys of theoretical studies (Van Winden, 2002).

Difficulties in instituting trade policy reform can be attributed to the number of reasons. According to Van de Walle (1994), informal groups and individuals take advantage of “the states” wealth capabilities and networks that pervade it to pursue individual and parochial interests. He observed that failures of economic reforms are sometimes attributable to these informal actions. Different groups have different agendas in seeing the reforms to fail. He cited that the owners of capital who have been receiving benefits would be potential adversaries while management and workers in parastatals may wish to see current system continues.

A study by Gawande and Krishna (2001), which was taken mostly by Baldwin (1985), the determinants of trade policy, could be classified as follows:

1.) The Pressure Group or Interest Group Model

The model emphasizes that the policy formulation was influenced by the capitalists or interest group that would like to protect their sector or interests. The level of protection in an industry is usually determined by them. This model usually revolves around the incentives face by the capitalists to influence politicians to move policy in a direction that would benefit them. The study made by Olson (1965), Stigler (1971), Peltzman (1976), and Pincus (1975) reveals the different abilities of various industries to overcome free rider problems and get organized to lobby government effectively. As such, the theoretical demonstration by Mussa (19740) and Neary (1978) of the redistribution impact of tariffs in the pressure of specific factors of production served as a framework to understand lobbying by specific factors.

2.) The Adding Machine Model

The model, due to Caves (1976), recognizes the voting strength of an industry in determining the extent of trade protection. The elected officials will favor industries with the largest number of voters for their benefit. The number of employees in the industry determines the level of protection.

3.) The Status Quo Model

The model, due to Corden (1974) and Lavergne (1983) emphasizes that government officials have respect for the "status quo" of the existing property rights and cautious enough to the unexpected outcome of changes in policy. The present protection usually depends upon the past levels of protection. The government would like to avoid large adjustment costs so they would rather settle for what was implemented in the past.

4.) The Social Change Model

The model, due to Ball (1967), Constantopoulos (1974), and Fieleke (1976) emphasizes that the decision of the government is affected by its motives to reduce the income inequality in the economy. Protection level will be high and tariff cuts will be low in sectors that employ low-income and unskilled groups.

5.) The Comparative Cost Model

The model suggests that industries with higher ratio of exports to production and lower import penetration ratio will be given lower protection as the government believes it is not necessary.

6.) The Foreign Policy Model

The model suggests that the trade policy outcome depends on the countries bargaining ability in the trade negotiations and commitment to international institutions. For instance, a country would lower its trade barriers on another country which it has direct investment.

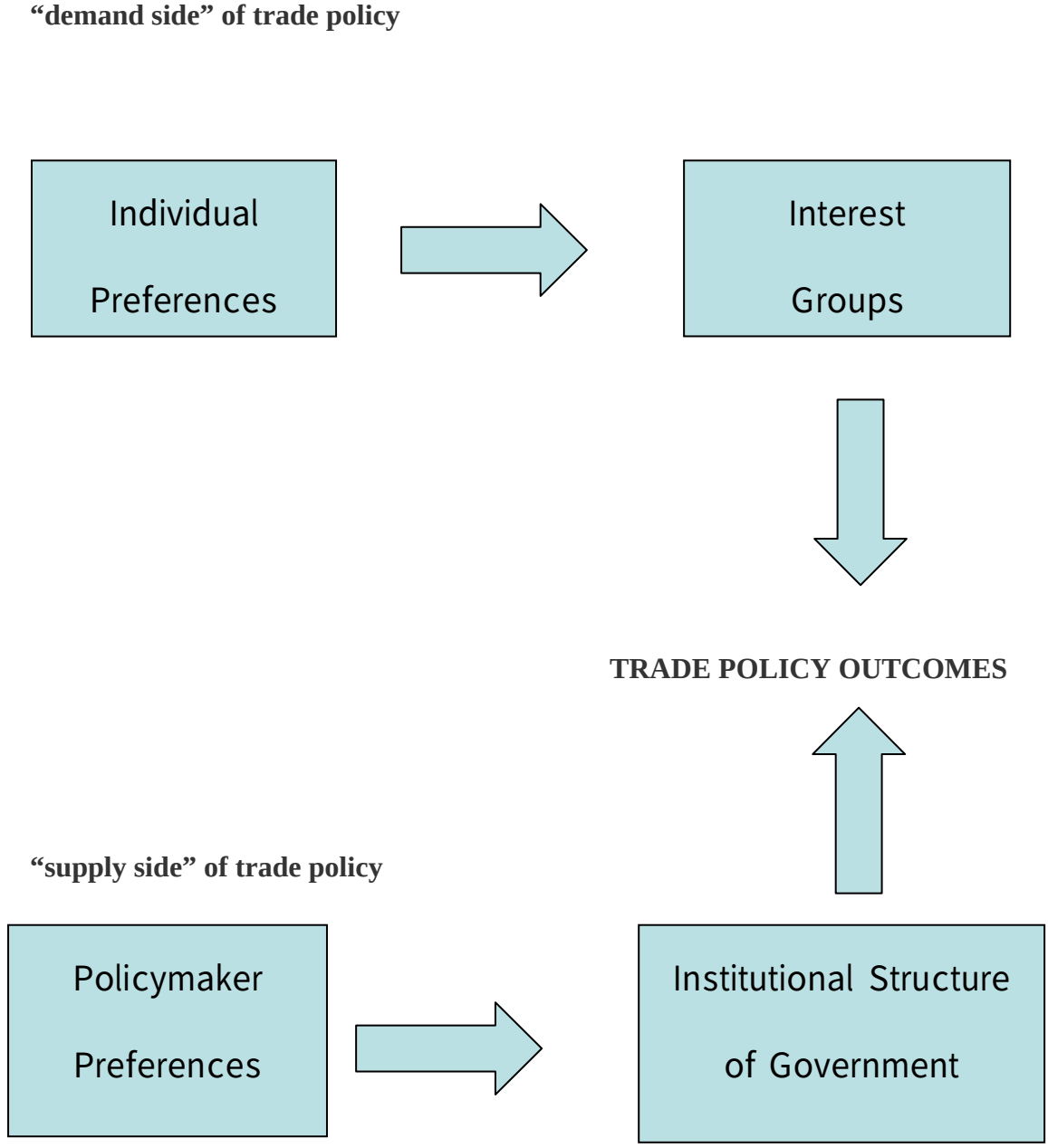
A. Theoretical Framework

Rodrick (1994) showed that in principle a political economy model of trade policy must have four elements. As illustrated in Figure 1, these include: individual preferences, interest groups, policymaker preferences and institutional structure of the government.

Under the economic model of the Hecksher-Ohlin or Ricardo-Viner type and the assumption that preferences for policy depends only on self-interest, the individual preference depends on the basis of their factor endowments or sector-specific skills. These individual preferences are channeled in the lobbying, campaign contributions, and voter registrations among others. These components have to do with the “demand side”.

The policymaker preferences depend on what their agenda is: either they want to get re-elected so they want to transfer resources to the favored groups or they really are interested in maximizing social welfare. This in turn interacts with the institutional setting in which policy formulation takes place. International settings also involve the international treaty obligations that rule out certain forms of trade interventions. Both elements act as the supply side of trade policy.

Figure 1. Theoretical Framework of the Political Economy Model (Rodrick, 1994)



III. HISTORICAL OVERVIEW OF TRADE POLICY REGIMES (1946-2004)

The Philippine has undergone five major stages of trade policy regimes: the protectionist policies, which prevailed after the country attained independence in 1946 up to 1979; the introduction of First Tariff Reform Program beginning 1981 to 1985; the revival of Import Liberalization in 1986 to 1989 after the Edsa Revolution; the Second Tariff Reform Program in 1991 to 1994; the Third Tariff Reform Program in 1995 up to 1998; and the Fourth Tariff Reform Program from 1998 to 2004.

A. The Protectionist Policies (1946-1979)

The aftermath of World War II resulted in severe devastation of the Philippine economy. The country relied heavily on the U.S. government war damage payments, relief and military expenditures and veteran's pension.

The character of trade policy shortly after the Second World War is largely determined by: (a) foreign exchange shortage; (b) the constraints imposed by the Free Trade Act of 1946; and the (c) fixed exchange rate in curbing imports. Hence, the policy response became that of raising domestic sales taxes on imports and imposing quantitative restrictions[2] (QR) (Tan, 1994).

Baldwin (1975) cited that for two years, 1945 and 1946, total U.S. government expenditures of $393 million more than covered combined imports of $364 million. Thereafter, the rapid revision exports from $64 million in 1946 to $327 million in 1948, coupled with continued high levels of U.S. government expenditures and foreign aid resulted in a rise of imports to an average of $613 million between 1847 and 1949 – an average level that was then one-third larger than the pre war value and

[2] The Import Control Act of 1948

was not again reached until the early 1960s. The outstanding export performance was due in large part to a rapid increase in export prices. The index of these prices (1937 = 100) rose from 156 in 1946 to 291 in 1948. The volume of exports in 1948 was still only 74% of the 1937 level.

Government officials believed that the country should have an additional export-oriented and import replacing production in order to meet the growing deficit problem. However, policy options were constrained due to the implementation of Philippine Trade Act of 1946 which was imposed by the U.S. government just before the scheduled independence of the country. This act mandated the country to have an eight year period of free trade between the U.S... Furthermore, the act stated that export taxes should not be implemented and Americans were also provided equal rights in the development of natural resources in the Philippines.

The government's effort to limit imports resulted in the enactment of Import Control Act (R.A. 330) in July 1948 but was only implemented in 1949 due to opposition of foreign importers. The act places various imports on a list of so-called luxury items that required import licenses.

However, the volume of imports from 1949 to 1950 was higher than in 1948. This can be attributed to the shifting from high-priced to low-priced imports of a specific commodity. Furthermore, an attempt to liberalize the country's import policy encountered a conflict with the government objective of stimulating import-substituting production through protection. This resulted to unnecessary hoarding and excessive imported goods which badly affected the local production.

Further efforts to promote import substitution continued to prevail until 1959. Only few measures were undertaken to stimulate exports. The tight exchange control that the government implemented resulted in undervaluation of exports. The people used exports as a way to transfer funds abroad in preparation for devaluation.

The government introduced various decontrol methods in 1960-1965 due to the continuing pressure from export producers added to the growing public sentiment in dissatisfaction in handling exchange control. The Central Bank introduced multiple exchange rates: an official rate (which is equaled the existing rate of Php 2 per dollar) and a “free market” rate which was initially set at Php 3.2 per dollar.

However, many import-competing manufacturing activities were adversely affected since manufacturers were faced with higher input costs. In sum, the decontrol effort did not reduce the size of the import substitution sector and the aim to establish a new type of export-oriented growth was not achieved. The import substitution sector did not face economic difficulties.

In the first two years of the next administration, decontrol measures continue and exchange controls were reimposed starting in mid-1967 due to the declining of the balance of payments brought about by the expansionary policies. In the late 1969, the government has no choice but to devalue the peso from Php 3.90 to Php 6.40 per US dollar since the balance of payments became untenable.

Despite initial attempts to implement trade reforms, trade policy in the 1970s remained inward-looking. Tariffs continue to be high even after the Tariff Code was simplified in 1973. These were six tariff rates ranges from 10 to 100 percent.

B. The Tariff Reform Program I (1981-1985)

The 1980s showed drastic change in trade reforms under one of the original structural adjustment loans from the World Bank. The Tariff Reform Program was introduced which aims to restructure the Philippine tariff system on a continuing basis to make it responsive to the needs of the economy taking into account changing patterns on trade and advancement in technology. The government embarked on restructuring the tariff system because of the recognition that over two decades of import-substituting activities resulted in overprotection of certain local industries. In turn, overprotection led to market distortions.

The TRP of 1981 was complemented by the lifting of QRs on imports, the abolition of all export taxes except those on logs, and by a tax reform. The objectives of the 1981 TRP was to make levels of protection uniform among and within sectors and to achieve effective protection rates (EPR) [3] within the range from 30 to 80 percent. Tariff rates were reduced gradually from a peak of 100% to a maximum of 50% and a minimum of 10% by 1985 (Tan, 1994).

The tariff review accompanying Tariff Reform Program I (TRP-I) covered all headings from Chapters 1 to 99 of the tariff schedule. A five-year period was allocated for the tariff modifications to mitigate the effects of the changes on the various sectors of the economy.

A series of review was conducted on the existing protective rates to phase out (a)

[3] The Effective Protection Rate is defined as *the percentage excess of domestic value added, made possible by the imposition of tariffs and other protective measures on the product and its inputs, over world market value added*.

those which were excessive; (b) those which had outlived their usefulness; and (c) where the burden of protection outweighed the return. The changes were expected to stimulate a shift in the composition of imports of raw materials from those with advanced processing to those which are more basic or in crude form. Inter-industry and inter-sectoral linkages in the economy were also included in the TRP-I.

The tariff band was narrowed from 10% - 100% to 10% - 50%. As a result, the average nominal tariff fell from 42% in 1981 to 28% at the end of TRP-I. The Tariff Reform Program I reorganized the system of protection to industries. It lessened the unfair practices towards only one industry or industry groups. It aimed to keep the industry's EPR within a range of 10%-80% and prevented it to become excessively high or low.

As a result, EPR's across industries was reduced. EPR for primary and agricultural industries continued to receive a low EPR of 3% while the EPR for manufacturing industries declined from 66% to 36%.

These reform focused on three areas: first in 177 non-essential consumer (NEC) and unclassified consumer (UC) items were reduced from a peak rate of 100-50%; second, tariff rates on 295 lines involving 14 key industries were reduced while rates on 295 lines involving 14 key industries were reduced while rates on 100 lines were involved; and third, for 10 residual sectors, rates in 128 lines were reduced while those on 13 lines were increased (Medalla, 1986).

The Import Liberalization Program was briefly disrupted due to the 1983 balance-of-payment crisis. The devaluation of peso was made in a span of one year. Import restriction prevailed as ad valorem taxes on imports increased and the importation of luxury goods were virtually banned.

C. Import Liberalization Program (1986-1989)

When the new administration was established in 1986, through People Power Revolution, it adopted an ambitious reform agenda that initiated liberalization of trade and exchange regimes. The Import Liberalization Program (ILP) was implemented to hasten economic recovery.

Many factors made the gains in this brief period more realizable; first, the initial strong political will of the new government; second the implementation of the ILP was riding on a consumption led recovery between 1986 and 1988; third, in late 1987, crude oil prices dropped while world prices of coconut recovered; and fourth, inflation rate was very low during this period (Tan, 1994).

About half of the 951 commodities were liberalized in 1986. These include manufactured goods such as textile, leather, rubber and paper. In 1987, QRs on 170 commodities were lifted which include 77 lines such as textile, yarn and fibers. In addition, QRs on 209 lines were lifted. Mostly are textile, yarn and fibers, paper and paperboard, iron and steel products. The period saw a gradual phased out. A more liberal Foreign Investment Act was ratified. Export tax on all products was abolished only with the exception of logs.

D. The Tariff Reform Program II (1991-1994)

The Tariff Reform Program II was promulgated and signed by the President under Executive Order (EO) No. 470 on 20 July 1991 and became effective on 24 August 1991. TRP II introduced a new tariff code that further narrowed down the tariff range. A five-year phase-in period was made in order to provide local industries the needed time for the transition.

Prior to the EO 470, EO 413 was signed in July 1990 to simplify the tariff structure over a period of one year. However, it was not implemented due to protests of domestic manufacturers. The Federation of the Philippine Industries, a private sector group advocating protection of domestic industries, was formed. This resulted in the postponement of the implementation.

The Tariff Reform Program II aimed to reduce the overall level of protection and diffuse tariff protection within and across industries. The government hopes to achieve the following: more efficient resource allocation; improved access of industry to essential inputs at lower prices; availability of more affordable and better-quality goods for consumers; and enhanced competitiveness of local industries in the domestic and export markets.

The number of Harmonized Commodity Classification and Coding System (HS) lines was reduced by 10%, from 6,193 tariff lines to 5,561 lines. This decline was due to the simplification of tariff nomenclature but such nomenclature modification adhered faithfully to the basic text of the international Harmonized System.

The final rates under EO 470 were: 3%, 10%, 20% and 30%. In July 1995, 95% of total tariff lines were dutiable at these rates. But on the other hand, EO 470 imposed duties of zero, 5%, 15%, 25% and 50% on a limited number of items.

At the end of the period, the average nominal tariff was reduced from the pre-EO 470 level of 28% to only 20%. Manufacturing sector registered the biggest reduction in tariffs, from 27% before EO 470 to only 19% by 1995. The average tariff for agriculture declined by 20% from the pre-EO 470 level of 35% to 28% in 1995. The more moderate reduction in agricultural tariffs was a consequence of the decision to protect sensitive agricultural products by retaining their tariffs at 50%.

A substantial decline in the overall average EPR level occurred. This can be seen from the change of 25% under the pre-EO 470 structure to 19% when the final duties were implemented. With the implementation of EO 470, the structure of protection also changed.

However, despite the aim of narrowing the tariff range, about 10% of the total numbers of the commodity lines were subjected to 0-5% and 50% tariff rates by the end of the program.

E. The Tariff Reform Program III (1995-1998)

To further liberalize the trade environment, TRP-III was implemented. TRP-III was introduced even before the final year of tariff reductions in EO 470 was obtained. Various Executive Orders were issued during this phase. EO 264, issued in 22 July 1995, further reduced the tariff range to 3% and 10% levels. The ceiling rate on manufactured goods was reduced to 30% while the floor remained at 3%. A four-tier tariff schedule was also created: 3% for raw materials, 10% for locally available raw materials and capital equipment, 20% for intermediate goods, and 30% for finished goods. EO 288, which becomes effective 15 January 1996, provided tariff reductions on non-sensitive agricultural products while EO 313, issued on 7 May 1996, sets in the interim tariff protection to sensitive agricultural products. EO 313 was indispensable due to the country's commitments to World Trade Organization (WTO). 170 tariff lines also becomes subject to tariff quotas.

Republic Act 8178 was implemented on 10 July 1996 as part of the government's commitment in WTO. RA 8178 lifted the quantitative restrictions on three products and defined minimum access volume for these products.

In 1998, several EOs were also formulated. EO 465 corrected the remaining tariff

distortions and smoothened the schedule of tariff reduction in 23 industries identified by the government as export winners. EO 486 paves way for the modification of rates on items not covered by EO 465 while EO 63 adjusted the tariff rates on six industries.

Upon implementation, the average nominal tariff declined from 19.72% in 1995 to 13.43% in 1997. Effective protection levels not only decline but the bias against the agriculture, fishery and forestry sectors relative to the manufacturing sector was also reduced.

F. The Tariff Reform Program IV (1998 -2004)

After a thorough review and evaluation again of the impact and pace of tariff reductions on the competitiveness of local industries, Tariff Reform Program IV was implemented. Re-calibration of tariff rates on 22 industries identified as “Philippine Winners” was made. This was embodied by EO 465 which took effect on 22 January 1998. The products covered by these 22 industries were: fertilizers, copper products, motor vehicle parts, iron and steel products, petrochemical products, jewelry, electronics, footwear, leather goods, lumber, fiberboard, veneer and plywood, textiles and garments, basketwork, seaweeds and carageenan, furniture and fresh fruits. The re-calibration affected 11% of tariff lines which was based on a merit criterion.

Afterwards, EO 485 was formulated and took effect on 10 July 1998 which aims to re-calibrate the tariff schedules for the residual items. Reduction to 144 of the number of tariff lines subject to tariff quota was also made.

Another EO was created on 1 January 2001, EO 334, that provided the tariff schedule from 2001 to 2004 for all products with the exemption of certain meat products. The EO also provided for the implementation of tariff band of 0%-5% by 2004 with the

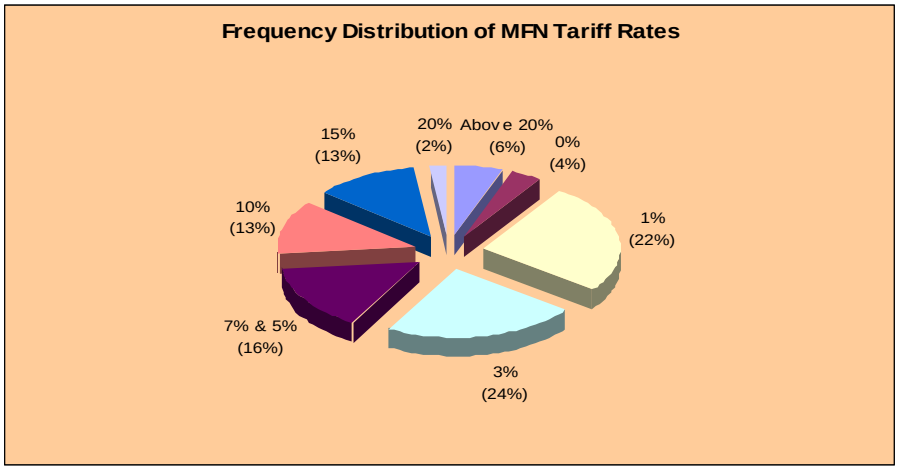
exemption of sensitive agricultural products with a 204 tariff rate of 30%.

Current Tariff Rates

As can be seen in Figure 2, currently, there are 15 tariff levels under the Most Favored Nation (MFN) tariff structure namely: 0%, 1%, 3%, 5%, 7%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, and 65%. The higher tariff rates are levied on motor vehicles and environmental waste (30%); vegetables (25%); and on sensitive agricultural products such as rice, live animals (except live bovine animals), pork, goat meat, poultry meat, potatoes, coffee, maize and sugar (35% to 65%). The country has a total of 11,059 tariff lines as stipulated in the ASEAN Harmonized Tariff Nomenclature or AHTN.

AHTN is an 8-digit commodity nomenclature agreed by the ten ASEAN member countries on 1 January 2002 which is based on the harmonized system and alignment of the national tariff nomenclature of each member country.

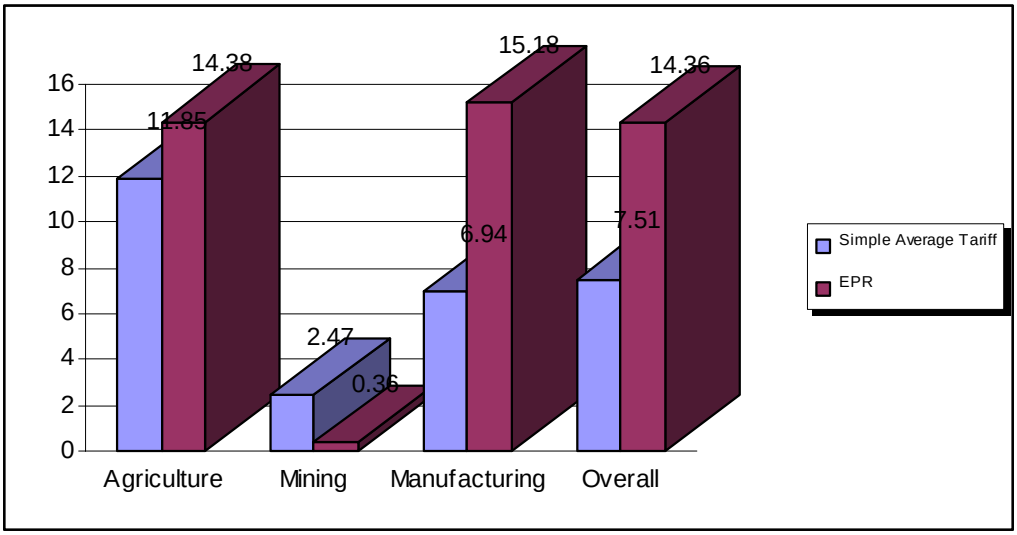
Figure 2. Frequency Distribution of MFN Tariff Rates



Source: Philippine Tariff Commission

The existing rate of protection on major industries such as agriculture, mining and manufacturing as well as the simple average tariff are shown in Figure 3.

Figure 3. Existing Effective Rate of Protection in Major Industries



Source: Philippine Tariff Commission

IV. THE "DEMAND SIDE" OF TRADE POLICY

A. Individual Preferences and the Industry

In analyzing the individual preferences, the major industries will be presented following Irwin (1994, 1996) and Magie (1978) that trade policy preferences are determined by the industry. Irwin (1996) using country level data to regress country votes on measures of country factor and industry mix revealed that the voting on the 1923 British general election on the issue of implementing new trade barrier was a result of the industry interest.

After independence in 1946, the Philippine was an agricultural nation. According to Baldwin (1975), the study by Richard W. Hooley on the Philippine growth rates and

the composition of output from the turn of the century up to 1961, the shift toward manufacturing and non agricultural activities during the 1950s should be regarded as an established trend. The rapid growth in manufacturing during the 1950s was part of the kind of "catch-up" growth in view of the stagnation and destruction during the wartime years.

Table 1. Average Growth Rates and Value Added Structure by Major Economic Sectors (in % , at constant 1985 prices)

Period	1951-60	1961-70	1971-80	1981-90	1991-00	2001-03
Value added growth rate						
Gross Domestic Product	6.2	4.8	5.7	1.7	3	3.89
1. Agriculture, Fishery, Forestry	4.8	4.2	3.9	1.1	1.8	3.59
2. Industry Sector	7.1	5.5	7.6	0.3	3	2.51
Mining & Quarrying	8.7	7.1	6.1	1.9	-0.2	16.86
Manufacturing	9.4	5.7	5.9	0.9	2.5	3.46
Construction	-0.6	4.2	14.1	-3.1	4.3	-4.84
Electricity, Gas and Water	4.3	5.4	11.6	4.1	5.6	2.56
3. Service Sector	6.7	4.7	5.2	3.3	3.6	5.07
Share in Value added						
1. Agriculture, Fishery, Forestry	32.5	29.7	25.6	23.8	20.8	19.7
2. Industry Sector	30.6	32.6	38.3	38	34.1	34.4
Mining & Quarrying	1.2	1.1	1.4	1.7	1.3	1.4
Manufacturing	22.3	25.6	28.2	26.3	24.3	24.2
Construction	6.1	5	7.1	7.3	5.5	5.6
Electricity, Gas and Water	1.1	1	1.7	2.7	3	3.3
3. Service Sector	38.3	38.4	36.6	40.4	42.4	45.8

Source: Aldaba, 2005

The country's economic growth over the past decades has been characterized as "boom bust cycle" by the local economists. It is evident in Table 1 that the two major sectors, agriculture, fishery and forestry and industry sector decreased. The agriculture

sector exhibited continuous dropped since 1951. The economy's output structure is characterized by a large services sector which continued to increase from an average of 37 percent during the 1970s to 40.4 percent in the 1980s, then 42.4 percent in the 1990s to almost 46 percent in 2001.

Agriculture's importance looms larger when it comes to employment, with nearly two-fifths (i.e. 37 percent) of jobs currently coming from the sector. Still, the services sector accounts for close to half of both output and jobs in the economy. But if one considers agro-processing and agricultural inputs manufacturing and trading (i.e. agribusiness sectors) along with basic agricultural production, about 40 percent of GDP and two-thirds of jobs in the economy arise from agriculture (Tolentino et al. 2001). With 70 percent of the country's poor coming from the rural areas where agriculture is the dominant source of livelihood and employment, the importance of agriculture to the Philippine economy cannot be overemphasized (Habito and Briones, 2005).

Given this scenario, the significance of "satisfying" the agricultural sector is inevitable for the politicians. In a study by Intal and Garcia (2005) on the relationship of rice in the Philippine politics, the result revealed that strong relationship existed between rice and the Philippine politics as the price of rice has been a significant determinants in the election results since 1950s, only with the exception of 1998 elections. The rising price has always been use by the opposition political parties against the incumbent administrations' rice policy and strategy. As Mata's (2004) stated *"the resulting loss in the people's confidence in the government is translated in the voter's preference against the incumbent administration"*. As a result of these circumstances, the agriculture sector continues to have high tariff rates compared to

other sectors. Currently, it has 14.38 percent of EPR while the manufacturing sector has 15.18 percent (see Figure 3).

The country's economic performance showed a sharp decline in 1998 as a spillover from the 1997 Asian financial crisis coupled with El Nino phenomena. Even though the effects were not as serious as in other East and Southeast Asian countries. But just like any developing Asian countries it accumulated large current account deficit. The country experienced a very large depreciation of peso against the major world currencies. The average exchange value of the peso was Php 26/US while in 2001 it was Php 51/US. The peso lost half of its international purchasing power and in effect led to a drastic change in the terms of trade. The Philippine exports become much more price competitive in the world market but imported goods were more expensive.

Current Economic Performance

In 2004, the National Statistical Coordination Board (NSCB) reported that the gross domestic product expanded by 6.1 percent as can be seen in Table 2. The 6.1 percent expansion exceeded the Medium Term Development Plan target of 4.9 – 5.8 percent as forecasted by NEDA. It is the strongest since the economy registered its last peak growth of 5.8 percent in 1996. The recovery has been sustained and is also broad-based across agriculture, industry, and services. The growth can be attributed to the favorable weather conditions and stronger global economic growth as well as to government policy and program interventions.

Agriculture rose 4.9 percent and can be attributed to favorable weather conditions in addition to the government's infrastructure, financial and technical support programs. On the other hand, industry and services rose at 5.3 and 7.3 percent respectively, with

the support coming from both domestic demand and foreign demand. Domestic demand showcased 6.7 percent higher on the back of strong and stable consumer spending and investments in fixed capital, especially private construction.

Table 2. Philippine Economic Indicators, 2004

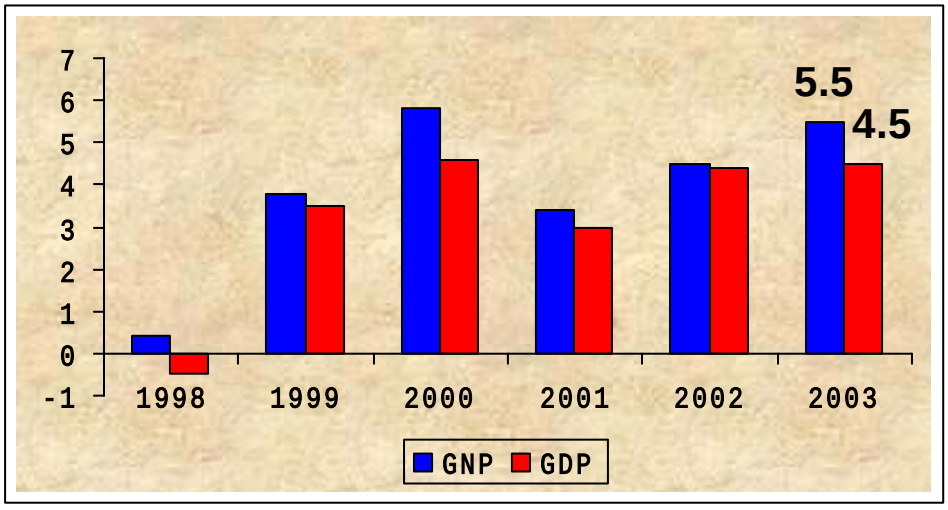
PHILIPPINES SUMMARY 2004			
		BALANCE OF	
REAL GROWTH, %		PAYMENTS	
GDP	6.1	Export growth in US$, %	9.3
Personal consumption	5.8	Import growth in US$, %	7.5
Government consumption	-0.8	Exports, fob US$ mn	39,598
Gross fixed capital expenditure	5.1	Imports, cif US$ mn	40,297
Exports	14.0	Trade Balance, US$mn	-698
Imports	6.3	Current account balance, US$mn	3,545
MARKET INDICATORS		- as a % of GDP	4.1
Exchange rate, to US$	56.17	Foreign debt, US$ bn	59.5
- % annual change on US$1	-3.1	- as a % of GDP	69.0
Population, millions	82.7		
- population growth rate, %	2.0		
Unemployment, % yr avg	11.9		
Inflation, CPI % yr avg	5.5		
Reverse repurchase o'night rate, yr avg	6.8		
Manufacturing prod. index, % chg	0.7		

Source: IMA, Asia

As of the first 11 months of the year, remittances grew 11 percent and reached $ 7.7 billion in 2004, contributing about a tenth of domestic economic production while exports of goods and services also expanded strongly at 14 percent following the turnaround in semiconductor electronics demand worldwide, with the recovery of tourism, and continued investments in the business process outsourcing and call centers. Semiconductors and electronics machinery, the top export merchandise, rose 13.5 percent as world demand recovered from last year's slump.

Other agricultural exports like desiccated coconut, pineapple, and sugar also contributed to the export gain. Tourist arrivals also rose 23.6 percent and reached 1.8 million in 2004. The influx of tourist contributed about $ 2 billion dollars to the economy. On the other hand, the booming call center industry employs 56,000 agents from about 20,000 seats in 2003 and a mere 1,000 seats in 2000. As of this moment, there are about 66 call centers in the country and 14 business process outsourcing companies.

Figure 4. Microeconomic Performance (growth rates in percent)

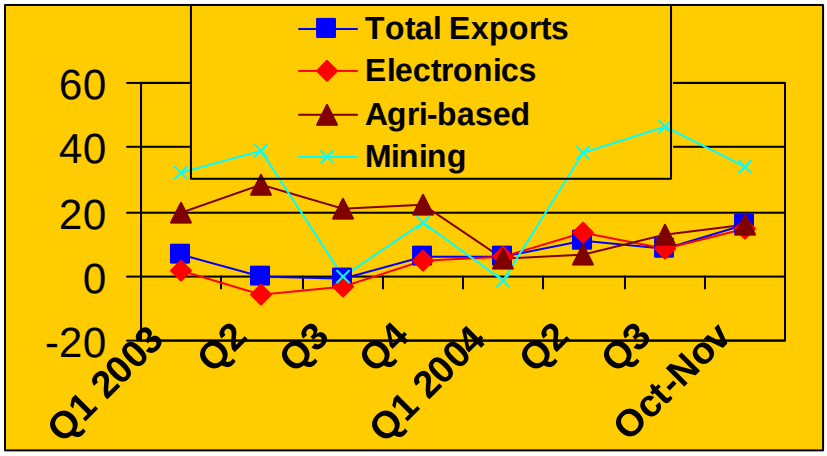


Source: National Economic Development Authority

According to the National Economic Development Authority (NEDA), the economic performance last year brings the average GDP growth in 2001-2004 to 4.0 percent as compared to 2.9 percent in 1998-2000. The increasing resiliency of the economy can be attributed to the various structural reforms taken over the years, particularly those that introduced greater competition and stable prices (see Figure 4).

Exports showcased an average rose of 15.8% in October-November, up from 8.5 % in third quarter of 2004 and 6.1 % in the fourth quarter of 2003. According to NEDA, all exports are on the rebound, led by electronics, as well as agro-based exports like coconut and sugar, and mining products like nickel, which are benefiting from strong global demand and firm commodity prices. Mining exports are up 34% in October-November, with prices rising by about 37 % (see Figure 5).

Figure 5. Growth Indicator: Exports (growth rates in percent)

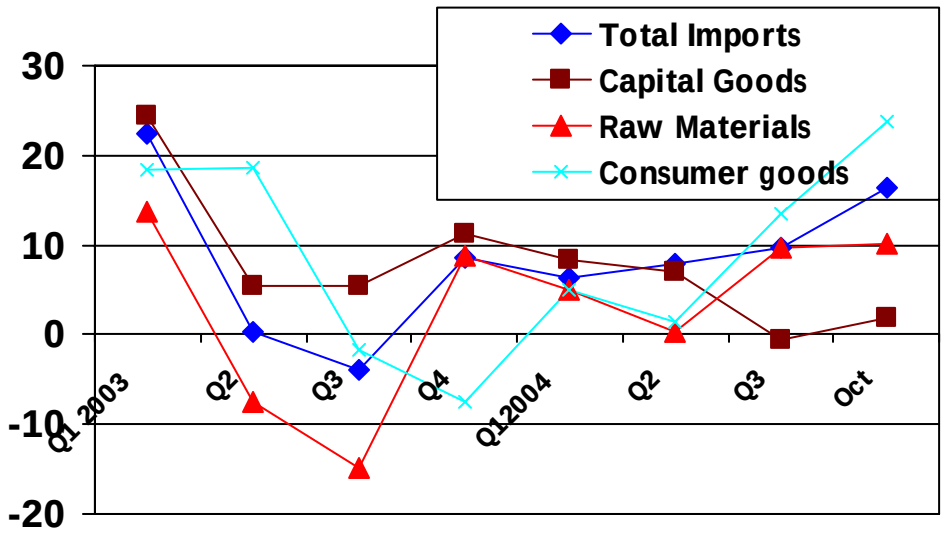


Source: National Economic Development Authority

In the case of manufactured exports, furniture and fixtures, processed food, machinery and transport, chemicals are also doing well in the market. China has been a major source of growth for exports. The total trade flows in China accounted for 6.4% of total trade flows.

Imports, which are an indicator or production activity, also rose a strong 16.3% in October 2004. Some of the growth can be contributed to high petroleum imports, imports of raw materials, consumer goods, and capital goods also showed an uptrend in October and in 2004 from last year's slump. Strong domestic and foreign demand and the recovery of the peso in the fourth quarter helped imports to recover based on the reports of NEDA as shown in Figure 6.

Figure 6. Growth Indicator: Imports (growth rates in percent)



Source: National Economic Development Authority

B. Interest Groups and Policy Reversal

Interest groups often played significant role in policy formulation and implementation. When making economic microeconomic interventions, government are necessarily influenced by small, special interest groups who stand to gain by large amounts. The costs, on the other hand, are borne by large, diffuse groups who don't have all the information regarding the policy and intervention tends to be excessive or misguided. Resource to political and bureaucratic imperatives, rather than economic viability, in making economic decisions is necessarily a welfare worsening course.

Powerful domestic producers engaged in cartel and lobbying activities often lead to policy reversals by the government. Intense lobbying was made by the interest groups to increase their tariffs or delay the tariff reforms. This action resulted in the government inability to sustain trade reforms.

Several instances can attest to this. The implementation of TRP-I was suspended in 1983 due to the pressure of interest group to the government. EO 413 of July 1990 was not implemented due to strong protests from domestic manufacturers. Federation of the Philippine Industries was formed in order to oppose the issuance of EO 413. The group successfully persuaded the government to delay the tariff reform agenda for one year. Instead, another EO was issued to simplify the tariff structure for a period of six years.

EO 486 in 1998, a comprehensive tariff reform package, also suffered the same fate. After the executive order was signed, different local manufacturers strongly opposed the implementation. As a result, another executive order was issued to increase the tariff rates on different items. The recent TRP-V was not implemented immediately due to strong pressure from the lobby groups.

There is real problem with lobbying process in democratic societies. Even though lobbying is a legitimate process of information transfer between constituents and government decision-makers; it also produces some obvious disparities. Whenever policy actions generate concentrated benefits and dispersed costs, the incentives and abilities to lobby are significantly different across groups. Potential beneficiaries can often use the advantage of small group size and large potential windfalls to wield disproportionate influence on decision-makers. Potential losers, whose numbers are large and expected costs per person are quite small and have no ability to lobby the

government effectively. Thus, in a democratic society in which lobbying can influence decisions, decisions are likely to be biased in favor of those policies which generate concentrated benefits and dispersed losses (Suranovic, 1997).

As Medalla and Aldaba (2003) pointed out, because of such activities, tariff distortions that are supposed to be corrected by trade reforms continue to persist. They cited the petrochemicals sector receives a tariff of 15% while finished goods only receive between 5-10 percent tariff protections. Meanwhile, in the cement sector, firms that operated like a cartel are able to receive additional protection against competing imports. Given these conditions, it therefore becomes very difficult to sustain trade reforms. Given the country's weak institutional and regulatory framework, the government tends to be inconsistent and policy reversals become apparent.

Given the above circumstances, the major objectives in implementing such policy reforms will be impossible to achieve. The negative effects will outweigh the positive ones. Oftentimes it will attract rent-seeking behavior and dampens firms' incentives to become efficient. The credibility of the government instituting trade reforms will also be questioned.

Rodrick (1989) stressed the need for the government to establish and bolster its credibility. Providing protection to some industries amidst the restructuring process will send negative signal to the industries and to the investors as well. Performance of the firms can also be affected as they will not adjust since they are expecting future protection. As such, the gains obtain from the previous reforms will be of no use.

He added that reversing tariff reform at this time when firms have already started to respond to reforms will create a lot of uncertainty and instability that can easily swamp the gains earned from previous reforms. Thus, it can do more harm than good. Particularly damaging would be the high inflation and low growth. Increasing tariff rates will lead to a large degree of variability in relative prices that goes hand in hand with inflation. With low growth, the firms' ability to adjust to changes in relative prices diminishes. Finally, a policy reversal could induce the government's credibility that will make investors and lending institutions doubt government's commitment to render well-meaning reforms.

V. THE "SUPPLY SIDE" OF TRADE POLICY

A. Institutional Framework

The Philippines become an independent Republic in 1946. The Constitution was modeled after that of the U.S. with a bicameral legislature and a President who was elected for a four year term and can only be re-elected once. This Constitution was changed when President Marcos imposed Martial Law in 1972 and adopted a new Constitution. A national referendum provided for a unicameral parliamentary system of government.

After the Aquino administration came into power by means of Edsa Revolution, a new Constitution was adopted in February 1987. There are three branches of the government: the legislative, executive, and judiciary. The legislative consists of a bicameral Congress composed of Senate and House of Representatives directly elected by the people.

The President implements the laws passed by Congress and has the authority regarding general policy issues through a system of executive orders, administrative orders and proclamations among others.

Public policy making is often long and tedious process. It is often influenced by the interplay of various factors from the personal to the social and the political. The passage of a bill into law is usually influenced by the interest group, the endorsement of the President, the interpersonal relations between the sponsor of the bill and the head of the committee of the bicameral Congress, and the legislative priorities of the chairman of the committee in the House of the representatives or Senate. The Philippine electoral system gives politicians strong incentives to build personal reputations and image that pursue candidate-centered strategies.

The prevailing policy environment in the Philippines leaves much to be desired. Policy making in this country has been described as “satisficing” rather than rational in its approach. Consequently, policymakers are willing to settle for what is “good enough” rather than what is best (Gonzalez, 1998).

1. The Structure of Trade Policy Formulation

The President has the responsibility for policy formulation, implementation and administrative functions. The Executive and Legislative both play important roles in policy-making.

The Philippine Tariff Commission is administratively attached to National Economic Development Authority and the President. This provides the analysis and advice on general tariff issues.

The NEDA is the agency responsible for formulating social and economic plans and programmes. The Department of Trade and Industry (DTI) is the main agency responsible for domestic and international trade and investment, industrial policies and consumer protection. The agency's main responsibilities with respect to foreign trade include: tariffs, non-tariff measures, export and investment promotion, standards, intellectual property and industrial planning.

1.2 The Decision-making Process on Tariffs

According to the Tariff and Customs Code of the Philippines, the President has the power to increase, remove or reduce the existing rates of import duty and any other change in classification. If there are petitions, the private sector or interest group can file tariff modification within the Tariff Commission. The Commission then conducts public hearings wherein interested parties can present their evidence and grievances. Findings and recommendations will be submitted to NEDA. The NEDA will then convene the matter to the Technical Committee on Tariff and Related Matters (TRM) to deliberate on the findings and recommendations. Then, it will be forwarded to the Tariff and Related Matters Cabinet Committee for approval. The approved recommendation will then be submitted to the NEDA board. The NEDA Board which is chaired by the President will approve the confirmation. Lastly, an Executive Order will be created for implementation.

According to a study by Dela Pena, Blaha and Avila (2005), the consultation process in the case of trade negotiations need some improvements since the present system is not institutionalized. In the past, the consultations have been conducted on an ad hoc basis. It just focused on briefing the stakeholders on the recent developments about multilateral trade negotiations. Usually, they have uneven awareness about the trade

negotiating process. They concluded that the quality of trade policy formulation process can be enhanced with broader and deeper trade-related policy consultations if this will be institutionalized.

Commitment's to the International Organization

The recent trade environment is heavily influenced by the Philippines commitments in different regional trading arrangements and major international policy developments. The country's commitment to international organization served as reinforcing factors for restructuring the trade policies. The country being the recipient of nine structural adjustment loans from the World Bank has no other choice but to impose trade liberalization in 1980. The Philippines participation in ASEAN Free Trade Area (AFTA) justified the adjustment in tariffs. The need to undergo several Tariff Reform Programs was also due to its commitment as signatory to the World Trade Organization (WTO). Being a member of Asia-Pacific Economic Cooperation (APEC), the country supported the Bagor Declaration of attaining free trade in the region by 2020.

The Philippines accession to the WTO on 1 January 1995 urged the government to pursue further trade liberalization and become integrated with different multilateral trading system.

The country's commitments in the WTO include:

a. Market access = full implementation of commitments in areas such as agriculture, industrial tariffs, textiles and clothing as well as services

b. Rules and Disciplines = include measures such as anti-dumping and countervailing duties, subsidies, safeguards measures customs valuation, intellectual property rights; and
c. Institutional topics = timely implementation of decisions and recommendations under dispute settlement mechanism and strengthening multilateral trading system.

B. The Political Elite and "Rent-seeking" Activities

During the inauguration of President Fidel V. Ramos in 1992, he stated an economic agenda that *"rewards people who do not produce at the expense of those who do and enables persons with political influence to extract wealth without effort from the economy. The political dominance of oligarchic groups is the reason why the Philippines has lagged so far behind the East Asian Tiger"*.

As Hutchroft (1996) commented, the Philippine political economy has long favored the interests of major families at the expense of national developmental objectives. Although the roots of their socioeconomic power can be traced to the development of landed elites in the nineteenth century, it was in the American colonial period that major families emerged as a national oligarchy, able to dominate the country's political and administrative apparatus and shape it to their own ends. Even as new entrants have continually expanded the ranks of oligarchy, and familial economic interests have diversified considerably throughout the postwar years, the business success and failure of family conglomerates has depended to a large extent on gaining favorable access to political power. When dominated by the elite, mainstream politics becomes a particularistic scramble for the spoils in which ideological differences and coherent interest-based political groupings rarely play a major role.

He also added that in the Philippines, the lines of formal authority are weaker and the disjuncture between authority and power is so pronounced. Corruption prevailed given the loosely structure and system. Oftentimes, in a disorganized bureaucracy such as this, the official chain of command is unclear and constantly shifting and the decision-making criteria are so arbitrary and unknown.

Domestic firms have grown accustomed to government-sanctioned monopolies and cartels together with price controls and government protection. In general, anticompetitive business practices have been accepted as part of the normal course of doing business in the country. Rather than compete with imports and focus on efficiency improvements, firms have tended to hide from the challenges of market competition by engaging in collusive acts and intensive lobbying for more government protection (Aldaba, 2005).

As Walden Bello[4] pointed out, running for office at any level of government is prohibitively expensive, so that only the wealthy or those backed by wealth can usually stand for elections. Thus, the masses do choose their representatives but from a limited pool of people of means that may belong to different factions-those "in" and those "out" of power- but are not different in terms of their political programs. The beauty of the system in the eyes of the elite is that by periodically engaging the people in an exercise to choose among different members of the elite, elections make voters active participants in legitimizing the social and economic status quo. Thus, has emerged the great Philippine paradox: an extremely lively play of electoral politics unfolding above class structure that is one of the most immobile in Asia.

[4] Professor of Sociology at the University of the Philippines, Diliman and Executive Director of focus on the Global South, Bangkok. This is part of the speech he delivered at the World Meeting of Democracy Promoting Foundations, Swedish Parliament, 28-30 August 2005.

Consequently, sustaining economic reforms becomes a difficult process which usually depends on political process reform. A full decade after the restoration of elite democracy, the Philippine party structure continues to be even more weak and volatile than it was in the pre-martial law era. In the absence of effective political parties organized around some basic programme agenda, the passage of legislation requires enormous expenditure of effort and resources on individual legislators. The overall cost – both in terms of public funds squandered and cabinets comprised by corrupt or inept politicians – often becomes apparent long after the short-term victory has been won. [5]

Such activities become apparent during the 1970s and 1980s. After the Marcos administration declared Martial Law in 1972, "crony capitalism"[6] emerged. Elite businessmen and politicians closed to the President were given the monopoly positions in the economy. They became the owners of big enterprise.

On the other hand, after the Aquino administration took the office, the Cabinet became homogenous with the strong influence of the powerful business community. Most of the government officials who assumed the post of the Central Bank and Department of Trade and Industry were the owners of big businesses.

As Kang (2002) commented, as the Philippine government always remained subject to manipulation, with trade policies on import-substitution, financial policies never consistently implemented and regulatory policies often a contradictory mix of special dispensations to favored cronies.

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[5] Joel Rocamora, "The Political Requirements of Economic Reform," Issues and Letters, Vol.4 (October 1995).

[6] Term used to describe a capitalist economy in which success in business depends on an extremely close relationship between the businessman and the state institutions of politics and government.

One study of the first Congress elected under the 1987 Constitution showed that only 31 out of 200 members of the House of Representatives were not previously elected officials or directly related to the leader of a traditional political clan. Business interests directly influenced the President to overrule already established policies, as in the 1990 program to simplify the tariff structure. Business and politics have always been deeply interwoven in the Philippines; crony capitalism was not a deviant model, but rather the logical extreme of a traditional pattern (Bresnan, 1986.)

As *The Economist* (1 July 2004), put it bluntly, congressmen spend their time in office consolidating these political dynasties by doling out jobs, favors and pork-barrel funds to their constituents. So they naturally gravitate to the camp of the leader who can provide the most largesse, often abandoning their party in the process. Presidents without a majority in the House of Representatives can be build one overnight, provided they are willing to pay for it with hefty dollops of public money. Some families even keep members in all the major parties to maximize their leverage.

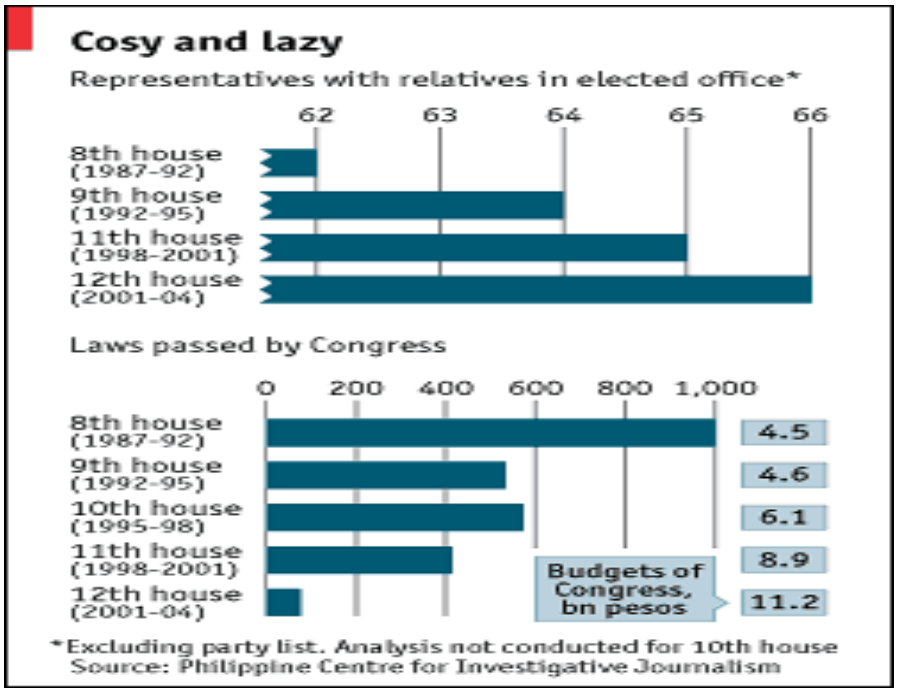
According to the recent study from the Philippine Centre for Investigative Journalism[7] (PCIJ), over 60% of representatives in the outgoing Congress had relatives in elective office and said to have rising slowly since 1986 as shown in Figure 7.

De Dios (1997) revealed that the involvement of landed families and their diversification into import substituting industrialization in the past, combined with the dominant position in local and national politics, has explained the lasting influence of protectionism in the Philippines. The emergence of small protected markets and availability of monopoly privileges resulted in “rent seeking” activities. The

[7] Shiela Coronel, et al. “The Rulemakers: How the Wealthy and Well-Born Dominate Congress.” *Philippine Centre for Investigative Journalism*, Manila 2004.

bureaucracy has a weak institution relative to the influence of dominant industrial and commercial interests.

Figure 7. Representatives with Relatives in Elected Office



Source: Philippine Centre for Investigative Journalism, 2004

Rent seeking, as defined by James Buchanan, is that part of the payment to an owner of resources over and above that which these resources could command in any alternative use.[8] Thus, rents are created when an actor manipulates prices and causes them to diverge from competitive levels, and the existence of rents can lead to corruption by various actors attempting to gain access to the rents. By manipulating prices, the actor himself, or some other actor on whose behalf the price manipulator is acting as an agent, is able to reap "excess profits". [9]

[8] James Buchanan, "Rent Seeking and Profit Seeking" , *Towards a Theory of Rent Seeking Society* (College Station: Texas, A & M University Press, 1980).
[9] Pranab Bardhan, "Corruption and Development: A Review of Issues", *Journal of Economic*

Rent-seeking is thus an integral component of the public choice model. When government, for instance, creates monopoly rent out of a competitive industry, this automatically transfers consumer surplus to the producers and a deadweight loss to the consumers. If we assume that this is not a mere transfer as it is often the case, interested groups must compete for this surplus. It is not surprising therefore that huge sums of money are spent in the form of legal services, advertising, the services of ex-politicians, among others, in lobbying governments and their agents for the monopoly rents. Such expenditures represent an additional social cost to monopoly (Rowley *et al*, 1986).

As always, the Philippine politics and governance serves as a hindrance to institute reforms. Policy formulation becomes a need to the vested interests of the politicians. Their greed on power and wealth often becomes a stumbling block to institute reforms.

VI. Policy Implications on the Trading System

The Philippine government adopted a highly trade restrictive and protectionist policy during the post -war period up to the 1970's. This system supported the inward-looking import substitution strategy at that time.

Several analysis and studies have been conducted on the effects of trade liberalization on the industries, especially lowering the tariff. According to Tan (1979), using the Input-Output table[10], the tariff system undertaken in 1973 did make any difference in the structure of effective protection. There was only small decrease in the average EPR for the manufacturing sector from 51% to 44%. This resulted in bias in favor of consumption goods over intermediate and capital goods. Bautista and Power (1979)

Literature 35 (1997).

[10] Input-output table is used in economic forecasting to predict flows between different sectors.

added that the 1974 EPR structure showcased a bias in favor of the manufacturing sector.

Erlinda Medalla (1998) characterized the past- protected protectionist as having all the negative effects. She commented that the said trade policy resulted in three major biases: (a) high tariffs and tariff escalation resulted in an import-substituting policy. Adopting low tariffs on imported inputs made them artificially cheaper, thus, hurting downstream industries and encouraging the use of imported inputs; (b) highly protectionist trade policy penalized the exports since the protectionist trade regime lowered the exchange rate; and (c) the protection structure resulted in artificially cheapened capital which encouraged greater capital intensity.

Furthermore, a study by Tan (1994) on the tariff reforms in the 1990s revealed that the policy reforms that came after EO 470 actually reversed the gains achieved by EO 470. The EO did not achieved the desired results because of the following reasons: they lowered the level of protection and its dispersal among sectors but did not change the structure of protection since the bias against exports continued on as shown by their EPRs; they did not significantly achieve a more neutral and even form of protection as shown by an inverted normal distribution of EPRs in the economy. She pointed out that one important tool in trade reform is an adjustment in the real exchange rate. Trade policy reform without reform in the exchange rate and inflation policy may not be able to obtain the gains and may even worsen the trade reform.

Restructuring the trade policies resulted changes in the country's output structure and export orientation. For instance, there has been a shift from consumer goods to intermediate goods. In addition, sustaining trade reforms becomes a difficult process.

For firms to reduce protection, they have to reduce costs either by moving labor and capital which often resulted in unemployment and bankruptcy.

On the contrary, powerful domestic producers engage in cartel and lobbying activities pressuring government to reverse trade policies. Some firms are unable to adapt to the new market environment and cannot compete entirely with foreign competitors.

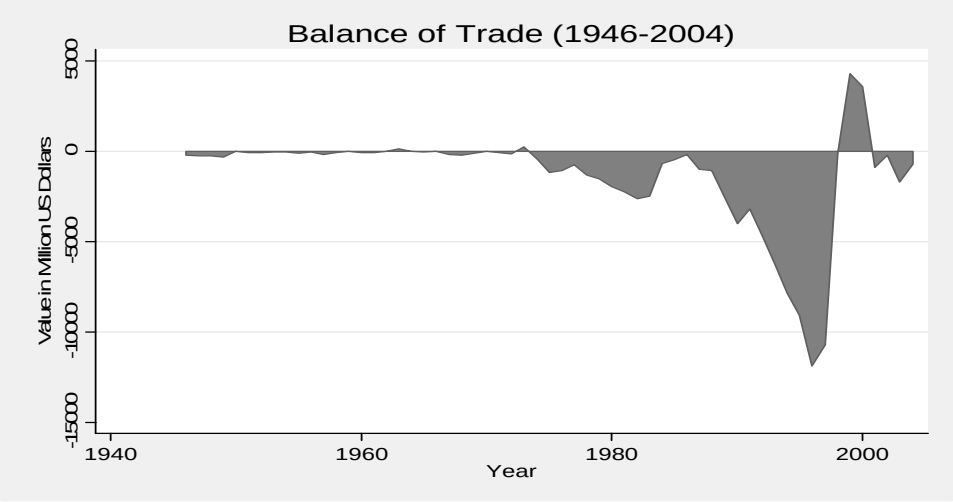
Sustaining trade reforms becomes inevitable in a government that has weak institutional framework. This often resulted in policy reversal or what Medalla and Aldaba (2003) called *backsliding*. The recent research conducted by Aldaba (2005) on various tariff legislations passed from 1998 to 2003 on the structure of protection revealed that while the overall level of effective protection has declined, it has remained uneven since some selected sectors have continuously received high effective rates of protection. Consequently, the economic distortions led to the inefficient use of resources. Usually, the favored sectors are intermediate goods like float glass, sugar, petrochemicals, and steel which are use as inputs to a lot of products. The large disparities of tariffs on the inputs to the outputs cause higher cost of production. This provided incentives for lobbying thus instituting trade reforms becomes difficult to sustain.

De Dios (1997) commented that trade reforms in the Philippines have suffered from a weak internal constituency since the gains to be reaped by industries, firms, and workers appear amorphous and far in the future. Most proponents in the past came from multilateral agencies, the technocracy and to the limited extent academe which did not greatly help the advocacy in a country that viewed external influence with suspicion and concrete interests as weightier than theoretical arguments.

Despite the trade liberalization and restructuring attempts by the government, it was only during 1966, 1973, 1999 and 2000 that exports exceeded the imports. Those years, as illustrated in Figure 8, show positive balance of trade. The rests of the years demonstrated negative balance of trade in favor of imports.

This shows that implementing various kinds of EOs and tariff reform programs by the government, still, the effects to exports cannot be seen. Some economist still believes that the government is not implementing liberalization in its truest sense. The agriculture and the manufacturing sector for example are enjoying higher rates of tariff up to now.

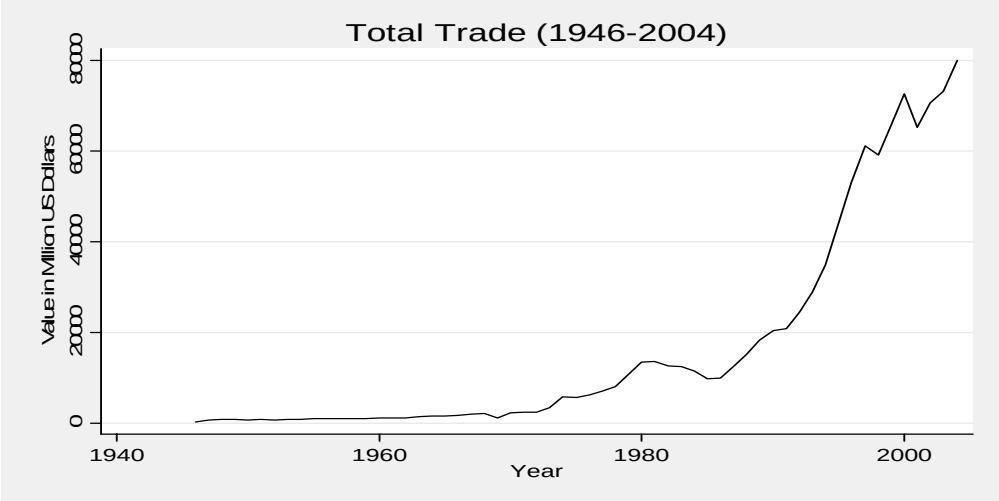
Figure 8. Balance of Trade (1946-2004)



Source: National Statistics Office

As can be seen in Figure 9, the total trade has been on an upswing since 1946. Several economic and political circumstances affected the country s' total trade.

Figure 9. Total Trade (1946-2004)



Source: National Statistics Office

VII. Conclusion

Political economy models task is to reveal other reasons for the policy choices made by the government. In a democratic society like the Philippines, the government officials are entrusted with the mandate to take the interest of their constituents. Elections allow the citizens to vote for the candidates they believe will work on their interests. Thus, candidates usually consider what will gonna give them position in the government.

The different trade reforms that the Philippines undergone was greatly influence by various factors: commitment to numerous international organizations, especially the World Bank and IMF; the powerful business sector which the political elite want to satisfy; and the influential lobby groups which are usually the owners of the industries protected.

So what has the last 58 years of trade policy regimes in the Philippines taught us? Given the political economy factors that determine the trade policy formulation, the lobbying activities by the influence groups created policy reversal which negatively affects the credibility of the government internationally. The selective protection to "satisfy" the politician's vested interest resulted to rent-seeking activities and distortions in the industries.

Instituting trade reforms becomes a difficult task in the light of having a weak institution. The weakness of the state coupled with rent-seeking capitalists exacerbates the problem. As Hutchcroft (1996) commented in his study of *Sustaining Economic and Political Reforms: The Challenges Ahead* in the Philippines, building and reinforcing the institutional and political foundations needed to sustain reform is a difficult and protracted process. Success can only be attained with a combination of effective leadership from the top and the emergence of new forces from below that able to challenge the long-standing oligarchic dominance of the economy. Thus, no matter how sound the policy agenda promulgated at the national level, there is little hope of coherently sustaining it in the absence of strong political and institutional foundations. Thus, strong political will is needed in the government to combat this influences.

The government should support the industries in order to be competitive globally. Instead of giving high protection to selective industries, the policymakers should change the policy that weakens their competitiveness. The government should choose the major industries and give utmost support for it to become competitive globally.

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APPENDIX

Trade Statistics (1946-2004)

Trade Statistics (1946-2004)				
Year	Exports	Imports	Total Trade	Balance of Trade
1946	64.19	295.86	360.05	-231.67
1947	165.55	511.35	676.9	-245.8
1948	319.21	568.2	887.41	-248.99
1949	255.85	568.69	824.54	-312.84
1950	332.7	356.18	688.88	-23.48
1951	415.74	479.52	895.26	-63.78
1952	352.41	426.11	778.52	-73.7
1953	400.61	447.34	847.95	-46.73
1954	412.09	451.64	863.73	-39.55
1955	419.26	536.34	955.6	-117.08
1956	472.68	509.61	982.29	-36.93
1957	430.66	621.39	1052.05	-190.73
1958	459.81	553.28	1013.09	-93.47
1959	505.54	520.96	1026.5	-15.42
1960	535.44	624.52	1159.96	-89.08
1961	540.75	622.17	1162.92	-81.42
1962	580.28	590.23	1170.51	-9.95
1963	770.57	645.36	1415.93	125.21
1964	779.38	802.04	1581.42	-22.66
1965	795.74	835.25	1630.99	-39.51
1966	877.41	873.61	1751.02	3.8
1967	891.5	1060.95	1952.45	-169.45
1968	962.11	1195.14	2157.25	-233.03
1969	983.17	181.78	1164.95	-98.61
1970	1142.19	1159.3	2301.49	-17.11
1971	1189.25	1260.83	2450.08	-71.58
1972	1168.43	1333.6	2502.03	-165.17
1973	1837.19	1596.62	3433.81	240.57
1974	2724.99	3143.26	5868.25	-418.27

1975	2294.47	3459.18	5753.65	-1164.71
1976	2573.68	3633.48	6207.16	-1,059.80
1977	3150.89	3914.76	7065.65	-763.87
1978	3424.87	4732.2	8157.07	-1307.33
1979	4601.19	6141.73	10742.92	-1540.54
1980	5787.79	7726.91	13514.7	-1939.12
1981	5720.4	7945.68	13666.08	-2225.28
1982	5020.59	7666.92	12687.51	-2646.33
1983	5005.29	7486.63	12491.92	-2481.34
1984	5390.65	6069.61	11460.26	-678.96
1985	4628.95	5110.67	9739.62	-481.72
1986	4841.78	5043.6	9885.38	-201.82
1987	5720.24	6736.97	12457.21	-1016.73
1988	7074.19	8159.38	15233.57	-1085.19
1989	7820.71	10418.82	18239.53	-2598.11
1990	8186.03	12206.16	20392.19	-4,020.13
1991	8839.51	12051.36	20890.87	-3,211.85
1992	9824.31	14518.93	24343.24	-4694.62
1993	11374.8	17597.4	28972.2	-6222.6
1994	13482.9	21332.57	34815.47	-7849.67
1995	17447.19	26537.63	43984.82	-9090.44
1996	20542.55	32426.93	52969.48	-11,884.38
1997	25227.7	35933.82	61161.52	-10,706.12
1998	29496.75	29659.89	59156.64	-163.14
1999	35036.89	30741.46	65778.35	4294.43
2000	38078	34491	72569	3587
2001	32150	33057	65207	-907
2002	35208.16	35426.51	70634.67	-218.35
2003	35750.13	37447.83	73197.96	-1697.7
2004	39598	40300	79898	-702