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I

AT the end of World War II, the Philippines was confronted by severe and interrelated economic problems. First, the destruction and dislocation of war left the productive organization prostrate and there was the basic problem of rehabilitating the productive apparatus of the economy. Second, the Philippines during the war had been denied access to customary import supplies and there was a pent-up demand for all kinds of consumer goods.[1] Third, while the Japanese occupation currency was repudiated, the extraordinary requirements of military expenditures and the slow recovery of domestic production resulted in the establishment of levels of peso prices and costs four to six times higher than pre-war. This was probably two to three times higher than the relative inflation in United States prices and costs, which had increased less than two times pre-war levels.

[1] This problem was complicated by the introduction of new consumer goods into the Philippine level of living by the contacts between Filipinos and the American liberation forces. Philippine demand for consumer goods was intensified and was manifested in the inclusion of American cigarettes, Parker "51" pens, wrist watches, etc., in the economic aspirations of the average Filipino. This, of course, is not to be criticized, but is pointed out here to explain, in part, the postwar pressure on the Philippine balance of payments.

These economic developments produced a remarkable expansion in Philippine imports and other foreign exchange payments, while foreign exchange earnings expanded slowly with the recovery of export production. The traditional pre-war export surplus was reversed and an unprecedented import surplus characterized Philippine trade in the early postwar years. The surplus in import and other foreign exchange payments was made possible by large amounts of United States expenditures in the Philippines.[2]

By the end of 1949, Philippine foreign exchange reserves were declining at a rapid rate, and it became apparent that there would have to be a drastic change in policy if a "tolerable" equilibrium was to be maintained in Philippine foreign payments.[3]

The situation was remedied by the imposition of import and exchange controls in December 1949, and the steady intensification of these controls until the threat to Philippine solvency in international payments was reduced. Import controls were applied with sufficient intensity to reduce the volume of imports in 1950 to 61 per cent of 1948-49 levels, while total Philippine foreign payments in 1950 amounted to 62 per cent of 1949.

Manipulation of the intensity of exchange and import controls has enabled the Philippines to maintain a "tolerable" equilibrium in which the "official" (two pesos per dollar) exchange rate is observed for the bulk of foreign exchange transactions channelled through the exchange control system. While the foreign exchange reserve position has fluctuated consider-

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[2] Between 1945 and 1949, United States government disbursements totalled $1.4 billion. This amount is roughly equal to the Philippine import surplus of $1,391 million for the same period. *Report to the President of the United States* by the Economic Survey (Bell) Mission to the Philippines, (Washington, 9 October 1950), pp. 35-36.

[3] The existing equilibrium was becoming "intolerable" inasmuch as Philippine foreign exchange reserves were draining away. If this "equilibrium" had persisted, the Philippines would have been forced to default on its international obligations.

ably,[4] foreign exchange reserves as of July 1956 were approximately the same as in December 1949, when controls were inaugurated.

While the Philippines has maintained a "tolerable" balance of payments equilibrium, there is considerable restiveness with the system of import and exchange controls and with the "official" exchange rate which is being maintained by the control system. During the last half of 1955, the Philippines witnessed a virulent controversy over economic policy, which was precipitated by dissatisfaction with the system of exchange and import controls and the emerging Philippine alternative to peso devaluation.

The present "official" (two pesos per dollar) exchange rate results in a peso which is overvalued in comparison with the currencies of countries which account for the bulk of Philippine international transactions.[5] To the extent that the peso is overvalued, a number of economic problems arise. It is convenient, for purposes of this paper, to consider three basic problems arising out of the present "official" exchange rate in order to analyze the emerging Philippine alternative to peso devaluation.

First, an overvalued currency tends to stimulate imports and other foreign payments. To the extent that the purchasing power of the peso to make payments abroad is relatively greater than the purchasing power of the peso in the Philippines, Filipinos will be motivated to spend pesos for imports, foreign travel, education, and other services. Second, an overvalued currency tends to depress exports and other foreign exchange receipts. The relative costs of production of Philippine exports depend, of course, on the peso exchange rate. If

[4] For example, the outbreak of hostilities in Korea and the subsequent stimulus to international demand and prices of raw materials coincided with a period of stringency in the control system and Philippine foreign exchange reserves increased by $133 million between April 1950 and April 1951.

[5] To the extent that the peso is fully convertible into other currencies, it is a "sound" currency.

the peso is relatively overvalued, the exporter who receives two pesos per dollar for his export proceeds, is placed at a competitive disadvantage. The two pesos which the Philippine producer/exporter receives for a dollar of export proceeds, and which he uses to pay his peso costs, have relatively less purchasing power than a dollar of export proceeds received by a competing producer in a country whose exchange rate does not overvalue the currency. Finally, an overvalued currency, other things being equal, tends to depress investment. Investment in export production is adversely affected by the poor profit prospects arising out of the overvalued currency. Investment in production for domestic consumption is adversely affected, since—given the structure of tariff rates—an overvalued currency reduces the level of protection which otherwise would be established for domestic producers.

The purpose of this paper is to summarize the policies which are being implemented by the Philippines to solve these problems. It is convenient to consider these problems in succession.

II

Philippine foreign payments have been in approximate balance since 1949. The tendency for Philippine foreign payments to exceed foreign exchange earnings, which was evident during 1945-49, has been brought under control by various policy measures. Equilibrium has resulted primarily from exchange and import control which have been utilized to ration the available foreign exchange among competing uses. The basis for rationing has been a more-or-less arbitrary scale of essentiality—in which basic foodstuffs, capital goods, and industrial raw materials have been given priority. Beyond the establishment of a scale of priorities, the exchange control authority (Central Bank) has not discriminated among alternative uses of foreign exchange and has sold the foreign exchange at a uniform rate.[6]

[6] There have been some significant exceptions to this generalization. For example, payments for imports of a limited number of commodities were not subject to the Special Tax on Sales of Foreign Exchange.

To the extent that foreign exchange was freely available for a particular commodity or service, the control system would not affect the price of the commodity or service. However, for the bulk of commodities and services, the control system allocated smaller amounts of foreign exchange than would otherwise be used to import the commodities or services. As a consequence, there remained the problem of allocating the reduced amounts of import commodities and services among potential Philippine consumers. This was done by means of the price system—i.e., importers sold the reduced quantities of goods and services at prices the market would bear.

Following the imposition of import and exchange controls, there was a sharp and persistent divergence between the peso prices of imports and other peso prices.[7] This divergence between the peso prices of imports and prices of other commodities is unrelated to any changes in the foreign currency prices of imports, and is only explained by the rationing of the reduced quantities of imports by the price system. The increases in prices of imported goods which resulted from the restriction in import quantities were, in effect, monopoly windfalls, the size of which depended upon the intensity of import restrictions. This windfall was the motivation for the graft, corruption, and anomalies which characterized the implementation of controls and was shared among the participants in import activities, i.e., bona fide importers, "dummies," and corrupt government officials.[8]

While import and exchange controls produced a "tolerable" equilibrium in Philippine foreign payments, economic policies have increasingly recognized the problem of diverting the monopoly windfall arising out of import restriction to the government, where it can be used in the interests of all Filipinos.

[7] Central Bank of the Philippines, *Fourth Annual Report,* 1952, Table I, p. 175.

[8] Normally the windfall arising out of import restrictions is diverted to the government by tariff duties. In the Philippine case, the so-called "Free-Trade" provision of the 1956 Philippine-United States Trade Agreement was the principal obstacle to implementation of policies which would have accomplished this objective.

For example, the Special Tax on Sales of Foreign Exchange (Republic Act 341 of 28 March 1951) diverted a substantial amount of the windfall to the government. Similarly, the acceleration in the rate at which Philippine tariff duties will be collected on imports from the United States, which was negotiated in the Laurel-Langley Agreement, will shift more of the windfall arising out of import restriction to the government. Finally, the increases in Philippine tariff rates promulgated in Executive Order No. 150 of 31 December 1955 represent further progress in this direction.[9]

The Philippines has achieved a satisfactory solution to the problem of excessive foreign exchange payments arising out of the "official" peso exchange rate. A substantial part of the protection arising out of the restriction in import quantities and the subsequent increases in the peso prices of imports has been shifted to protection implemented by tariffs which had the important value of diverting the monopoly windfall arising out of import restriction to the Government. To the extent that import restriction and protection is implemented by tariffs rather than exchange and import controls, the intensity of controls will (by definition) be relaxed.

To the extent that the control system remains necessary to limit foreign payments to the available exchange, the need for more tariff protection and/or adjustment in the peso exchange rate remains. There is considerable evidence that controls are still necessary to maintain a "tolerable" equilibrium in Philippine foreign payments. More important, Filipinos have aspirations for rewarding economic growth and expanded real incomes, and positive steps are being taken to realize these objectives. Some part of any increase in real and/or money

[9] There has been considerable discussion of the capacity of importer retailers to "pass on" the higher tariff rates to consumers in higher prices. Other things being equal, if peso prices of imports are increased, smaller quantities can be marketed. To the extent that this occurs, additional foreign exchange will be available for allocation to potential importers. The existence of potential competing importers will therefore tend to limit "passing on" to ultimate consumers higher tariff rates, and will ensure that the windfall arising out of import restrictions is diverted to the government.

income will represent demand for imports of goods and services. Therefore, a combination of policies (tariffs and some intensity of import controls) which produces a satisfactory equilibrium currently will tend to become inadequate as real incomes expand. Therefore, Philippine economic policy should be concerned with the problem of expanding foreign exchange earnings.

III

While the problem of limiting imports has been successfully solved by Philippine policy makers, the remaining problems have been handled with less success. To stimulate export production, a number of lines of policy have been experimented with. For example, increasing amounts of government investment have been made in agricultural experimentation and research to increase the productive efficiency of export industries, e.g., abaca, coconuts, cacao, etc.[10]

Second, there has been limited activity with marketing schemes, both internal export promotion agencies, e.g., PHILCOA, NAFFCO, and international marketing schemes such as the International Sugar Agreement. It is probably safe to say that such activities have not removed (and probably cannot remove) the competitive disadvantage to Philippine exports arising out of the existing official exchange rate.

Another line of policy has been direct subsidization of export production. However, currently, direct export subsidization is limited to gold production where the government pays approximately ₱105 per ounce for gold or, at the official peso exchange rate, about fifty per cent above the world price. There is little evidence that such a policy is being considered for other export industries.

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[10] The process of reducing costs of production in this way is frequently referred to as "rationalization." If Philippine export industries are competitively handicapped by the present exchange rate, one remedy will be to increase productivity and thereby reduce peso costs of production.

A related policy which has been employed to a limited degree is one of indirectly subsidizing export production by permitting the producer/exporter to retain a part of his foreign exchange earnings. Under this type of scheme the exporter is able to sell his foreign currency proceeds in the black market or import commodities for sale at the relatively high prices resulting from import controls and the restriction of import quantities. The producer/exporter is thereby able to realize a more favorable exchange rate than the official rate.[11]

The principle of export proceeds retention was applied in early postwar gold regulation under which producers/exporters were permitted to market the bulk of their gold output in premium markets.[12] More recently, this policy was given legislative approval in the so-called "No-Dollar" Import Law (Republic Act 1410 of 10 September 1955) which permits exporters/producers to utilize foreign exchange proceeds from marginal exports, over and above exports during a historical base period (1950-1954), to import commodities into the Philippines.[13]

There was prolonged controversy over the implementation of Republic Act 1410 and the rules which ultimately were agreed upon virtually emasculated the export incentives intended in the law. Imports under the law were limited to re-

[11] The intensity of the incentive established will depend upon (a) the proportion of foreign exchange earnings at the free disposal of the exporters, and (b) the exporter's freedom to use his foreign exchange to import commodities severely restricted by controls, i.e., "unessential" commodities. It is apparent that such schemes will tend to be self-defeating since the freedom to import restricted imports will tend to eliminate the monopoly windfall arising out of import controls.

[12] For a survey of Philippine policy with respect to the gold industry, see: *American Chamber of Commerce Journal*, Vol. XXXII, No. 1, January 1956, pp. 9-10.

[13] Republic Act 1410 provided for other so-called "No-Dollar" imports including large amounts of goods brought in by returning residents and gifts received by Filipinos from abroad. These exceptions to the control system, which would be disastrous to the effective implementation of exchange and import controls, have not been fully implemented.

latively "essential" commodities, imports of which have been relatively little restricted and hence the prices of which include relatively little windfall margin.

Another type of policy which has the effect (among others) of subsidizing export production is that of manipulating internal taxation to give more favorable treatment to export industries. An example of such a policy would be the current exemption from taxation of "new and necessary" industries.[14] To the extent that new "essential" industries produce for export, an incentive to expand exports is established.

While there has been considerable Philippine experimentation with the foregoing policy alternatives, i.e., subsidization of export production both directly and indirectly, they remain quite controversial and the benefits which might be derived from these policy alternatives tend to be dissipated in the uncertainty which inevitably attends the controversy.[15]

In view of Philippine rejection of peso devaluation and the evident reluctance to resort to wholesale subsidization (direct or indirect) of export production, what alternative policies are available to expand export production and foreign exchange earnings? There is considerable evidence that the alternative envisaged is a continuation of the relatively conservative postwar monetary and fiscal policies to produce further reductions in the structure of peso costs and prices.

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[14] Republic Act 35 of 30 September 1946 exempted persons, partnerships, companies, or corporations engaging in a "new or necessary" industry from all internal revenue taxes for a period of four years. Republic Act 901 of 30 June 1953 provides that "new and necessary" industries will be exempt from all taxes until 31 December 1958 after which the tax exemption will be rapidly reduced until, beginning in 1963, these industries will no longer benefit from tax exemption.

[15] For example, the policy of tax exemption of essential industries is currently under attack on the grounds that profit rates are excessive in such industries. Of course, the profit opportunity offered by tax exemption was the incentive intended by the law. Similarly, the gold subsidy law is due to expire in the near future and debate over this policy is currently taking place.

With the exception of a brief period following the outbreak of war in Korea, Philippine costs and prices have tended to decline. The decline was quite rapid in the first four years following World War II, when productive capacity was rapidly rehabilitated and an unprecedented import surplus increased the supplies of goods and services in the economy. The outbreak of hostilities in Korea reversed this process, as prices in international trade—both Philippine imports and exports—tended to increase. Beginning in 1952, Philippine peso prices resumed their downward trend, although at a relatively slow rate.

The architects of postwar Philippine economic policy deserve great credit for their consistency in the face of strong temptations to resort to inflationary monetary and fiscal policies. The postwar decline in Philippine prices, as compared to price movements in the United States and in other countries with which the Philippines trades, has gone far toward reducing the inflated cost/price structure which has handicapped the recovery of Philippine exports. However, the remaining "deflation" will be extremely difficult. For example, whereas the cost of living in the United States is today approximately 200 per cent of prewar, for the Philippines, the comparable ratio is perhaps 400 per cent.[16] While such comparisons are admittedly crude, they are rough indicators of the magnitude of the task confronting Philippine policy makers if they hope to implement relatively conservative monetary and fiscal policies until Philippine exports are restored to something approaching their prewar competitive position.

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[16] For example, using the average of the Cost of Living Index of a Wage Earner's Family in Manila for 1937-40 as the base, this index in 1949 stood at 368. (Central Bank of the Philippines, *First Annual Report*, 1949, Table 46, pp. 285-286.) While this index was discontinued, the index of retail prices of selected commodities in Manila (1949=368) moved as follows in recent years: 1950: 369, 1951: 406, 1952: 391, 1953: 379, 1954: 361. (Central Bank of the Philippines, *Sixth Annual Report*, 1954, Table 57, pp. 290-292.) (Since Dr. Golay wrote this article the Central Bank has come out with a revised estimate of the national income for 1954.—EDITOR)

It is, of course, possible that improvement in the competitive position of Philippine exports will be facilitated by relative increases in costs and prices in countries which consume Philippine commodities or which are competing export producers, or that changes in international demand will produce relative increases in prices of Philippine exports. Any attempt to predict movements in international demand and supply conditions is hazardous and relatively unfruitful. However, there are few grounds for assuming that world prices of Philippine export commodities will tend to increase over present levels or that there will be significant inflation vis-a-vis the Philippines in countries with which the Philippines trades. Prices of Philippine export commodities have tended to decline from their levels that prevailed in the earlier postwar years.[17] While the long term prospects for prices of industrial raw materials are probably favorable, such a development cannot be counted upon to close the remaining gap between the internal purchasing power of the peso and the official exchange rate.

If "deflation" is the alternative envisaged by economic policy makers, two questions should be considered. First, is the required rationalization in peso costs and prices feasible; and, second is such a process in the interests of Filipinos as a whole?

With respect to these questions, it is probably safe to say that the required deflation in peso costs and prices will be politically unpopular and will involve costs in terms of foregone production and consumption. That is, reduction in the structure of peso costs and prices can result from credit contraction, budgetary surpluses, and other related policies which tend to reduce the flow of monetary income. Such a process inevitably will have a depressing effect on investment and employment, both through the contraction in credit and through adverse

[17] The index of Philippine export prices (1948-49=100) was 92.8 in 1950, 99.0 in 1951, 78.0 in 1952, 95.2 in 1953, and 84.5 in 1954. (Central Bank of the Philippines, *Sixth Annual Report*, 1954, Table 29, p. 225.)

profit prospects which develop as monetary contraction occurs.[18]

"Deflation" as a policy alternative contrasts sharply with the expansion in real and money incomes, output and employment envisaged in current Philippine economic planning. For example, the current (Rodriguez) Five-Year Plan provides for an expansion in Philippine gross national product from ₱7,375 million in 1954 to ₱11,877 million in 1959, an increase of 61 per cent. The Plan provides for relatively high levels of investment which will result from expanded government economic activity, high levels of profits and internal savings of business and credit expansion.

However, granting the assumption that the alternative of further "deflation" in peso prices and costs is economically and politically feasible, what will be the real costs of this alternative? To the extent that the necessary deflation in money incomes adversely affects profit prospects and investment, the process is going to have real costs in terms of foregone production, employment, and consumption or real income. That is, the process of deflation results in structural unemployment and loss of output as the economy adjusts to relative price movements which are inevitable in such a process. Moreover, the process at best will be slow and the stimulus to export production and trade will materialize slowly, if at all. Therefore, as contrasted with other policy alternatives, there will tend to

[18] While the analogy has many limitations, appraisal of Philippine exchange rate policy can usefully refer to the experience of the United Kingdom when that country attempted to restore the pre-World War I exchange rate for the pound sterling in 1924. British export industries went into a decline that persisted until the end of World War II. Moreover, the stagnation of the export industries proved to be a depressant to the entire economy, and the United Kingdom failed to share in the decade of world-wide prosperity and trade which ensued after World War I. For an extremely readable and persuasive economic appraisal of the British policy decision to restore the pre-World War I exchange value of the pound sterling, the reader is referred to J. M. Keynes, *The Economic Consequences of Mr. Churchill.* Sir Winston Churchill was Chancellor of the Exchequer at the time the decision was made.

be costs in terms of foregone export production and foreign exchange earnings for which the real cost will be the foregone imports.

There is uniformity of opinion that current levels of Philippine imports are inadequate, not only in terms of demand for consumer goods, but—more important—in terms of import requirements for accelerated economic growth. If Philippine aspirations for economic growth materialize, some part of the expansion in real (and monetary) income will represent demand for imported goods, both consumption goods and capital goods. Therefore, it behooves the economic policy makers to realistically face the problem of expanding Philippine foreign exchange earnings in order to provide for expanding import requirements.[19]

IV

As pointed out earlier, an overvalued currency tends to discourage investment, both potential domestic investment and investment by foreigners. An overvalued currency directly reduces the profitableness of export production and thereby discourages investment in such production. On the import side, other things being equal, the level of protection established by a given structure of tariffs and/or quotas will be determined by the exchange rate of the currency. For example, if the peso exchange rate should be changed to four pesos per dollar. the peso costs of imported goods would be higher and the peso prices of imports would tend to be higher. Therefore, domestic production which might not be profitable at the existing official two-pesos-per-dollar exchange rate because of the competition of imported goods, would tend to become more profitable (less unprofitable). Moreover, the bulk of Philip-

[19] It is true, of course, that accelerated economic growth can be accomplished without an expansion in external trades; the U.S.S.R. is the most prominent example. Similarly, there is considerable evidence that India and China may also achieve accelerated economic growth without an expansion in foreign trade. However, it is doubtful if Philippine economic policy makers contemplate such a process for their country.

pine tariff duties are ad valorem duties which vary directly with the peso cost of imports. Therefore, if the peso were over-valued, it would mean that the valuation of imports for purposes of assessing tariff duties would be relatively low and the protection arising from a given structure of tariff rates would be lower than it otherwise would be.

The system of import and exchange controls which has maintained a "tolerable" equilibrium consistent with the "official" peso exchange rate has had important consequences for foreign investment. It is generally recognized that a principal obstacle to high levels of foreign investment arises out of the uncertainty inherent in controls.[20]

The Philippines has implemented a number of positive investment policies with considerable success. To begin with, stringent import controls have resulted in a relatively high level of protection which has induced substantial amounts of investment, both domestic and foreign, in production of import-competing goods for Philippine consumption. This development was reported as early as 1952 by Governor Cuaderno of the Central Bank.[21] A visitor to the Philippines is impressed by the burgeoning industrial suburbs of Manila with branches of foreign firms in juxtaposition with indigenous Philippine firms. These firms, producing for the domestic market, are attributable to the protection arising out of import quotas.

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[20] For example, the Report of the Presidential Mission on Foreign Investments (Malacañan press release, 26 February 1955) tabulated the most frequently cited requirements for foreign investment in the Philippines. Such requirements (in order of frequency) included: (1) freedom to remit capital; (2) freedom to remit dividends; (3) freedom to remit savings of foreign businessmen upon their permanent return to their country of nationality; (4) assurance of adequate raw material supply through sufficient exchange allocations. Similarly, the U.S. Department of Commerce study, *Investment in the Philippines*, (Washington, D.C., February 1955, p. 5) pointed out the significance of exchange and import controls as an unfavorable aspect of the Philippine foreign investment climate.

[21] Cuaderno, M. "The Bell Trade Act and the Philippine Economy," *Pacific Affairs*, December 1952, pp. 324-325.

Protection arising out of exchange and import controls is probably less effective in inducing investment than an equivalent level of protection implemented by protective tariffs. This arises out of the temporary nature of controls and an inevitable arbitrariness in their implementation.[22] However, the Philippines is now in a position to make a rapid transition to a system of protection implemented by tariffs.[23]

With respect to foreign investment, there will remain the important obstacle of controls over non-trade payments, including remission of profits and disinvestment. Central Bank policies with respect to the problem have been farsighted and this, combined with tax concessions to "new and necessary" industries, has contributed materially to the present levels of investment, both domestic and foreign. However, no one can be complacent about current levels of investment, and it is probably realistic to conclude that there remains a fundamental divergence between the interests of investors and the maintenance of the present "official" peso exchange rate.

One further comment is in order at this point. To the extent that the peso is overvalued by the official exchange rate, the peso cost of imported capital goods will be relatively low and more investment will be made in imported capital goods than otherwise would result. This consideration should not be exaggerated. For example, an overvalued exchange rate increases the real cost of Philippine resources required for

[22] Philippine exchange controls were initially justified as a temporary expedient. This was also evident in the successive short term legislative authorization of the control system.

[23] The Revised Philippine-United States Trade Agreement sharply accelerated the collection of Philippine duties on imports from the United States. Moreover, the substantial increases in Philippine tariff duties promulgated in Executive Order 150 of 31 December 1955 and the forthcoming revision in the Philippine Tariff Code should complete the transition to a more desirable system of protection implemented by tariffs. This will not only tend to correct the faults inherent in a system of import and exchange controls, but will divert the windfall arising out of import restrictions to the government where it belongs.

investment where such investment is made out of export proceeds, or is foreign investment financed by conversion of foreign currencies at the official exchange rate. More important, it may well be true that decisions to invest reflect profit prospects, i.e., the anticipated rate of return, rather than the current prices of imported capital goods and local resources.[24]

V

The emerging Philippine alternative to peso devaluation has successfully limited foreign exchange payments to foreign exchange availabilities and the Philippines is in the midst of a rapid transition to commercial policy autonomy and protection implemented by tariffs. There is no Philippine balance of payments problem in the conventional sense that foreign exchange payments chronically exceed foreign exchange receipts and a "tolerable" balance of payments has been maintained since 1949.

Philippine economic policies have been less successful in expanding export production and trade. Philippine exports, including gold production, are today probably no greater than in 1937-40. Philippine experience contrasts sharply with the post-war expansion in the volume of world trade which in 1955 reached 155 per cent of 1937-38 levels. In the absence of more effective policies, the "official" exchange rate will continue to limit the profitableness of export production and trade and will continue to be an obstacle to high levels of investment in the export sector of the economy.

In the absence of policies to stimulate exports and foreign exchange earnings, the Philippines faces the prospect of a prolonged period of foreign exchange rationing and relatively low levels of imports while continuation of relatively conservative monetary and fiscal policies brings about the reduction in peso costs and prices necessary to maintain the relative prof-

[24] It is trite to observe that there was probably no net capital formation in many countries during the depression of the 1930's although the out-of-pocket costs of investment were relatively low.

itableness of expanded Philippine export production.[25] In the absence of such policy alternatives as peso devaluation or substantial export subsidization, such a process is probably essential if the Philippines is to achieve further progress toward recovering its pre-war position in world trade.

[25] This is not to say that current Philippine export production is unprofitable. The important point is that present levels of Philippine export production are low because entrepreneurs confronted by relatively adverse profit prospects produce at levels which are profitable. Expansion in production and exports would tend to follow establishment of higher profit margins. The present "official" exchange rate is a basic determinant of the profitableness of export production.