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THE IMPACT OF EXPORT INCENTIVES AND EXPORT-RELATED POLICIES ON THE FIRMS OF THE LESS DEVELOPED COUNTRIES - A CASE STUDY OF THE PHILIPPINES

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ABSTRACT

The Impact of Export Incentives and Export-Related Policies on the Firms of the Less-Developed Countries -- A Pilot Study

by Charles P. Staelin, Amherst College, with the assistance of Gonzalo M. Jurado, University of the Philippines.

This study attempts to shed some light upon how export incentives and other export-related policies influence the behavior of active and potential exporters. It asks several interrelated questions: 1) how do firms view the export activity itself, 2) how do firms view and react to governement policies in terms of their perceptions of exports, and 3) how do these views of both exports and export policies depend upon the economic and political environment in which the firms are embedded? In seeking answers to these questions a survey of 193 exporters and potential exporters in the Republic of the Philippines was conducted in April and May, 1974. Our single most important observation is that direct financial incentives have not led Philippine firms to consider exports; rather it has been the more immediate prodding of domestic difficulties and external contacts which has done so. At the later stages of export, however, firms seem more cognizant of the direct profitability of exports and thus of the role of export incentives. Yet here the incentives required may be far smaller than those needed at the earlier stages. We thus conclude that government policies should more carefully distinguish between the recruitment of new export firms and the encouragement of existing firms. Direct financial incentives, although possibly effective for the latter purpose, do not seem effective for the former.

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Cette étude tente d'apporter des éclaircissements sur la manière dont les stimulants et autres politiques relatives à l'exportation influencent le comportement des exportateurs actifs et potentiels. Elle pose plusieurs questions étroitement liées: 1) comment les compagnies voient-elles l'activité d'exportation elle- même, 2) comment les compagnies voient-elles et réagissent-elles aux politiques gouvernementales en termes de leurs perceptions des exportations, et 3) comment ces vues et des exportations et des politiques d'exportation dépendent-elles de l'environnement économique et politique dans lequel se trouvent les companies? Pour chercher une réponse à ces questions on procéda, en avril et mai 1974, à une enquète sur 193 exportateurs actifs et potentiels dans la République des Philippines. Notre seule importante observation est que ce ne sont pas les encouragements financiers qui ont amené les compagnies philippines à s'intéresser aux exportations; elles y ont plutôt été poussées par l'aspect stimulatif plus immédiat des difficultés domestiques et des contacts externes. Cependant, aux stades plus avancés de l'exportation, les compagnies semblent être plus instruites de la rentabilité directe des exportations et donc du rôle des encouragements à l'exportation. Ici encore les encouragements requis sont peut- être beaucoup plus réduits que ceux nécessaires à des stades moins avancés. Nous concluons donc que les politiques de gouvernement devraient plus attentivement faire la distinction entre le recrutement de nouvelles compagnies d'exportations et l'encouragement des compagnies existantes. Des stimulations financières directes, bien que peut- être effectives pour atteindre ce dernier but, ne semblent pas effectives pour le premier.

THE IMPACT OF EXPORT INCENTIVES AND EXPORT-RELATED POLICIES ON THE FIRMS OF THE LESS DEVELOPED COUNTRIES - A CASE STUDY OF THE PHILIPPINES*

by Charles P. Staelin
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It is becoming increasingly apparent that exports are vital to the development of the Less Developed Countries (LDCs). Exports form by far the largest source of foreign exchange for the LDCs and it is widely acknowledged that the progress of many LDCs has been constrained and distorted by lack of sufficient foreign exchange for their development programs. Other sources of foreign exchange are limited; in particular, foreign aid is failing to keep pace with the growing needs of the LDCs and foreign private investment is not adequate to take up the slack.

Moreover, development through industrialization and import-substitution, a policy advocated and pursued by many LDCs over the past two decades, has resulted in economic distortion and inefficiency. Whatever growth these policies have generated seems in many countries to have slowed, and the economies of these LDCs must now be "rebalanced" through the expansion of their export sectors if inefficiency is to be reduced and, more importantly, if new growth sectors are to be found. Many LDCs turned inwards in the hope of growing faster than world primary product markets would allow. Ironically, after a brief spurt of growth, the progress of their industries is now constrained by the slow growth of their domestic markets. In addition, for small LDCs which

* The research described in this paper was supported by the U. S. Agency for International Development under contract no. AID/CM/otr-C-73-241 with the Center for Research on Economic Development of the University of Michigan.

have never had the option of self-sufficiency, exports offer the only path to the rapid expansion of output.

Finally, the exposure through exports of LDC economies and industries to the outside world can do much to keep the LDCs abreast of new technology, to increase efficiency through competition, and to establish the commercial ties which can insure the LDCs of increased participation in the world economy.

As a result of previous import-substitution policies, many LDCs find themselves saddled with relatively large and often inefficient manufacturing sectors. These sectors typically operate at less than full capacity because of both inadequate domestic demand and a shortage of the imported raw materials and replacement parts needed to operate them. Many LDCs have tried to promote the exports of these under-utilized manufacturing sectors in order to solve both these problems. Yet the promotion of manufactured exports is a difficult and complex task and for each of those LDCs which have succeeded, there are many more which have floundered.

Unfortunately, the economics of export promotion policies remains under-researched. Countries have typically been secretive about the incentives they have offered to their export firms, and the understanding of export incentives has not been helped by the great variety and complexity of policies employed. It is important to remember that export policies impinge upon the firm in every aspect of its operation, e.g., in the price of its output (both exported and sometimes domestic), in the price of its intermediate inputs (both domestic and foreign), in the cost of the primary factors it consumes (particularly capital), in the marketing of its output, in its ability to expand (through government licensing), in its access to credit, in the risk the firm bears on export sales (through export insurance), in the taxes it must pay, and in the whole tone of its relationship with the government bureaucracy and the web

of policies which constrain its actions. These and other points of contact give export policies an important role in industrial policy in general, but in particular they allow the government considerable power to control the activities of export-sector firms and to influence the activities and remuneration of the many physical and factor inputs into the export sector.

Given the potential power and scope of export incentives, it is clear that if export-promotion strategies and policies are to succeed, they must be carefully planned and well-executed. If not, export promotion may, in its time, do as much injury to LDC economies as import substitution has already done.

The research described in this paper was designed to further the knowledge required to adequately plan and execute export promotion drives. It does so in part by departing from the traditional assumptions of profit-maximizing firms and marginal activities, for these assumptions, basic to almost all past studies of export incentives, have proven to be less than fully realistic in the context of LDC firms. Instead, we have in this study applied the concepts of innovation theory to the decision of the firm to export. Although our results are still tentative, we believe that they support such an interpretation of firm behavior in the LDCs. We wish to emphasize that this paper is only a summary of results and conclusions; it does not contain any of the statistical analyses and institutional detail upon which the results and conclusions were based. Those readers who wish to know more about the analysis underlying the discussion in this paper are invited to consult our "Supplemental Report."[1]

1/Charles P. Staelin and Gonzalo M. Jurado, "The Impact of Export Incentives and Export-Related Policies on the Firms of the Less-Developed Countries--A Pilot Study," Supplement to the Final Report, University of Michigan, Center for Research on Economic Development, January 1976 (209 pp. and appendices). Interested readers are also invited to correspond with the authors at Amherst College and the University of the Philippines, respectively.

Exports as an Innovation

Most of the existing studies of export promotion policies employ the assumptions that firms maximize profits and view the adoption of exports as a "marginal" activity, that is, the traditional tools of the theory of the firm are employed in analyzing the impact of export incentives on the actions of the firm. Yet any observer of an LDC firm (and perhaps of any firm) will realize that this is far too simplistic and inaccurate an approximation of the firm's behavior in the fact of export incentives. The firm considers much more than profitability in the decision to export. The risks involved; the effects of exports on the firm's position in the domestic market; the role of exports in determining the firm's relations with government and its ability to be considered with partiality in the distribution of government favors in such areas as import licenses, tax treatment and industrial licenses; the ability of exports to establish ties abroad with potential suppliers of technology, credit or other important inputs; the ability, in terms of expertise and resources, of the firm to break into competitive world markets; the perceived long-term commitment of the government to the export drive, its willingness to "cut red tape" and to help in times of unforeseen setbacks; all these factors and many more influence the decision of the firm to export. Above all, the effect of exports on the firm's ability to survive in an often harsh and capricious environment is crucial to its decisions.

Indeed, psychological and institutional factors may be virtually overriding in some cases. In the Philippines for example, Power and Sicat noted that "the 'overvaluation syndrome' (of the 1960's), in the form of an economic inferiority complex, . . . has made the idea of expanding industrial exports seem far-fetched to businessmen and government officials alike."[2] This complex

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2/ John Power and Gerardo Sicat, The Philippines - Industrialization and Trade Policies, Oxford University Press, London, 1971.

resulted not from export policies but from the web of import-substitution policies which enmeshed potential exporters. In India, exports are often described as a firm's "patriotic duty"; although patriotism may not be entirely free of the profit motive, it is clearly not completely determined by profits. If exports were simply a matter of profitability one would likely not observe the failure of many export promotion drives.

Moreover, even were the firm's decision to export motivated strictly by profits, there would still be difficulties in the analysis of export incentives. Many export incentives are quite complex in their impact on profits while others operate only indirectly on profits. Of the first type are such incentives as those relating to investment licensing, the licensing of imported raw materials and capital goods, and the exemption from certain laws, e.g., laws concerning labor practices and monopoly power. Of the second type are many marketing incentives and services, and above all the good will of the government. Previous studies of export incentives have analyzed highly simplified versions of the first type of incentive, and have generally ignored the second.

What is required then is not only a careful enumeration and quantification of export incentives, but also an inquiry into how they actually affect the firm's decisions concerning export. One must further ask how the enviroment in which the firm and the government act and interact may alter the impact of incentives. Unless this information is known, government cannot hope to manipulate its policy variables to achieve a desired result, or, conversely, to predict the results of its policies.

This study attempts to shed some light upon how export incentives and other export-related policies actually do influence the behavior of active and potential exporters by asking several interrelated questions: 1) how do firms view the export activity itself, 2) how do firms view and react to

government policies in terms of their perception of exports and 3) how do these views of both exports and export policies depend upon the economic and political environment in which the firms are embedded? Being unable to answer these questions ourselves, we have gone to the firms themselves in search of the answers.

A survey was made of 193 exporters and potential exporters in the Republic of the Philippines. The Philippines was chosen for several reasons. First, the Philippines has recently begun an export promotion drive after more than 25 years of import substitution. This major and recent reversal of policy allows us to study the reaction of firms to a discrete change in policy. When policy is altered in so major a fashion, the impact of the policy change can be more easily differentiated from other influences on firm behavior. Second, the recent export experience in the Philippines has been quite positive, giving us a change in behavior to study. And third, although the introduction of export incentives has been accompanied by a significant increase in exports, there is little evidence to indicate that it was the incentives themselves which led to the firms' consideration of exports, or that incentives were even crucial to the outcome of these deliberations. Indeed, the Board of Investment, the body supervising the Philippine export program, has recently begun to sense that incentives are overgenerous in that firms might have made the same decisions regarding exports even if incentives had been curtailed.

The work which has been done on actual firm behavior in the LDCs--accomplished mostly with respect to technological change--has shown that the firm responds only imperfectly with respect to profit-maximizing behavior, and that the normal theory-of-the-firm tools are, therefore, often inappropriate. Indeed, there is a growing feeling among economists that new behavioral theories are required if firm behavior is to be adequately described.

One new approach which seems particularly relevant in the context of this study casts the firm in the role of an innovator.[3] In this context, exports can be thought of as an innovation and export incentives can be viewed as altering the probability that the firm will exhibit innovative behavior. Exports are clearly new to most LDC manufacturing firms, and they are often considered with no less uncertainty and ignorance than are the changes in production techniques and marketing which normally are the concern of innovation theory. Indeed, not infrequently the decision to export will have to be accompanied by innovative production, marketing and administrative techniques, if exports are to actually result. And all changes in techniques will involve both investment and risk. The hesitation with which LDC firms accept innovation in the production and marketing areas is well documented. Observation leads one to believe that they are no less hesitant with respect to exports.

Put in this light, it is clear that export incentives cannot rely simply on changes in profitability, but must often alter the very perceptions and behavior of the firm with respect to exports.

Carrying on with this approach, the innovative firm is viewed as a satisficing decision unit facing a myriad of alternative activities--each activity being a given production/sales technique. Some activities involve export and the goal of export incentives is to push the firm into one of these export activities, hopefully the most efficient one. The key, of course, is the method by which a firm decides to change from one activity to another.

In general, it is assumed that the firm is less likely to undertake (even profitable) new activities a) the closer are its present profits to its profit expectations, b) the more risky is the new alternative, c) the poorer is the firm's experience with that activity in the past, d) the less reliable is

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3/ See, for instance, Sidney Winter, "Satisificing, Selection and the Innovating Remnant," Quarterly Journal of Economics, LXXXV, 2, May 1971.

its knowledge of the techniques and prices associated with the new activity, e) the less profitable is the new activity with respect to other possible alternatives, and f) the more "effort" is required for the adoption of the new activity and the more disruption is caused by any change in activities.

Export incentives of course touch directly and indirectly on all of these factors, affecting the risk of export, its profitability, the past experience of the firm (if it had exported previously), the information which the firm has regarding export sales and production, and the effort a firm must expend to initiate and maintain exports. For instance, government services to exporters may significantly affect the "effort" a firm must expend, even if the impact of these services on actual profits is small. Moreover, under these assumptions the profitability of the export activity is only one of several factors in the decision to export. A profitable firm, such as one operating in a sheltered domestic market, is less likely to try a given export activity than one facing a fall in profitability due to competitive pressures or a declining domestic market. Measures which lower the profitability of present activities are therefore likely to be more effective than those which simply raise the profitability of exports.

The importance of studying incentives as a group and within a particular environment is also emphasized by this approach as a firm's perception of risk depends upon the whole web of incentives and particularly upon its perception of the commitment of government to the export effort. The success of other firms with exports will also affect a firm's perception of both risk and the reliability of its information. This factor may point to a "demonstration" effect that makes it advisable to concentrate promotional efforts on a few firms at a time, so as to insure a successful example.

Indeed, for a firm to innovate it must first be aware that the innovation is possible. Decisions are not made in a vacuum; rather they are made among known alternatives. It is important, therefore, to study not only the ways in which choices are made among alternatives but also the ways in which innovations become alternatives. There are at least three possibilities: 1) a firm can, it its routine search for new possibilities, hit upon, i.e. "invent," a product, process or idea that can become the basis for an innovation, 2) a firm can, again in its routine search for new possibilities, become aware of an innovation which has resulted from another firm's inventive activity (perhaps long before), or 3) a firm can have the awareness of an innovation "forced" upon it.

Although exports are, presumably, beyond the inventive stage, one can profitably investigate both the second and third possibilities above. Many firms begin operations completely unaware of the possibilities of the export activity; the "invention" appears to have little relevance for them and there is little possibility that it will be realistically considered. How then does the search behavior of firms turn up the export possibility and under what conditions is the awareness of such a possibility forced upon the firm? Indeed, what is the nature of the search activity itself and do firms differ systematically in the nature of their search activity or in the likelihood that they will be subject to outside influence?

A more formal model is obviously required if we are to proceed much further with this view of the firm as a satisficing innovator. One such model would involve the construction of a detailed mathematical description of firm behavior and then the simulation of the impact of incentives on a "typical" firm's progress toward the initiation of exports. Although it seems that this type of model will become more feasible as economists increasingly direct

their attention to models of firm behavior, we have taken another tack: instead of attempting an ex ante explanation of behavior, we content ourselves, initially, with trying to predict it. Having accomplished this task we then see what plausible explanations of behavior seem consistent with our observations.

The Model and the Sample

Yet even if we are to concentrate largely upon the prediction of past behavior, a model is still required. In that model we retain the concepts of the firm as an innovator and of exports as an innovation, but we drastically reduce the number of alternatives open to the firm by defining an export "path". On this path the firm is faced with, at the most, four decisions. They are: 1) the decision to consider exporting as a new activity, 2) the decision to actually initiate exports, 3) the decision to consider the expansion of the export activity, and 4) the decision to actually expand exports. Increased exports result from affirmative decisions at steps 2 and 4, i.e., the entry of new firms into the export activity and the expansion of that activity by existing exporters. The goal of government policy should then be to increase the probability of an affirmative decision at one or both of these steps, and this will require action to increase the probabilities of affirmative decisions at steps 1 and 3 as well.

Our approach involves associating various characteristics of the firm, the export environment and government policies, with the firm's final decision at each stage of the decision path. By regressing the various characteristics on a dummy variable with values of zero or unity--depending upon whether the firm has made a negative or affirmative decision--the probability that each characteristic or policy will be associated with an affirmative decision may be determined.

Of course, association does not necessarily imply causation or even explanation. And, without an idea of causation, it becomes very difficult to determine the influence of policy on the various probabilities even if we are successful in determining the probabilities themselves. This is the major disadvantage of the regression technique versus the actual modeling of firm behavior. Yet there is still much useful information which may be gained through these regressions.

First, in designing government policy one should know at which kinds of firms the policy should be directed. The regression analysis indicates the characteristics of those firms which are most likely to export and, hopefully, to respond to export policies. The analysis also indicates the types of policies most valued by successful exporters.

Second, external knowledge about the structure of the firm and the manner in which decisions are made can be used to suggest plausible hypotheses of firm behavior, hypotheses which can then be tested for consistency with observation. This exercise is useful not only in itself but also as a first step in building models of firm behavior; for in order to usefully model the behavior of the firm one should first attemp to verify and quantify the hypotheses of firm behavior which the model is to embody.

Respondents of course can often relate causal chains in the interviews and, although there are sometimes problems in asking them to do so-- respondents may sometimes simplify or falsify their recollection of the decision process, or impose upon past decisions knowledge subsequently attained--we have relied fairly heavily on this practice. The responses obtained both supply us with some of the hypotheses required for the regression analysis and serve as a check on other hypotheses which emerge from it.

Our sample consisted of 193 firms in sixteen industries, including a large proportion of the firms registered as exporters with the Board of Investment and a random sample of firms in the same industries which were not so registered. The distribution of firms along the export path is given in Table 1. Forty percent of the firms had progressed far enough to have actually expanded their exports while only 18 percent had never considered exports at all. Indeed, we had difficulty finding those 34 firms which had never considered exports. In spite of our attention to exporting firms, our sample did not turn up a disproportionately large number of foreign-owned firms. Sixty-three percent of the enterprises in the sample were wholly Filipino-owned, 6 percent were wholly foreign-owned, and the remaining 31 percent were of joint ownership.

The answers to the questionnaire seem to have been given in good faith and with reasonable accuracy; however, the survey suffers from its limited size, as indeed do most surveys of this type. With only 193 firms and a normal rate of nonresponse, the different subgroups are often too small to enable our results to be attributed with great significance in the purely statistical sense. In addition, because we were interested primarily in exporting firms, the distribution of firms is highly skewed in this direction. Both problems are insolvable at this stage and we do not feel that they invalidate our results. However, they have obviously limited, to some extent, the usefulness of rather more sophisticated techniques and interpretations.

The most serious problem, however, lies in the difficulty of distinguishing between causation and simple relation. In looking at the attitudes and the characteristics of the firm at a given point in time, it is difficult to know whether different characteristics or attitudes are causally related or whether they are simply associated with each other--i.e., whether one attribute is

TABLE 1

Distribution of Firms along the Export Path

		Proportion in per cent
C_{no}	- Never considered exports	18
C_{yes} X_{no}	- Considered exports but never exported	10
X_{yes} R_{no}	- Exported but never considered expansion of exports	20
R_{yes} E_{no}	- Considered expansion but never expanded exports	9
E_{yes}	- Expanded exports	42
	NA	1

(Number of cases = 193)

the cause of another or whether they simply appear together by some coincidence or through the causal influence of some third and unknown attribute. In many cases causation is not an issue, in the simple prediction of some event, for instance. However, we wish in many cases to discern the influence of policy on export decisions and for that purpose causation is important. We have, in many cases, attempted to question the firms directly about their motivations for certain actions and we have in other cases been able to infer some degree of causation from the separation of events or attributes in time. Still, we are cautious in drawing policy implications from our results because of our uncertainty about direct causation.

Summary of Major Results

The export incentive schemes of the Republic of the Philippines are relatively straightforward in comparison to those of many LDCs, and they are relatively modest in terms of the subsidies they provide. Although many different measures are provided to exporters, the major incentive is an income (profits) tax deduction figured on local production costs. The incentive is direct and seemingly efficient, but it is not large, running as a proportion of export revenues to perhaps 8 or 9 percent, according to our estimates. There is, as well, the usual import duty drawback scheme, the value of which varies greatly from firm to firm depending upon the volume and type of their imported inputs. Yet duty drawbacks of this type are less a positive incentive to export than they are the removal of the disincentive provided by tariffs. Other incentives tend to be minor. Moreover, their value as purely export incentives is compromised by their often being available to nonexport producers under the Investment Incentivies Act. This is not, in itself, bad; yet one must be careful not to infer that all the incentives granted under the

Export Incentives Act are incentives only for exports.

We may check our estimates of the overall value of incentives with the figures provided by our sample firms. The median estimated value of all incentives was 27 percent of the export price, although estimates were available for only a relatively small number of firms. Median estimates of duty drawbacks alone were 17 percent, a substantial proportion of the total. Firms might have a tendency to overstate the impact of incentives on their export prices and, because we asked for the increase which would be necessary in order to equate the profits on export sales with those on domestic sales, firms would likely be including rather higher rates of domestic profits in their estimates. Yet, even taking the responses at their face value it is clear that Philippine incentives are not overly generous relative to those found elsewhere.

Moreover, the most important export incentive may well be the Philippine exchange rate, one of the few in the less developed world which is not substantially overvalued. This has allowed exporters to receive relatively high export prices (in terms of domestic currency) without the need for substantial, direct export incentives. Furthermore, the steady change in the Government's tariff and exchange rate policy in favor of exporters and away from the highly import-substituting bias of the 1950s and 1960s has no doubt had a substantial psychological impact on exporters, in addition to its obvious financial benefits.

As noted above, our major goals were to discover the kinds of firms which moved along the export path and to determine the forces which motivated them to do so. Our results suggest that firms progressing along the export path do have certain special characteristics; for instance, they tend to be younger and to be run by their owners rather than by managers. Some degree of foreign ownership is also associated with such firms although foreign tie-ups may

retard firms in expanding exports. And finally, export firms tend to be more "progressive". Domestic market positions also seem to influence export decisions with some weak evidence that poor domestic conditions encourage the investigation of exports. Perceived threats from domestic competition also seem to be associated with exporting firms except when that competition is foreign owned. More important than domestic market power, however, is the existence of excess capacity.

The desire to employ excess capacity is a strong motivation for firms to proceed along the export path even if the existence of excess capacity does not stem from domestic market difficulties. At every stage, firms cited capacity utilization as a prime reason for export.

Our investigation of the goals of the firm turned up few clear conclusions except that firms expect roughly the same goals of export as they do of their overall activities. Exports seem not to be undertaken to satisfy any special needs (except perhaps the utilization of excess capacity as noted above) but rather are seen as an integral part of the firm's overall activities. In particular, short-run profits do not seem to be an expected goal of exports, and firms which are willing to accept lower profits on export sales than on domestic sales are more likely to export. It would seem that the profits on export sales need not be large.

A firm's relationship with government shows an interesting association with exports as firms further along the export path seem more rather than less disillusioned by government and government policy. Since it is difficult to explain why disillusionment would encourage exports, we tend to conclude that exporting firms' contacts with government are more likely to lead to problems and subsequent disillusionment than do the contacts of non-exporting firms.

Firms with more knowledge of exports are more likely to investigate them. This not surprising observation suggests that export information be widely disseminated. And there are certain indications that the information should be objective. Firms which did not in their investigation of exports discover any unexpected impediments to export were more likely to go on to export than those which did discover unexpected impediments, regardless of the number expected. One of the ways in which a firm first learns of exports is through enquiries from foreign buyers. Yet, although many of the firms in our sample had been approached by foreign buyers and, although these contacts did stimulate the investigation of exports, such contacts did not in themselves lead ultimately to the initiation of exports.

The types of difficulties expected by firms going on to export are suggestive. It is high costs and not low export prices which seem the major deterrent to export. Both result in low profits of course, but the former is consistently cited by all firms at all stages of the export path as a major, if not the major difficulty. The cost and availability of raw materials are particularly prominent as well in the problems which firms wish to see government address, and assistance in procuring reasonably priced raw materials is the most consistently mentioned form of assistance desired. Uncertainty in the export market is also an important deterrent to export.

Most firms would like to see increased government assistance for exports but their idea of assistance is quite broad, going far beyond the purely financial incentives. Indeed, the role of financial incentives in export decisions is not at all clear. Most export firms suggested that they would have exported even if incentives had not been available and would not cease exporting if they were withdrawn, while most firms which decided against export

claimed that the presence or absence of incentives also had little to do with their decision. In addition, many firms do not avail themselves of all possible incentives. All this suggests that the role of financial incentives is small. Yet, in seeming contradiction, most firms felt that increased incentives would lead them to increased exports. (These responses are summarized in Table 2.)

The seeming contradiction in these areas, however, becomes resolved when we view the initiation of exports as an innovation rather than simply as a marginal change in the firms' activities. Innovations often call for large investments in many areas, from production to management, and these investments may in turn demand substantial and relatively certain returns. As noted above, we speculated that the incentives under the Philippine export promotion scheme were small and figures provided by the firms tend to confirm this speculation. It may well be that incentives, at their current, modest levels, are not of themselves sufficient to motivate exports. This may be particularly so in the uncertain economic and policy climate perceived by most Philippine firms where dependence upon any current policy measures might be avoided as being too risky. Other more "stable" factors--factors over which the firm has more control--would then form the basis for a positive export decision. Once exporting however, i.e., once the investment has been undertaken, incentives are useful and may be considered in making marginal decisions about the volume of exports. There is, then, a two-part problem, getting the firm to export and then increasing the level of its exports; financial incentives may be useful for the latter but not so useful for the former. (Or, to put if differently, the level of incentives required for the former may be completely inappropriate for the latter.) Other kinds of assistance--i.e., direct aid in establishing an export business--may thus be more appropriate for potential exporters and the

TABLE 2

Responses to Questions about Incentives

	Yes %	No %	number of firms responding
All firms:			
Did the firm receive direct government assistance when it was established?	30	70	185
Did any government policies (e.g. tariffs) indirectly encourage the establishment of the firm?	30	70	181
Exporters only:			
Did the firm know before it considered exporting of the incentives available?	74	26	120
Would the firm have exported if government incentives and services had not been available?	73	27	134
Would the firm continue exports if government assistance were withdrawn?	31	69	124
Would the firm increase exports if government assistance were increased?	92	8	129
Are incentive payments handled quickly and fairly by:			
BOI	91	9	99
other agencies	59	41	93
Do present incentives induce increased labor content?	76	24	118
Has the above inducement changed since PD 92?	29	71	72
Do you think the life of the incentives will be extended for your firm?	86	14	95
What do you see as the condition of the firm's export activity when incentives expire?			107
very good	5		
good	52		
poor	27		
very poor	16		
Never exported only:			
Did the presence or absence of incentives enter the firm's decision not to export?	11	89	36
Would the firm again consider exporting if more assistance were available?	81	19	37

responses of our sample firms suggest the variety and importance of such assistance could be substantial.

The kinds of government support desired by the firms in our sample are listed in Table 3 (firms were asked for the "most important things the Government could do if it really wanted to encourage exports in this industry"). Although financial incentives figure prominently in their responses, they by no means stand alone.

Policy Implications

The major policy implications of this study stem, we believe, from the rather clear conclusion that the decision to export is indeed seen by Philippine firms as an innovation. Innovations do not result from marginal decisions, and therefore neither marginal analysis nor policies designed on the basis of marginal analysis will work properly in inducing firms to export.

Traditional financial incentives are designed to alter the relative profitability of export versus domestic activities, on the margin. They are not designed, however, to induce innovation. Of course, incentives do increase the relative profitability of the innovative activity and increase the likelihood that it will be undertaken. Yet profitability is not the only consideration in the decision to innovate and the degree of profitability needed to overcome other obstacles to innovation, such as uncertainty, a lack of information or simple inertia, may be great. Moreover, unlike the cost of inputs and the prices of outputs, these other impediments to innovation will vary greatly from firm to firm. Therefore, although financial incentives may result in equal profit incentives for different firms, they will not result in equal amounts of innovative activity. There are then two problems:

TABLE 3

The Most Important Things Government Could Do to Encourage Exports

	number of mentions	proportion of all mentions (%)	proportion of firms responding (%)
Give more incentives	57	19	34
Assist in financing	39	13	23
Reduce tariffs on raw materials, reduce the cost of utilities	38	13	23
Improve export procedures and government services	35	12	21
Assure the availability of raw materials	18	6	11
Establish a better information and consultation center	13	4	8
Eliminate the export tax	11	4	7
Assist in export marketing	11	4	7
Subsidize labor training programs	10	3	6
Assist in developing better production technology	10	3	6
Relax restrictions on imported capital	9	3	5
Establish bonded production facilities	9	3	5
Reduce high ocean freight rates	4	1	2
Assist in the provision of infrastructure	3	1	2
Abolish the minimum wage	2	1	1
Other	27	10	16
Total	296	100	

different firms will require different amounts of incentives and the amounts of incentives required for the introduction of exports may prove to be overgenerous for the maintenance and expansion of exports. What are needed then are: 1) some method of identifying those firms most likely to innovate, along with the level of incentives appropriate for each and/or 2) other, hopefully more efficient means than financial incentives for inducing innovations. This latter accomplishment would allow financial incentives to be used more efficiently in their proper role of altering marginal decisions on the maintenance and level of the export activity.

We should note again that the Board of Investments is also aware of these problems for it faces the not uncommon situation of awarding overgenerous incentives to exporting firms while still wondering about the best way to induce new exporters.

Our study has shown, we believe, that export firms do share certain characteristics and that it therefore might be possible to identify likely candidates for export promotion. It is not clear, however, how useful this observation may be to policy makers. First, we have only begun to define those characteristics and we have not ourselves attempted to identify potential exporters, <u>ex ante</u>. This is a potentially fruitful area for future research. Second, under present incentive schemes, government would have difficulty in discriminating among firms. Financial incentives must be offered equally to all comers for both good political and better administrative reasons. To attempt to discriminate among firms on the basis of the rather subjective characteristics we have begun to define would invite both conscious and unconscious abuse. Our two problems then may not be separable; it may not be useful to identify likely exporters if current financial incentives remain as the major policies inducing initiation.

Another observation of the study gives this point increased relevance. Most export firms do not make the decision to export on the basis of financial incentives at all but rather they make their decisions on the basis of other, more fundamental considerations. Many firms seem not to avail of all the incentives for which they are eligible, and most firms insist that they would have decided to export even in the absence of incentives and would continue to export if incentives were withdrawn. Firms disregard incentives for at least two, interrelated reasons. First, immediate profitability is not the only consideration in the decision to export. Our data suggest that firms seek rather more long-run goals from export and that they are more effectively pushed than pulled into the export activity. Second, firms are reluctant to place too much faith in government policy and this element of uncertainty makes firms hesitant to engage in any so fundamental a change in the operations of the firm solely on the basis of government incentives. And indeed, since the life of the incentives is limited for each firm by law, firms would be foolish to rely heavily upon them even if they felt more certain about the future of government policy. Strong incentives should be limited in duration because they become much more powerful and therefore much less necessary in the marginal decisions of established exporters; yet the limited life of these incentives renders them much less effective in performing the task they were intended to perform, namely inducing firms to initiate exports.

This is not an unfortunate situation as government should wish to see export decisions made on a sound economic basis. If we have learned anything from the growing literature on infant and state-supported industries it is that activities initially dependent upon subsidies seldom mature to self-sufficiency. And the Philippines is particularly fortunate in this regard since its reasonable exchange rate allows firms to arrive at sound economic decisions in the social as well as the private sense without large incentives.

We do not, of course, wish to argue that incentives are then unnecessary, simply that financial incentives may not be the most appropriate means of inducing firms to begin exports.

What then does induce the initiation of exports? Well in keeping with the view of exports as an innovation, a push of some kind seems particularly important. For the firms in our sample, the desire to utilize excess capacity seemed to be a major push, as was the existence of domestic competition. Yet it was not the weaker firms which were induced by these forces, for firms seldom mentioned poor profit performance as an inducement to export. Rather it seemed as if excess capacity or decreasing domestic market potential forced firms to reexamine their whole orientation. Firms were not then pushed into exports by temporary crises, but by more long-term considerations. Short-run profits were definitely not a goal of firms initiating exports.

Once again it is not clear how useful an observation this is, for how can government policy yield such a push? Can government threaten domestic market positions or purposefully create excess capacity? In the former case it would be very difficult to induce firms to trust government by engaging in exports if government were playing heavy-handed in domestic markets. And, in the latter case, the creation of excess capacity can be extremely costly in capital-scarce economies. Yet perhaps there are some more useful implications.

First, the"push" factor points to the oft-noted fact that mature, competitive industries make better export prospects. Domestic competition in mature industries can provide the push required for export. In addition, this same competition along with the often declining growth rates of domestic sales in such industries can result in the excess capacity which prods firms to consider exports and which allows them to do so. Of course, government cannot play too

direct a role in this process; the stimulation of competition is a matter of overall development strategy rather than of specific incentives. Yet the importance of "market" solutions in the context of private firms is demonstnated once again. Industrial licensing policies are, perhaps, one area in which government can play a more direct role in this process. The licensing of extra capacity in mature industries, largely for competitive reasons, should be given a more sympathetic hearing than is normal, if the industry involved might potentially export.

Second, the existence of excess capacity might serve as one easily identified characteristic of potential exporters. If government can identify those firms and industries where "push" factors are already in operation, government inducements to export might be more effectively and efficiently applied. We should note at this juncture that firms often seem to have been induced to export by the successful export activities of other firms in their industry. The existence of this "demonstration effect" and the need for a prodding toward export would seem to imply that a concentration of promotion efforts at the industry level rather than the firm level might be more effective. The same push factors are likely to apply to several firms within the industry, many impediments to export are as or more easily solved at the industry level than at the firm level and the externalities of the demonstration effect can be more effectively employed. Japan and Korea both seem to have used this approach to good effect.

Third, "push" factors other than competition and excess capacity might be employed. We noted that enquiries from abroad were useful in inducing firms to consider exports. Although they were not, in themselves, sufficient to lead firms to the initiation of exports, such inducements may at least

satisfy the precondition that firms be made forcefully aware of the export activity. In this vein we should emphasize that the simple availability of accurate information about exports and exporting is very important in the early stages of the export path. Firms cannot consider alternatives about which they have little information; the provision of useful and accurate information (e.g. of export prices, policies, procedures and successful experiences) to a large number of firms without their first having to request it could prove to be an inexpensive but effective means of promotion. Although the provision of information and foreign contacts may not seem to provide a prod to export, evidence from this and other studies suggests that firms will accept an innovation if they can effectively be made aware of its soundness.

Of course, other policies too might be used to provide a "stick". For instance, the Philippines now requires exports for the registration of certain firms, especially foreign-owned firms, and other countries tie capacity licenses and the provision of raw materials to a commitment to export. Such policies are no doubt effective but their effectiveness is generally limited to those firms wishing to expand or change products, i.e., the more innovative firms. Yet these firms may, given the existence of relatively rational market signals, be the very firms least needful of heavy-handed policies. Does an "overkill" present problems? We are not in a position to give a definitive answer. Clearly not all firms are equally capable of efficient exports and one danger of overly powerful incentives is that inefficient firms might be induced or forced to engage in exports. This danger would seem to be more prevalent when the incentive takes the form of the stick rather than the carrot. Indeed, one of the beauties of financial incentives is that they bestow roughly equal gains on all firms and therefore maintain the differential between more and

less efficient firms. Force, on the other hand, tends to make no such distinctions.

An important area of future research would seem to be this problem of how best to provide the "push" factors which are seemingly necessary for the initiiation of exports.

All of the discussion to this point has assumed that the market properly reflects the basic soundness of exports as an innovation for the firm in terms of its private and social profitability. Although this is not a valid assumption in many LDCs, it does seem to be a valid one in the Philippines, at least since the advent of the liberalizing policies of the past five to ten years. Yet there is room for policy action in this regard as was indicated by the responses of the firms in our sample. In particular, firms wish to see government act in the areas of raw material supplies and export finance. Of course any firm would like to see government take any action which will lower its costs, without regard to whether the action is socially justified or not. Therefore, government should not accept as justified any and all demands of the firms. But the kinds of problems cited by firms seem amenable to government policy and justified by the circumstances.

We are not now in a position to suggest policy solutions to these problems; the formulation of solutions would require more detailed research into specific areas of difficulty. But the general thrust of our findings indicates that government should, where possible, concentrate on providing, through the market, a sound economic basis for the export activity while at the same time prodding firms to actively consider the new activity. Certain policies, such as the duty drawback, may therefore be necessary in order for market imperfections to be ameliorated. However, as long as firms continue to pay more attention to

market signals than to government incentives, the market, not simply government subsidies, must reflect the profitability of exports.

This study has, perhaps, raised more questions than it has answered. But, if it has at least indicated the relevant questions to be asked, it will have succeeded in the majority of its goals. If we were to isolate the single most important observation it would have to be that direct financial incentives have not led Philippine firms to consider exports; rather it has been the more direct prodding of domestic difficulties and external contacts which has done so. The experience of other countries, such as India, where import and industrial licensing policies have been used successfully to "prod" firms to export, confirms the importance of domestic factors in export decisions.

Yet the wisdom of interfering so directly in the affairs of the firm is not clear. Such interference generally results in distrust of government by the firms and may therefore be self-defeating in the long run. More importantly, the economic costs of such interference are frequently very great, in terms of inefficient resource allocation, and yet they are hard to measure and even harder to control. The beauty of direct financial incentives is their simplicity, both in measurement and control, and it remains to be seen if more effective policies can be designed for the early stages of the export path.

At the later stages, firms seem much more cognizant of the direct profitability of exports and thus of the role of export incentives. Here, however, the incentives required may be far smaller than those needed at the earlier stages. Firms are more aware of the benefits of exports to their business, perceived risks may be much smaller, and export-related costs may have decreased.

We conclude that the decision to export is an innovation for the firm and that government policies should then distinguish between the recruitment of new export firms and the encouragement of existing export firms. Direct financial incentives, although possibly effective for the latter purpose, do not seem effective for the former.

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