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ECONOMIC DEVELOPMENT IN THE PHILIPPINES: A FRUSTRATED TAKE-OFF?

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Since the early 1980s the Philippine economy has been suffering from a serious setback. It has been plagued with a prolonged recession accompanied by political unrest including a separatist movement. In order to solve these multiple problems, international development agencies recommended standard policy prescriptions. But politically strong vested interest groups did not let the Philippine government implement these policies wholeheartedly. As a result, attempts to end economic recession had failed. This paper explains the resource base and development challenges facing the Philippine economy today. It also outlines appropriate policies and strategies to meet those challenges and records progress made in the various sectors of the economy. In the light of the present trend, the paper highlights the future prospects of the Philippine economy.

Introduction

The Philippines was one of the progressive nations in Asia in the early 1950s. During the three decades after the Second World War, its economic performance was no less remarkable than other Southeast Asian nations. But a prolonged economic recession since early 1980s, when the neighboring countries accelerated their economic growth, has turned the Philippines into the "sick man of Asia." The recent development history of this country is characterized by political conflicts including a separatist insurgency in the south, frequent natural disasters including the eruption of Mount Pinatubo in 1991, consistently high inflation, a chronic

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external debt overhang, repressed financial system, regressive taxation, dilapidated economic infrastructure, sluggish and erratic economic growth, and a highly skewed income distribution which is epitomized by a huge disparity in urban and rural living conditions. Multilateral development agencies have pushed standard prescription to remedy the economic ills, which faced stiff resistance from politically strong vested interest groups, and the government has made only half-hearted attempts to implement them. After three years of relatively strong political leadership since 1992, there is a ray of hope that economic recession in the Philippines may soon be over.

This paper explains the resource base and development challenges faced by the economy, outlines policies and strategies pursued to meet those challenges, and records progress made in various sectors of the economy and its impact on the level of living of the people. It concludes by evaluating the prospect of economic recovery in the light of the most recent changes in policies and development trends.

Resource Base

Natural Resource

The Philippines is not as blessed with natural resources as many of its Southeast Asian neighbors. The country has limited reserves of copper, gold, and nickel, which have been seriously depleted from 10.8 billion tons in 1973 to only 3.6 billion tons in 1991. The value added from mining declined from 2.8 percent of the gross national product (GNP) in the early seventies to 1.1 percent in recent years. The Philippines has to import fuel to meet its energy needs; petroleum products accounted for a quarter of its import bills during periods of high economic growth. The economy has been subjected to severe pressures from the oil crisis of the early and late 1970s and during the Gulf War.

Land is an important means of livelihood for the majority of the people but has been under pressure of over-exploitation from a growing population and limited employment opportunities in the non-farm sectors. About one-third of the 30 million hectares of land mass of the country is now cultivated and the number of farm households run up to an estimated 4.6 million. The average size of farm is estimated at 2.16 hectares by the agricultural census in 1991, and land available per head of agricultural worker is only 0.94 hectare. The number of farm households increased by 96 percent during the 1971-91 period, which led to an extension of cultivation to village commons and forest margins. During 1971-91, the area under temporary crops grown on lowland valleys increased by 37 percent, while the area under permanent crops grown on highlands and hill slopes increased by 63 percent, seriously depleting the forest reserves.[1]

The village woodlands, fallows, and pastures declined from 2.07 million hectares in 1971 to 0.47 million hectares in 1991. Concerned with the over-exploitation of forest resources, the government has converted the unclassified forest land, which comprised 29 percent of the land mass in 1971, to classified forests that now account for almost half of the land area. The government's policy of preserving the forest land has led to a decline in agricultural incomes and export earnings from forest resources. The value added from forestry declined from 3.9 percent of the GNP in 1970 to only 0.38 percent in 1993.

Human Resource

In 1995, the Philippines had 68.4 million people within a land area of 300,000 kilometer square, making it one of the most densely populated countries in Southeast Asia. Population density in 1990 was 208 persons per kilometer

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[1] For details, see reports of *The Philippine Census of Agriculture.*

square of land area, compared with 216 in Vietnam, 110 in Thailand, 100 in Indonesia, 64 in Myanmar, 54 in Malaysia, and 47 in Cambodia. The population is currently growing at 2.2 percent per year, adding 1.5 million people every year. The population is projected to grow another 43 percent within the next 25 years.

A distinguishing characteristic of the Philippines compared with its Southeast Asian neighbors is the quality of its human resources. The mean years of schooling for population aged 25 years or more is 8.0 years for male and 7.2 years for female, one of the highest among the developing world and almost double the level achieved in Thailand. Nearly three quarters of the relevant age group enrol in secondary schools compared with 32 percent in Thailand, 43 percent in Indonesia, and 58 percent in Malaysia. The enrollment ratio at the tertiary level is 27 percent of the age group. The male-female disparity in education is nonexistent in the Philippines. In fact, at the secondary and tertiary level, the enrollment ratio is higher for females than for males. The high quality of human resources places the Philippines in a very favorable position in the international labor market. Remittances from overseas workers are an important source of foreign exchange earnings for the country.

Because of the high fertility rate, almost 40 percent of the population are young children, or of school-going age, i.e. below 15 years. Another 5.2 percent of the population are aged 60 or more. Thus, the economically active age group constitutes only 55 percent of the total population, of which nearly 73 percent participate in the labor market. The high participation rate is mainly due to the extraordinarily high participation of women in economic activities. The labor force participation rate among the economically active age group is about 92 percent for men and 54 percent for women. Women are more heavily involved in personal and social services and in trade and commerce than men, and they participate almost equally in manufacturing industries. Agriculture, transport, and construction activities employ mostly male workers as depicted in Table 1.

Table 1 - Utilization of Human Resources: Occupational Distribution of the Labor Force

Occupation	1985 (third quarter)			1992 (first quarter)			Percent of total labor force in the occupation	
	Male	Female	Total	Male	Female	Total	1985	1992
Agriculture	7,233	2,465	9,698	7,998	2,587	10,585	43.8	41.1
Manufacturing and mining	1,113	927	2,040	1,479	1,179	2,656	9.2	10.3
Economic infrastructure	737	26	763	1,139	35	1,174	3.4	4.6
Transport services	889	42	931	1,134	55	1,189	4.2	4.6
Trade and commerce	1092	1862	2,954	1,341	2,348	3,689	13.3	14.3
Personal and social services	1446	1962	3,408	1,887	2,307	4,194	15.4	16.3
Unemployed	1473	889	2,362	1290	977	2,267	10.7	8.8
Total labor force	13,983	8,173	22,156	16,268	9,488	25,754	100.0	100.0
Economically active population	15,096	15,080	30,176	17,745	17,725	35,470	-	-

Source: National Statistical Coordination Board, *1994; Philippine Statistical Yearbook*, Makati, Philippines.

Agriculture employs only 45 percent of all workers, compared with more than 60 percent in neighboring countries. By international standards, the growth of the labor force is very high. The labor force participation rate rose in 1970 due to increasing female participation. The growth in labor force was 3.4 percent per year during 1971-75, 4.2 percent during 1976-86, and 3.0 percent during 1986-92.

Development Challenges

A formidable development problem for the Philippines is its large population in relation to the natural resources and the relatively rapid growth. Because of the high concentration of assets and economic power in a few hands, it is expected that the economic gains will be unequally distributed. To make a significant dent in the poverty situation, the Philippines has to target a high rate of growth of per capita incomes so that some benefits reach the poor people through the normal market mechanism. If the Philippines wants its per capita income to double every 10 years, the gross national product must increase at 9 percent per year if the population increases annually at 2.0 percent per year. This is the GNP growth target that has been set for the terminal year in the 1993-98 Medium-term Philippine Development Plan.

With the present structure of investment in the economy, the incremental capital/output ratio is estimated at 3.5:1, which will be higher if emphasis were given on infrastructure development and on the growth of manufacturing industries that are more capital-intensive in nature. This means that to attain a 9 percent annual growth, the Philippines must invest at least 32 percent of its GNP for development purposes. Capital accumulation of this magnitude is difficult without substantial inflow of external resources including private foreign investment. A large population impedes private savings as even economically poor households desire to provide at least secondary level education to all children and potential savings are utilized for meeting educational

expenses. Since 45 percent of the population are children, the high population growth impedes the government's capacity to invest in basic economic infrastructure after providing adequate public funds for human resource development — i.e, building and maintaining social infrastructures for health, education, and training.

The most formidable challenge to the economy is how to generate productive employment for the labor force currently growing at 3.0 percent per year and how to sustain a growth in labor productivity at rates that provide incentives to employers and increase wage rates on a regular basis. Agriculture is the largest employer, but since agricultural growth will depend on technological progress, the employment generation potential of the sector is severely limited. Also, since most of the people are literate, they dislike manual work and there are evidences of premature adoption of agricultural technologies that save manual labor. Additional employment must be generated in the manufacturing and services sector which needs support from the government in terms of massive investment in the development and maintenance of transport and communication infrastructure, and generation and distribution of electric power.

Structure and Growth of the Economy

Long-term Growth

Since 1950, the national income has been increasing at 4.5 percent a year. Much of this growth was offset by the population increase of 2.8 percent per year during the 1950-93 period. Thus, per capita income increased by a meager less than 2 percent per year. This long-term near-stagnation of the economy obscures respectable economic progress during the period in question.

Although the Philippine economy was growing slowly, by 1980, it reached a per capita income level of US$929 — almost similar to that of Thailand and 40 percent higher

than that of Indonesia.[2] In the early 1980s, an economic recession set in from which the country is yet to recover. The GNP growth slowed down to the level of population growth during the 1980-83 period, but then had a large absolute decline after the assassination of Benigno Aquino, the political opponent of then President Marcos. This event led to a serious political crisis and ultimately to the downfall of the Marcos Regime through "people's power" in 1986. The GNP dropped by 12 percent and the per capita income by 18 percent during the 1983-86 period. Since then production growth has barely kept pace with population growth. Per capita income in 1993 was still 9 percent lower than the level reached in 1980.

The performance of different sectors of the economy can be reviewed from Table 2. The productive sectors, agriculture and industry, grew at respectable rates of 4.6 percent and 8.2 percent per year, respectively, during the 1950-80 period, and the share of manufacturing industry in GNP reached 28 percent by 1980. Most notable was the expansion of economic infrastructure as evidenced by a 14 percent per year growth in value added in construction and power, whose share in GNP increased from 4.4 percent in 1970 to 10.9 percent by 1980. It is the infrastructure and the manufacturing sectors that suffered most during the period of economic recession. The value added in construction activities declined by 60 percent during the 1983-86 period. In the manufacturing industry, growth was a meager 0.6 percent per year. Only the services sector, i.e., transport, trade and public administration maintained a modest rate of growth during this long economic recession.

Agriculture

Agriculture accounts for nearly 22 percent of the GDP composed of staple grains rice and corn (5.1 percent);

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[2] National Statistics Coordination Board, *Philippine Statistical Yearbook*, various issues.

Table 2 - Progress of Different Economic Sectors, 1950-93

Sectors	Sectoral shares of GDP			Rate of growth (percent/yr)		
	1970	1980	1993	1950-70	1970-80	1980-93
Agriculture	28.2	25.3	21.1	4.6	4.9	1.2
Manufacturing & mining	25.8	28.1	24.3	8.7	7.1	0.6
Construction & power	4.4	10.9	7.7	2.2	14.2	-1.3
Transport & communication	4.3	4.7	5.2	6.9	8.9	3.0
Trade & finance	25.2	21.4	24.1	5.5	4.6	2.4
Other services	13.9	10.2	14.7	6.4	5.1	3.6
Gross domestic product	101.7	100.6	97.2	5.4	6.2	1.4
Gross national product	100.0	100.6	100.0	5.4	6.4	1.7

Sources: National Statistics Coordination *Board; Philippine Statistical Yearbook*, various issues.

vegetables and fruits (5.2 percent); plantation crops, coconut and banana (1.9 percent); sugarcane (0.7 percent); livestock (4.5 percent); fishery (3.9 percent); and forestry (0.4 percent). Forestry accounted for nearly 3.9 percent of the GDP in 1970, but the government's policy of preservation of forest resources has led to a drastic decline in value added from forestry at 3.5 percent per year during the 1970s, and 13 percent per year since 1980. The deceleration of agricultural growth from 4.8 percent during the 1970s to 1.1 percent during the 1980-93 period was largely due to the contraction of economic exploitation of forest resources.

The period of economic recession also experienced an absolute decline in value added from plantation crops, which performed remarkably well in the 1970s. Value added in coconut plantations, which occupy 26 percent of the cropped land, increased at 5.3 percent during the 1970s, but declined to a negative 4.3 percent during the 1980-93 period. Income from banana plantations had an absolute decline of 2.5 percent per year during 1980-93, compared with an impressive 12.4 percent per year growth during the earlier decade. For sugar, falling world prices, deterioration of the peace and order condition in Negros Island—the country's sugar bowl, and termination in the mid-1970s of the Laurel-Langley Agreement which provided Philippine sugar exporter access to the lucrative US sugar market under a quota system, contributed to its sharp contraction in the 1980s.

The growth of the main staple grain rice also contracted from 4.1 percent per year in the 1970s to 2.1 percent in 1980-93. The factors causing the slowdown in production included stagnation of public investment in irrigation, exhaustion of productivity potential of high-yielding modern varieties, diversion of land to nonagricultural uses particularly near urban centers, continued decline in world rice prices, and degradation of crop production environment owing partly to the practice of intensive rice monoculture in irrigated areas and to soil erosion induced by rapid deforestation (Balisacan et al., 1993).

The economic recession, however, did not prevent the poultry and livestock sector from sustaining its respectable rate of growth. Livestock and fisheries registered the highest rate of growth at 4.8 and 6.1 percent per year, respectively, among the various subsectors in agriculture, and was the main driving force behind the growth of agriculture during the 1980-93 period.

Industry

The manufacturing industry accounted for 24 percent of the GDP in 1993, composed mainly of food manufactures (9.6 percent), petroleum products (2.3 percent), chemical products (2.0 percent), garments and footwear (1.7 percent), beverage industry (1.1 percent) and electrical machinery. Surprisingly, textile manufacturing, which is usually an important economic activity in the early stages of development, is of little importance in the Philippine economy. The growth in the manufacturing sector decelerated from 7.0 percent in the 1970s to only 0.6 percent during the 1980-93 period.

In the past, industrialization in the Philippines has been biased strongly toward urban centers through policy-induced import substitution. A basic reason behind the underdeveloped rural industry is the dual structure of Philippine society, reflecting the highly skewed and unequal distribution which has its origin from the Spanish colonial rule. The opening of the Philippines to the world economy at the turn of this century under the American colonial regime led to rapid economic development based mainly on the expansion of export-oriented plantation crops, coconut, and sugarcane controlled by the absentee large landowners at the expense of household industries in rural areas due to the lack of both effective demand and the investible surplus (Resnick, 1970, pp. 51-73). As agricultural surpluses are being extracted by landlords, little funds are left in rural areas to be mobilized for investment in rural industries. Partly because of its strong urban bias, the industry sector was hit hardest during the

political crisis in the early 1980s. Although the sector has been recovering from the bottom reached in 1985, many manufacturing subsectors have not come back to the production level attained in 1980 (Kikuchi, 1994). The subsectors that registered negative growth during the 1980-93 period are textiles (-2.5 percent per year), food manufactures (-1.1 percent), and chemical products (-0.6 percent). Tobacco manufacturers and nonmetallic materials maintained the status quo. Only electrical machinery and equipment (6.9 percent), petroleum products (5.3 percent), and the beverage industry (4.3 percent) had a moderate rate of growth during the 1980-93 period.

In recent years, the export sector received considerable boost from the rapid expansion of exports of garments and electronic products. The exports of garments also generated considerable employment in rural areas as the business is organized by subcontracting production activities to a large number of small-scale rural enterprises. The number of garment exporters increased from 706 to 1,428 during the 1984-93 period, while employment in garment increased by 69 percent. In Laguna Province in Southern Luzon, two-thirds of the subcontracting farms operate with a size of less than 20 workers per unit (Kikuchi, 1994). The expansion of these two export items did not contribute much to the growth in the industry sector because of low value added ratio.

Infrastructure

In the Philippines, public investment for infrastructure was drastically reduced during the period of political disturbance in the early 1980s which contributed to the prolongation of economic recession. It was already high at 6.4 percent of GNP in 1975 and further increased to 6.4 percent of GNP by 1982. This was an important factor behind the vibrant construction activities in the 1970s that provided fuel to the rapid growth in both the agriculture and the manufacturing sectors. During the 1983-85 period, however, public sector investment on physical infrastructure drastically dropped to only 2.8 percent of the GDP; it

remained at that level until 1993. The impact of this reduced public spending on expansion of various infrastructure facilities is shown in Table 3.

Table 3 - Development of Physical Infrastructure, 1970-1993

	Year				
Infrastructure	1970	1980	1993	1970-80	1980
Production of energy (million kilowatt hours)	6,794	18,583	26,592	10.6	2.8
Length of paved road (km/100 km^2 area)	4.8	9.3	8.8	6.8	-0.4
Length of bridges (000 meter)	163	221	248	3.1	0.9
Irrigated area (000 hectare)	450	649	785	3.7	1.5

Sources: National Statistics Coordination Board; *Philippine Statistical Yearbook*, various issues.

The Philippines suffers from serious shortages of electric power. But electric energy was one of the fastest growing sectors in the 1970s, when production capacity increased at 10.6 percent per year. But growth was drastically reduced to only 2.8 percent per year during 1980-93. As a result, by late 1980s, the power supply became inadequate in relation to the country's demands. Shortages leading to frequent power failures became a common phenomenon in both rural and urban areas. This led to underutilization of industrial capacity. Many industrial enterprises had to invest in electric generators which increased the cost of production and reduced competitiveness in both international and domestic markets.

The Philippines has an extensive road system but the quality of roads, in general, is poor. The total road density is about 53 kilometers per 100 kilometer square of land area,

compared with 17 in Thailand and 12 in Malaysia. But the paved roads constitute only 14 percent of the total road length in the Philippines, compared with 48 percent in Thailand and 80 percent in Malaysia. The better-quality roads are found along the coast which basically serves to connect the water transport which suffers from inadequate port facilities. The interior areas are served mostly by gravel and earth roads which are not available for motorized transports during the long wet season. Because of the poor quality of roads, the unit cost of transport is high, and farmers have to sell their produce immediately after harvest to agents of marketing oligarchy at prices much lower than that prevailing in urban markets.

The length of paved roads increased at an impressive rate of 6.8 percent per year during the 1970s but had an absolute decline since 1984 because of inadequate investment on maintenance. The number of motor vehicles however increased 2.5 times and the number of trucks and utility vans increased 3.6 times during the 1980-93 period, putting extremely high pressure on the stagnant road network, causing traffic jams and wastage of time. Similar was the story for irrigation infrastructure. The facilities built during the 1960s and 1970s could not be properly maintained. There was very little public investment since the early 1980s for generation of new capacity. As a result, growth in irrigated area decelerated from 3.7 percent per year during the 1970s to 1.5 percent in 1980-93. The recent expansion was partly due to private investment on pumps and tubewells.

The quality of irrigation from public systems has deteriorated due to siltation of dams and inadequate maintenance of canals. Many irrigation systems now serve to provide supplementary irrigation during the wet season but fail to provide adequate water to grow rice during the dry season. An important constraint to expansion of public investment on infrastructure is the underpricing of the services and the government's failure to recoup the initial investment from the users. In recent years, the government has been encouraging private sector investment in infrastructure activities.

External Trade

Foreign trade accounts for a large segment of the Philippine economy, but for most of the years since the early 1970s the Philippines suffered huge deficits in the balance of trade. In 1993, export earnings accounted for 20.5 percent and import payments 33.8 percent of the GDP. The changes in the composition of the export and import trade can be reviewed from Table 4.

Traditional export items are copper concentrates, copra, coconut oil, centrifugal and refined sugar, logs and lumber, and abaca products. Except for coconut products, most of these items experienced a downward trend in earnings since the late 1970s. But two new items, electronics and garments, became important export earners by 1980 and were the major source behind the growth in export earnings during the 1980-93 period. Over the same 1980-93 period, the share of coconut, sugar, forest and mineral products in total export earnings fell from 51 to 9 percent, while the share of electronics increased from 12 to 31 percent and that of garments from 9 to 20 percent.

The imports consist mostly of consumer goods, machinery and transport equipment, mineral fuels, chemicals, food and live animals, and crude materials excluding fuels, in that order of importance. In the 1970s, the imports of mineral fuels accounted for more than one-fourth of the total import bill, which has shrunk to 12 percent by the early 1980s due to the stagnation of the industrial sector and the decline in oil prices in the world market. Once industrial activities pick up, mineral fuels will again become an important component of the import bill. The Filipino people prefer imported durable products, irrespective of quality, to domestic manufactures, and the large crowd in duty-free shops of returning overseas workers and their relatives is a common sight. The share of consumer goods in the total import bill has been increasing consistently since the mid-1970s.

The deficit in the balance of payments amounted to nearly 8 percent of the GNP in the 1970s, which was

Table 4 - Growth and Composition of External Trade, 1976-93

Item	Year			
	1976	1980	1986	1993
Export earnings (percent of GNP)	15.1	17.9	16.6	20.5
Composition of exports (as percent of earnings)				
Coconut products	21.0	14.0	8.1	4.3
Sugar products	17.8	11.4	1.0	1.1
Forest products	12.0	8.1	3.7	0.4
Mineral products	11.9	17.8	5.4	3.2
Electronics	-	11.6	20.9	31.2
Garments	1.1	8.6	18.6	20.0
Import payments (percent of GNP)	23.3	25.6	18.4	33.8
Composition of imports (as percent of import bill)				
Machinery and transport equipment	29.3	23.6	15.6	32.7
Consumer goods	21.0	26.5	38.0	34.3
Mineral fuels	23.9	28.4	17.1	11.5
Chemicals	10.0	9.8	14.4	9.7
Food and live animals	8.7	6.9	8.5	6.8
Trade balance (percent of GNP)	8.2	7.7	1.8	15.3

Source: Asian Development Bank, 1994, *Key Indicators of Developing Asian and Pacific Countries*, Economic and Development Resource Center, Manila.

financed with easy availability of foreign aids and loans till the end of the decade. But with increasing debt service liabilities and the tight foreign aid situation after the second oil price shock, it became difficult for the government to manage the balance of payments situation. The government resorted to devaluation of the peso to reduce the gap in the balance of trade. The exchange rate was depreciated from P8.54 per US dollar in 1982 to 20.4 by 1986, which had the desired effect of reducing the import bill from 25.6 percent of the GNP in 1980 to 18.4 percent by 1986. It did not, however, have much effect on increasing export earnings as most of the exports were primary products with inelastic foreign demand and domestic supply. In fact, the export earnings also fell from 17.9 percent to 16.6 percent of the GNP. For imports, the impact was more on capital goods and raw materials than on consumer manufacturers thereby adversely affecting the industrial sector. The trade gap narrowed substantially to 1.8 percent of the GNP by 1986, but it could not be sustained. Imports again started growing at a much faster rate than exports, and by 1993, the negative trade balance reached 15.3 percent of the GNP. The growing trade gap is being financed with the increasing flow of short-term, private foreign investment and remittances from workers employed overseas.

Unemployment and Poverty

The combined forces of rapid growth in labor force and the slow pace of employment generation in productive sectors created a large pool of unemployed and underemployed workers. The unemployment rate remained low in the 1970s at 4-5 percent of the labor force, but increased to 7 percent by 1985 and to 9 percent during the 1991-93 period. The deceleration in the growth of productivity of the main cereals—rice and corn — and the contraction of the export markets for agriculture-based products, coupled with the arduous nature of farm jobs pushed literate workers to move out from farm to nonfarm occupations and from rural to urban areas. This tended to depress real wages outside the farm, especially for unskilled occupations in the informal

services sector. The decline in real wages was much faster for skilled and unskilled workers in the nonfarm sector than for agricultural laborers (Balisacan, 1994).

Increasing unemployment and declining wage rates imply deteriorating living conditions of the poor people. Table 5 shows the extent of poverty in the Philippines during the 1961-91 period. In terms of the level of per capita incomes, the Philippines has a large proportion of poor people estimated at 65 percent for rural areas and 47 percent for urban areas. This is mainly because of the high concentration of assets and income. The Gini Coefficient of income distribution is estimated at 0.38 for rural areas and 0.43 for urban areas. Available evidence does not show any direct relationship between economic growth and incidence of poverty. During the 1960s when economic growth was impressive, the inequity in income distribution became more acute particularly in rural areas, but there was substantial improvement in the poverty situation. The higher income groups benefited more from the growth, but because the rate of growth was impressive, some benefits also reached the poor. But it is interesting to note that during the economic recession in the 1980s, the improvement in poverty

Table 5 - Incidence of Poverty in the Philippines, 1961 - 1988.

	percent of poor people		Gini concentration ratio of income	
Year	Rural areas	Urban areas	Rural areas	Urban areas
1961	80.2	65.0	0.39	0.51
1965	71.2	57.4	0.41	0.50
1971	66.1	51.3	0.45	0.44
1985	63.3	52.0	0.38	0.44
1988	54.1	40.0	0.38	0.43

Source: Balisacan (1992, 1994).

situation continued which may partly be due to the reduction in income inequality in rural areas as shown by the decline in the Gini Coefficient. It suggests that the middle and upper income group may have been hurt more by the economic recession than the lower income groups.

Macro Policies and Economic Management

Industrial Policy

The Philippines followed an import substitution industrialization strategy that continued to dominate industrial policy until the early 1980s and greatly influenced the formulation of government policy in other sectors of the economy. A 1950 legislation required licensing for all imports and established controls on foreign exchange allocation by an Import Control Board. These measures created an industrial oligarchy who oriented their production toward the domestic market and established an inefficient industrial structure based on extraction of rents under the umbrella of import protection.

Baldwin (1975) argued that industrial growth was significantly accelerated during the 1950s by the import substitution policies of the government. But once the relatively easy type of import substitution was over, the growth in the manufacturing sector as well as in the economy as a whole declined. There was considerable distortion in resource allocation created by these inward-looking policies, and the bias toward capital-intensive production reduced the scope of employment generation. The bill on account of imports of capital equipment and raw materials exceeded the savings of foreign exchange from domestic production of potentially importable consumer goods and contributed to widening the gap in the balance of trade. In the early 1960s, faced with foreign exchange shortage, allegation of corruption in import licensing and foreign exchange allocation, and pressure from landed interests and exporters of agro-

based products, the government undertook a policy of phased elimination of the import control system and devalued the currency by almost 100 percent.

In the mid-1960s, a policy of export promotion was followed in industries identified as "pioneer" or those with new products or processes and those considered preferred or with substantial excess capacity, without changing the structure of trade protection. The Investment Incentives Act of 1967 established the Board of Investments to determine investment priorities, process applications, and administer incentives. The Export Incentives Act of 1970 extended support to registered exporting firms in the form of tax exemptions, duty-free imports of capital equipment, and duty drawbacks on imported intermediate goods. The export incentives were further extended in the 1970s by presidential decrees establishing export processing zones and bonded warehouses with a preferential rediscounting facility at the central bank on credit for export financing. The unrealistic exchange rate policy and the duty-free importation of capital goods created a capital-intensive bias in industrial development. The structure of exports shifted away from agro-based industries heavily dependent on the use of domestic raw materials to industries with very low value added component based on imported raw materials and capital goods. This partly explains the slow growth of industrial employment and value added in spite of a rapidly expanding foreign trade sector.

Although the need to promote an outward-looking, internationally competitive industrialization process has been recognized since the late 1960s, a serious effort at reforming the structure of trade protection was made only in the beginning of the 1980s. A program for gradual reduction of tariff rates, movement from quantitative restrictions on imports to control through tariffs, abolition of export taxes, and reforms of indirect tax system were part of the first World Bank structural adjustment loan contracted in 1981. The policy reforms were, however, implemented half-heartedly and in an incoherent manner. In a review of trade and industrial policy during the 1986-89 period, Medalla (1990)

concludes that minimal changes have been made in the tariff rates and the structure of trade protection has hardly changed. Another attempt at simplification of the tariff system and trade liberalization in 1990 met stiff opposition from vested interest groups who were politically powerful and have always exerted pressure on the administration to avert policies that hurt them.

Agricultural Policy

Government interventions in the agricultural sector aimed at achieving several, often conflicting objectives such as to stabilize food grain prices, raise farm incomes, maintain low prices of wage goods for urban consumers and industrial workers, and to attain self-sufficiency in foodgrains in the pursuit of food security. The level and nature of these government interventions and the relative importance of policy objectives have, however, changed over time in response to changes in the domestic demand and supply situations of the staple grain, the macroeconomic environment, and the political economy forces. The policy instruments consisted of price policies to influence the incentive structure, public expenditures for irrigation, research and extension to increase farm productivity, and land reforms to improve the distribution of incomes from rice and corn farming.

Domestic rice prices have been influenced by the government monopoly in an international trade and domestic marketing operations under the National Food Authority (NFA). The NFA projects the demand-supply gap and sets the level of external trade to maintain a politically acceptable price level. Quantitative trade restrictions were also imposed on import of fertilizers in the early 1970s but were lifted in 1986. Import tariffs and advance sales tax were imposed on other tradeable inputs such as farm machinery and pesticides. The advance sales tax was abolished in 1986, but import tariffs continue to drive a wedge between domestic and border prices of tradeable inputs.

The impact of the price intervention policies was measured by Intal and Power (1991) by estimating the trend in the nominal and effective protection rates. During the 1960s, the nominal protection rates were lower for inputs than for outputs, hence, effective protection was positive. During the 1970-84 period, the nominal protection for rice was negative while the domestic prices for inputs continued to be higher than the border prices, which resulted in negative price incentives for rice farmers. The continued downward trend in the price of rice in the world market with an upward trend in domestic prices has turned the nominal protection rate positive since 1985, but the negative effective protection rate continued till the end of the 1980s. The price incentives again turned in favor of the farmers during the 1990-94 period.

The government also invested heavily during the 1970s in the development of irrigation facilities. The government constructed, operated, and maintained large surface water-based irrigation systems. Although irrigation fees are charged to farmers, actual collections do not fully cover the cost of operation and maintenance, and the investment costs are fully subsidized. At its peak in 1979/80, the expenditure for irrigation accounted for 20 percent of total public expenditure for infrastructure development and 40 percent of the expenditure for the agricultural sector. With the sharp drop in world rice prices, severe budgetary squeeze and debt service problems since the early 1980s, public expenditure for the development and maintenance of irrigation facilities fell sharply in real terms, which was the main contributing factor to deceleration in the growth in rice yields since 1984.

The Marcos government enacted land reforms in 1972 by imposing ceilings on landholding at 7.0 hectares to improve the economic conditions of the tenants. The reforms stipulated that share tenants who worked from a landholding of more than 7.0 could purchase the land they tilled, while those on holdings of less than 7.0 would become leaseholders. Certificates of land transfer (CLTs) were issued to tenants and emancipation patents (EP) were to be granted to new owners

when they complete compensation payment to the former landowner. The program, however, was applicable only to rice and corn farms where the concentration of land ownership was less acute. The plantation crops were left outside the purview of the land reforms. During the 1972-85 period, CLTs were issued to only 755,000 out of which only 12,000 were covered by EP.

The Aquino government (1986-92) instituted a Comprehensive Agrarian Reform Program (CARP) in 1987, which covered all agricultural lands, but had limited impact because of various exemptions, loopholes in legal provisions, and weak and slow implementation. Only 293,000 hectares of land were distributed to 173,000 farmer-beneficiaries. While both reform programs intended to reduce share tenancy, the proportion of tenant farmers and the incidence of tenancy actually increased during the 1971-91 period.

Monetary Policy

The Philippines has one of the least developed financial systems in Southeast Asia. In 1987, the money supply was only 22 percent of the GNP in the Philippines, compared with 31 percent in Indonesia, 67 percent in Thailand, 75 percent in Malaysia and 85 percent in Singapore. The money market is characterized by the government's repression of asset prices, subsidized equity programs for private development banks, and an oligopolist commercial banking system nurtured by the Central Bank's aversion to the entry of foreign banks.

The policy regime in the financial market has gone through three phases. During the 1956-73 period, the government allowed market forces to operate in the money market while controlling the intermediation of surplus funds through the banking system. Lending rates were governed by the Usury Act of 1916 which prescribed ceilings on interest at 12 and 15 percent, respectively, for secured and unsecured loans. The deposit rates were fixed at low levels and hardly adjusted with changing inflation rates. During the period

1974-81, the coverage of the central bank's authority was broadened to include the pricing of assets and the structure of all financial institutions involved in credit allocation. While rates on long-term deposits were deregulated, the Central Bank continued to specify interest ceilings on short-term instruments. Incentives for intermediation in the money market were dampened by a reserve requirement of 20 percent of deposits of commercial banks and non-bank financial institutions and a 35 percent transaction tax on all primary borrowings in the money market. Beginning in 1981, a mix of free and administered market policies have been promoted with the lifting of ceilings on interest rates, but further control of financial intermediations through the imposition of record high reserve requirements and taxes on deposit transactions. In 1984, the reserve requirement was raised to 24 percent, and a 5 percent tax on gross receipts of banks and a 20 percent tax on deposits and money market earnings of depositors/investors were imposed. These taxes comprised 25-39 percent of the average intermediation cost of the banks.

The trend in the nominal rates of deposit and lending rates of interest can be seen in Table 6. It also compares the interest rates with the rate of inflation in the country. The real rates of interests on savings deposits have almost always been negative. The lending rates were raised and kept at high levels throughout the 1980s. The difference in interest rates between time deposits and loan and advances were raised from less than 5 percent in the 1970s to around 10 percent during the 1980s. This large gap is due not only to the high rates of taxes on financial intermediation but also to the oligopolistic nature of the financial market. The system thus discouraged mobilization of savings and financing of investments by small-scale entrepreneurs who have little access to financial institutions.

Fiscal Policy

In the Philippines, fiscal policy is characterized by an expansion of the public sector, an inelastic and regressive tax

Table 6 - Trends in Nominal and Real Rates of Interest, 1965-93(percent per annum)

Item	Year				
	1965-73	1974-80	1980-86	1987-91	1992-93
Deposit rates					
Savings deposit	5.9	7.6	9.5	4.6	9.5
Time deposit	6.7	10.7	12.9	13.8	11.5
Lending rate	12.0	12.9	20.0	19.3	17.0
Inflation rate	11.2	13.7	17.1	11.0	7.2
Real rate of interest	-4.5	-3.0	-4.2	-2.8	4.3
Gap between deposit and lending rates	5.3	2.2	7.1	5.5	5.5

Sources: Asian Development Bank, 1994, *Key Indicators of Developing Asian and Pacific Countries,* Economic and Development Resource Center, Manila, Philippines. National Statistics Coordination Board, *Philippine Statistical Yearbook*, various issues.

system dependent on indirect taxes on domestic manufacturers and imported goods, and financing of growing fiscal deficits with loans initially from foreign and later from domestic capital markets.

The expansion of the public sector in the economy that took place throughout the 1970s was mainly to consolidate the political base of the ruling elite during the Marcos regime. In fact, much of the growth in public investments and the consolidated public deficits during the 1970-84 period could be traced to the increased presence of public corporations. In the post-Marcos era, however, the increase in public expenditure was mainly due to the inflation of the debt service liabilities which increased from 1.8 percent of GNP in 1982 to about 10 percent by 1990.

The tax structure of the Philippines can be seen from Table 7. The tax revenue remained almost stagnant at around 12 percent of the GNP until 1988. During the Marcos regime, property taxes were almost insignificant and income taxes accounted for less than one-fifth of total tax revenue. The government heavily depended on its income on sales and excise taxes on domestic manufacturers, which accounted for nearly a fourth of the public revenue and on taxes on imports and exports contributing another two-fifths to the government exchequer. The income from public corporations declined from 19 percent of total revenue in 1975 to 13 percent in 1983 in spite of the rapid expansion of government control on economic activities. This indicates a trend of growing inefficiency in the operation of public enterprises. In the post-1986 period, however, there has been a commendable effort to increase public revenue through increasing efficiency in the collection of income and trade taxes, while at the same time reducing the rates of import tariffs and eliminating export taxes. The share of income taxes increased from 20 to 29 percent during the 1983-93 period, while the share of trade taxes decreased from 36 to 23 percent due to rationalization and reduction of tariff rates. The revenue from trade taxes increased to 32 percent by 1993 due to increased efficiency in the collection of these taxes.

Sustaining Economic Recovery

The present government which came to power in 1992 has already made a significant improvement in economic management, consolidated political power, and strengthened democratic institutions that created a base for sustained economic recovery. The inflation rate has come down to 5.7 percent, exports increased by 16 percent in 1994 and 26 percent in the first quarter of 1995, while imports grew at 9 percent. There has been a dramatic increase in the inflow of private foreign investment. The power failure almost disappeared because of the personal attention given by the President to the energy sector. The GDP registered a growth of 4.1 percent in 1994 against a 2.1 percent increase in 1993 and is

Table 7 - Tax Structure of the Philippines, 1975-93

Source of government revenue	1975		1983		1988		1993	
	percent of GNP	percent share	percent of GNP	percent share	percent of GNP	percent share	percent of GNP	percent share
Taxes	12.0	81.8	11.0	87.3	11.4	80.0	15.3	88.4
Income	2.8	18.9	2.5	19.8	3.5	24.2	5.0	28.7
Property	0.0	0.2	0.1	0.7	0.0	0.3	0.0	0.9
Excise and sales	3.2	21.6	3.6	28.7	4.1	28.5	4.4	25.3
International trade	5.9	39.8	4.5	36.2	3.2	22.7	5.5	31.8
Other	0.2	1.3	0.2	1.9	0.5	3.3	0.4	2.5
Nontax revenue	2.7	18.2	1.6	12.7	2.8	19.9	2.0	11.6
Total	1.47	100.0	12.6	100.0	14.2	100.0	17.3	100.0

Source: National Statistics Coordination Board, *Philippine Statistical Yearbook*, various issues.

expected to rise to 5.4 percent in 1995. The growth was based on improved fiscal performance and liberalized trade and financial policies.

Several areas, however, need continued attention to sustain economic recovery. One potential weak area is the government's plan for infrastructure development which has been the key factor behind the economic recession. The public sector program for infrastructure development proposed in the Medium-Term Philippine Development Plan for 1993-98 is shown in Table 8. The growth in public expenditure for infrastructure development is planned at 7.7 percent per year which is totally inadequate to support a 7-9 percent targeted growth in national income by the terminal year of the plan. The allocation for energy and power sector is projected to grow at only 3 percent per year, while the expenditure for the communication sector is expected to decline by 25 percent. Only the transport and water resource sectors are expected to grow at 14 percent per year. Total public expenditure for infrastructure development is in fact projected to decline from 4.7 to 3.8 percent of the GNP. The relative reduction in public expenditure may be due to the government's policy of gradually shifting the responsibility of infrastructure development from the public to the private sector. The policy may, however, adversely affect the backward regions and low-income groups and stifle economic growth and accentuate income distribution. Since infrastructure is so underdeveloped and has long been neglected, it must be treated as a high priority area for government involvement.

Another area of weakness is the continuing reliance on foreign investment to finance the trade and current account deficits and to make up for the country's low saving rate which is still substantially below the level reached in the late 1970s. The government must give attention to reduce the import bill on account of consumer goods to eliminate the trade gap, and at the same time, increase the real rates of interest on deposits to encourage and mobilize domestic savings. The government is also going to rely heavily on the private sector for the planned increase in savings and investment rates from 17.6 percent of

GNP in 1993 to 27.8 percent by 1998 as seen in Table 8. This target will be hard to realize unless there is further improvement in efficiency in the financial sector which should reduce the existing large gap between the lending and the deposit rate of interest and provide greater access with regard to credit to small-scale entrepreneurs. The government should also continue its efforts to mobilize more revenue from improving efficiency in tax collection and modernizing the indirect tax system, and to contain the growth in public services to increase its capacity to finance infrastructure development. The medium-term development plan in fact projects a decline in public savings from 6.3 percent of the GNP in 1993 to 5.8 percent by 1998.

Implementation of sound macroeconomic policies will need strengthening of democratic institutions, reducing dependence of politics on vested interest groups, removing bottlenecks in the legal and regulatory systems so that institutions are capable of designing and enforcing non-arbitrary sets of rules to guide economic activity, and improvement in the law and order situations through

Table 8 - Projected Growth in Savings and Investment, 1993-98 (percent per annum)

	Average 1987-92	Actual 1993	Planned 1998
Foreign savings	2.7	5.9	1.7
Domestic savings			
Private	16.6	17.2	23.8
Public	4.4	6.3	5.8
Investments			
Private	16.3	13.9	21.1
Public	2.1	3.7	6.7

Source: Republic of the Philippines, 1993. *Medium-term Philippine Development Plan 1993-98.*

reducing political conflicts. There has been significant achievement in these areas over the last three years and much more remains to be done. Implementation of land reform to reduce the influence of landed interests and local power structure in the political system may contribute greatly to the development of the sociopolitical infrastructure needed for efficient macroeconomic management to sustain high rates of economic growth.

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