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# The Philippine Review of Economics



**ARTICLES IN THIS ISSUE**



**BOOK REVIEW**



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and the **Philippine Economic Society**

**PRE**

# The Philippine Review of Economics

A joint publication of the UP School of Economics (UPSE)
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# Two memoranda from G. Ranis

Gustav Ranis

The renowned development economist Gustav Ranis (1924-2013) will always be associated with the dual-economy model he developed with John Fei [Fei and Ranis 1961]. In addition, however, Ranis took a special interest in Philippine economic affairs and the direction of policy. In 1973, he led a team of foreign and Filipino economists that produced a highly influential volume popularly known as the "Ranis Report", arguing comprehensively for a strategy of labor-intensive export-oriented industrialization and rural development as a development strategy for the country that was then under martial rule. Shortly after the Philippine debt crisis sharpened in 1984 and after the EDSA Revolution of 1986, Ranis returned periodically to the country under the auspices of the U.S. government to provide assessments of the country's economy as well as to provide policy advice to the new government under President Corazon Aquino.

The following are two hitherto unpublished memoranda Ranis produced during that period which the Editors believe yield valuable insights into the history of economic policy-making and political economy. They reflect Ranis's personal assessment of Philippine economic performance and problems confronted by the post-Marcos government. Of particular interest are Ranis's views on what he regarded as important structural reforms needed to lay a basis for sustained Philippine growth after the crisis, how the government's commitment to reforms would likely be affected by multilateral assistance and debt restructuring then being proposed, and the importance of country-ownership of such reforms.

The Editors are grateful to Prof. Florian Alburo of the U.P. School of Economics (who was deputy-director general at the National Economic and Development Authority at the time) for providing access to these documents, which were circulated informally during the period among policy makers and academics.

**JEL classification**: F34, F35, F41, H70
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## I. Macro and micro in the Philippines - December 1988 (January 1989)

In 1973, I was privileged to lead a major inter-agency mission to the Philippines which culminated in the so-called Ranis Report.[1] Since 1984, I have been making repeat visits to the Philippines at the request of the U.S. Government. The last visit under these arrangements took place in December 1988. Given the benefit of this historical perspective, a few general comments on the macro scene may be in order. Section 1 will accordingly focus on my assessment of the current macro-economic setting and of current macro-economic negotiations with donors on policy and resources. Section 2 will present an updating of my views on the crucial rural development scene. These comments build on, but endeavor not to repeat, the arguments presented in my reports of Summer 1987 and March 1988.

### 1. The Philippine economy and the debtor/creditor community

It is difficult to avoid the overall assessment that the Aquino Government has to date been most successful in the political arena, intermediately successful in the prosecution of its various internal counter-insurgency objectives, and least successful in achieving its economic objectives. While there was a good deal of euphoria around during my last visit, based largely on the current recovery of growth rates, a dispassionate look at the facts would tend to quickly bring one down to earth.

Specifically, the 6 percent growth rates during the past couple of years have to be seen in the context of negative growth over the several years which preceded them. Moreover, most of the current recovery has been consumption-led, fueled by large government wage increases and, to some extent, by public sector investment, including in construction. Finally, the Philippines has been lucky in the recent past, both in terms of favorable exogenous shocks, including price declines in oil and price rises in copper and coconuts, and the benefits of currency realignment among her major competitors, plus the impending withdrawal of Generalized System of Preferences (GSP) benefits from her competitors. In other words, it is much too early to talk about a solid recovery, or even a non-spectacular sustainable one, and much more appropriate to see the situation in terms of "getting off the floor" and benefitting from one-shot exogenous shocks. In this context the current argument with the IMF about 6 percent versus 6.5 percent future growth seems to me highly irrelevant.

[1] [This refers to the volume *Sharing in development: a programme of employment, equity and growth for the Philippines* published by the International Labor Organization in 1974—*Editors*.]

But even if one could assume the resumption of 5 percent to 6 percent annual growth rates over the near term, in my considered opinion such growth could well be very reminiscent of the narrowly-based growth performance of the economy in the '70s, i.e., it could, in fact, not serve to ameliorate the underlying malaise of maldistribution, regionally and across families, which has been the basic companion to narrowly based growth in the Philippines historically.

But even the continuation of this current narrowly based growth rate is probably not sustainable in the absence of a change in the effective tax picture. The Philippines has one of the lowest tax/GDP ratios and one of the least efficient investment allocation records in Asia, i.e., a historical incremental capital-output ratio of at least 4. The latter means that any of the assumed rates of growth, varying between 5 percent and 6.5 percent, (with the World Bank actually more optimistic than NEDA), would require an investment rate in excess of 23 percent to 24 percent, compared with the present level of 17 percent at best. The former, with the tax take declining from 12 percent to 11 percent of GDP, i.e., moving in just the opposite direction of what was anticipated, means that it would indeed seem difficult to be able to maintain even a 5 percent to 6 percent growth rate in the future unless additional foreign capital filled the entire gap. This is neither a realistic nor particularly attractive proposition as will be indicated below. It is to be hoped, as Mrs. Aquino has recently promised, that a major effort will be made to substantially improve collections from the present tax structure. What has apparently contributed to the current problem is the all-too-rapid switch from sales to value-added taxes, an unnecessary major reduction in domestic petroleum prices linked to the decline in international prices, as well as a loss in import duties due to an increase in smuggling. But the basic issue, I believe, is that the Philippines is faced with a taxpayers' revolt based on the absence of effective land taxes and the general perception on the part of most of the population that the benefits of government expenditures are unlikely to be commensurate with the taxes paid.

As it is with the switch from under-the-table to on-the-table taxes, it is with other dimensions of the structural reform program to which the Philippine Government is itself officially committed. Specifically, much still needs to be done in terms of the commitments on import liberalization, especially on the non-tariff side; with respect to a more efficient functioning of public enterprise, and the privatization effort which has become bogged down; with respect to a really active exchange rate policy, which currently exists in name only; and, most of all, with respect to the broadening out of the non-agricultural base from the relatively small band of urban large-scale industrial enterprises. Financial reforms remain incomplete, especially in the non-agricultural sector (see my earlier reports), but even in agriculture the Philippines retains an agricultural lending quota system, instead of moving to rural credit; the gross receipts tax continues to help create huge gaps between deposit and lending rates (which indeed have increased over the past year); and the Central Bank's policy of restricting entry to new rural branch banks continues unabated.

One has to acknowledge substantial success in the removal of the agricultural monopolies, the reduced role of the NFA, etc. And it is the better part of wisdom to leave to one side the issue of land reform, a very big subject on which the jury is still out but on which there is precious little unofficial optimism. All in all, it is perhaps not too harsh a statement, therefore, to conclude that full reforms have been accomplished mainly where Marcos cronies were involved, e.g., the agricultural monopolies, while effective defensive responses from vested interest groups have made themselves increasingly felt over time in most other areas.

It is hence also no exaggeration to note that the sacrifices incurred during the austerity period of '83-'85, which could have laid a good basis for more fundamental reforms to follow, have not been compensated in any sense of the word. Thus, the time that was bought at considerable sacrifice, especially by the lower income groups, has not been used to good advantage. And now, as higher growth rates resume, there is a very real threat of a return to the atmosphere of the '70s, i.e., one of complacency, the feeling that good growth rates can refloat all the ships and a lack of concern with the narrowly based and temporary nature of this resumed growth path. This new complacency is, I believe, further complicated, in contrast to the 1970s, with the welcome return to democracy and increased congressional pressures which often move things in a populist and short-term redistributional direction rather than towards finally "biting the bullet" in terms of the Philippine Government's own assessment of what needs to be done to ensure sustainable growth with equity.

Given some historical perspective, I do, of course, perceive a major shift, since the early '70s, in what the Government as well as the private elite stress, in terms of the society's expressed objectives, and even instrumentally. Everybody seems to be agreed now on the importance of agriculture, of the rural economy, of small and medium enterprises and of balanced growth in the rural areas. This represents a 180° shift from the focus of the discussion in the early '70s. But when it comes to implementation the picture is still not so different; and when it comes to the agenda for further action, I am afraid I must say that the glass is more than half empty.

It is in this context that current discussions about a Multilateral Aid Initiative (or Philippine Aid Plan) could assume special importance. There is little doubt that substantial additional resources will be flowing into the Philippines even if no new aid initiative gets off the ground; the U.S. bases agreement and Japanese recycling plans already provide for substantial additional inflows, as do the lending intentions of the international agencies, the World Bank, ADB etc. The question before the house is whether these inflows can be utilized to materially change the structure of the economy or to permit it to continue on its present course. The sense of complacency that I fear-is currently reasserting itself in Manila, even as compared to two or three years ago, is in danger of being further enhanced by this presumptive easy access to additional foreign capital, virtually for the asking. Realistically, this is the most likely outcome; but it is not inevitable.

My basic concern, in other words, is that what easy access to commercial bank lending did to incipient reforms in the Philippines in the mid-70s could well be duplicated by the easy access to public capital flows in the 1990's. It is for this reason that I believe a Philippine Assistance Program[2], properly fashioned, represents an opportunity and should retain our high priority attention -- and not only from the point of view of its political visibility and its ability to help attract additional resources, but emphatically also its contribution to the necessary task of restructuring as defined by the Philippine policy makers themselves. This requires that the additional resources be used to ease the pain of adjusting to policy changes which the Philippines views as in her own interest, rather than - as in the past - to enable the system to continue along a second- or third-best growth path. It would indeed be a major tragedy if the Philippines, in contrast to what's happening in Thailand and threatening to happen even in Indonesia, misses once again the opportunity to do what the majority of its own analysts believe to be in her own best interests.

In my view, it is important, therefore, for both the international community and the Philippines to seize on the possibility of a Philippine Assistance Plan with all seriousness—more with an eye to improving the quality of what goes on between the various parties, rather than mainly as an instrument for enhancing its quantity, though the latter would naturally follow and be helpful. The importance currently being attached to the Philippines, internationally, for a number of reasons, including geo-political, especially by the United States and Japan, provides us with perhaps a fleeting opportunity. It should not be lightly discarded by relegating the new process to something ill-defined, an "enhanced consultative group", but more than likely to deteriorate into the usual ritual dance we have become familiar with. Instead, I think it might be used to provide a fresh opportunity to address the question of just how the Philippine adjustment process can be substantially improved to take advantage of these prospective increases in resources in a reliable fashion. This would require the major donor/creditors to be involved in a process which has technical credibility as well as political acceptability, both in the Philippines and outside, and could thus provide a new window, lending freshness to a tired process, intellectual as well as political.

As far as the intellectual side is concerned, the major contours of a synchronized, sequenced basic reform program in the Philippines are probably well understood by now. No major innovations or miracles can be expected. Rather, the problem has been and threatens to continue to be one of political will

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[2] [The official name became the Philippine Assistance Plan or Multilateral Aid Initiative, an effort among several donor countries and multilateral financial institutions to increase levels of official development assistance to the government of Mrs. Aquino. Ranis sometimes switched to using "Aid" instead of Assistance and "Program" instead of Plan, understandably since the final terms of the plan were still being discussed at the time of his writing.—*Editors*.]

and implementation. The question is how one obtains the support of more than a narrow technocratic elite committed to putting the country on the path previously followed by the East Asian "tigers" and currently by some of the Philippines' ASEAN neighbors.

How can the majority of the decision makers, politicians as well as technicians, be convinced that more than another ritual dance is required to achieve "growth with equity" along new tracks in a country which has been debating these matters for a long, long time? It is, in my view, in the area of modest institutional-organizational innovation that a new way must be found to permit the virtually inevitable additional resource flows to be associated with domestic policy packages, negotiated in a way which is more effective and acceptable to all the parties than our past experience.

My own view continues to be that a wise men's group, requested by the Philippine Government, to fashion a resources cum additional policy action program over a five- to ten-year period, which would then be submitted to the Consultative Group for discussion, amendment and action, might provide a way out of the present impasse. It seems clear to me that a segment of the Philippine Government is suspicious of a segment of the international community which is seen as having its own (changing) fads and agendas, serving special DC interests, blowing hot and cold at different times of the year and, most importantly, showing insufficient understanding of domestic political constraints. There are, indeed, influential members of the Philippine cabinet who come close to rejecting all efforts at conditionality, certainly by bilateral donors, and focus only on the additional major resource needs to restart growth with equity. But even they recognize the need for additional policy changes. What I perceive them to feel strongly about is the need for any real reform program to be domestically "owned", in substance as well as appearance, with technical and financial assistance provided from the outside—in contrast to somebody else's program which they are forced to sign off on, understand it or not, and like it or not. If the Philippine Assistance Plan is to become part and parcel of the decision-making process in the Philippines and, as importantly, part of the domestic implementation process, I believe the initiative must be allowed to shift from the international agencies to the Philippines and the conditionalities attached to the package over a longer, i.e., five-to-ten-year, period be increasingly self-imposed.

What this implies is that, putting to one side continuing programs of the "business as usual" variety, the international donor community, including the United States, be willing to play a more passive, banker-like role, i.e., ready to respond to a request for a major temporary ballooning of resources in relation to the ballooning of policy commitments. In an increasingly politicized Philippine context, it will become increasingly difficult to accept programs seemingly imposed by an enhanced World Bank-dominated super CG [Consultative Group] and virtually impossible to implement them.

The biggest problem for a major donor, especially one with so many other relationships with a country, as the U.S. has with the Philippines, is that we have a "need to lend" and to continue to be "in the game", a motivation more powerful than the need to ensure the quality of the process, a fact not lost on the Philippines. Paradoxical as it may seem, the routinized consultative group meetings, emergency reviews, bridge loans, and weekend crisis meetings to rescue countries really tend to drown out substantive policy dialogue and make it less rather than more likely that substantial policy change results. Consequently, I believe the Philippine Government should be encouraged to take the lead in proposing their own Philippine Assistance Plan—possibly assisted in the task by an independent group of experts—to which the international community would then be expected to respond. This, of course, requires endorsement of this somewhat different process by all the parties in advance, i.e., agreement that at least the joint technical assessment which emerges represents a common point of departure for further negotiation.

We all recognize that neither the Fund nor the Bank nor any of the bilateral donors, nor even the Philippine Government, will hand over their charter obligations to any third party. But what could be expected, and indeed required if one is to achieve something of a departure from the routine of the past, is an *ex ante* stated willingness by that international community and Government to take the findings of such a wise men's group, assembled by the debtor country, as the baseline for the negotiations which would inevitably follow. The process would have to be endorsed not only by the Philippine executive branch but also by the legislature in order to reduce the chances for internal mischief as well as to ensure broad political support for what may be termed a mini-Brandt Commission on the Philippines.

What is basically suggested here, therefore, is that while "business as usual" inevitably continues, if a Philippine Assistance Plan is to come into play, with additional resources and additional policy commitments, we need a negotiating process which is more passive from the outside and more self-conditionality-oriented on the inside. Instead of just adding another layer of review, it would be hoped that such a process would indeed also reduce the annual volume of separate friction-laden missions, each asking very similar questions of the same badly stretched senior Philippine officials. Needless to add, the all-too-frequent occurrence of donors being played off against each other, on the one hand, as well as the perceived threat of cross-conditionality, on the other, would consequently be minimized.

Like Mexico, and very few others, the Philippines has a special place in the foreign policy considerations of any U.S. administration. By initiating a truly multilateral process which provides a better chance for long-term development in the Philippines, and thus the long-term security of any bases, there is an opportunity here, it seems to me, for an independent group of experts, responsible to the Philippine Government but endorsed by the international community, to commit itself to program conception as well as implementation, in the sense of being able to be called back some years down the road. While, for most countries, given the current budgetary concerns in most of the D.C. capitals, no additional large-scale capital flows can be expected, the Philippines is currently something of an exception. This is why the Philippine Assistance Plan represents a chance for a somewhat different ball game which may not be there forever. We should all be talking much less about debt relief or moratoria and much more about how additional resources, however made available during this unusual "shot-gun honeymoon" period, can be utilized for really good purposes. Already a good deal of cynicism seems to surround the Philippine Assistance Plan within the Philippine Government. Yet the U.S. is on the line to do something "special"; discussions with other donors, especially the Japanese, have gone forward. If the process is now permitted to deteriorate into just another extension of the routines of the past, I think we will all have missed a substantial opportunity.

## 2. The most critical micro-issue: rural development/decentralization

As was pointed out in earlier reports, indeed ever since the early 1970s, nothing will probably be more critical to the success or failure of the Philippine economy over the next decade than its effort to mobilize the rural economy, both its agricultural and non-agricultural components. The system's capacity to move forward on this front as part of a two-pronged attack on the system's historically narrow development base, i.e., along with export-oriented labor-intensive industrialization, in turn, depends heavily on the extent to which the requirements of rural credit, infrastructure, and technology diffusion are satisfied. These in turn, as has been pointed out before, depend heavily on the extent to which the Government can be persuaded to decentralize decision-making power to local bodies.

Given the fact that a measure of autonomy is mandated by the 1987 Constitution, the battle about the interpretation of this mandate and its implementation is currently being joined in Manila. To my mind, there exists no potentially more serious sectoral micro-issue currently before the body politic, and thus before donors who want to be helpful, within the overall context of the kind of macro-economic bargaining discussed in Section 1.

As one would expect, the definitions about decentralization/autonomy currently invoked in Manila abound. The Department of Trade and Industry apparently views decentralization as consonant with the establishment of BOI [Board of Investments] branches and People's Economic Councils. While the Department of Agriculture's intentions are clearly different, the present reality as incorporated in the National Agricultural and Fisheries Councils is not much better, i.e., both are based on the principle of something that is being handed over on a string but still subject to central control.

NEDA [National Economic and Development Authority], previously focused too exclusively on the Regional Development Council structure, gives evidence of a recent change in attitude—even from its recent CEDP[3] experience—but there still remains a large question of whether or not the regional level is not much too aggregative for purposes of real decentralization, especially since the regions are not really viable units but mainly drawn for administrative and/or political convenience. Finally, there is a minority which defines decentralization as autonomy at the sub-regional level, i.e., at the provincial, municipality, and even barrio level, with a substantive relaxation of strings in the offing.

The facts are quite clear; in spite of the large volume of rhetoric on this subject in vogue for decades, at present local government units control only about 4 percent of the total public investment program. Even where local governments' fiscal powers are on the books, e.g., with respect to the property tax, only a very small percentage of the potential is collected, largely because there exists very little confidence that what is sent up will come down in any way which is perceived as really productive by local bodies.

At the same time, several initiatives are currently in the works. One is decentralization to the Mindanao and Cordillera Autonomous Regions, both of which have strong political motivation and a relatively short time fuse. It is difficult, for this observer at least, to see how this type of decentralization can be or should be, in fact, generalized to the rest of the economy over the short run. Secondly, the Governors' and Mayors' Conferences are getting more heavily involved, with the Governors' Conference currently apparently in a position to allocate infrastructural investments both at the provincial level as well as below, i.e., to municipalities on the basis of actual or anticipated project performance. If that particular decision is ultimately upheld, decentralization would clearly stop at the provincial level. Finally, the Department of Local Government favors direct grants, both at the provincial, the municipal, and possibly at the barrio level. But at the time of my December visit they had apparently been at least temporarily overruled in favor of the Governors' Conference scheme.

The best test of a really viable decentralization or autonomy program, in my mind, as I have pointed out in earlier reports, is the institution of an honest-to-goodness block grant program, or, preferably, programs. I strongly believe that such block grants must have the features of automaticity, universality, and continuity and should not be confused with, possibly very worthwhile, pilot programs, impact programs, or politically motivated autonomy measures for particular regions. In other words, in addition to all else that may be, and is likely to be, going on, it is very important to have a small, relatively clean-water, block-

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[3] [The Countrywide Employment Development Program or CEDP was a major initiative of the Aquino government to revive employment through public spending on road and irrigation construction and repair in rural areas. —*Editors*.]

grant program, which reaches every single municipality and province—later on perhaps even barrio—with a small amount of dependable resources to be allocated according to the priorities set by the local bodies. It is vitally important, in other words, that, in addition to any Governors' Conference allocation, there will also be direct municipio level block grants to handle the allocation of somewhat smaller scale infrastructural investments. Ultimately, once there is additional human capacity in place, one should be prepared to institute a small direct block grant program at the barrio level as well.

The administration of all such block grant programs should ideally be in the hands of the Department of the Budget as the issuer of checks directly to the various local bodies, with the Department of Local Government as presently constituted kept "out of the loop". This is not because there aren't individuals in the Department of Local Government who have the best intentions in terms of devising an honest-to-goodness-block-grant program with all the aforementioned attributes, but because I think it is difficult, given the history of that Department and its past interventionist image, including some very legitimate and important political functions, for it to, in fact, also perform the role being discussed here. In other words, I doubt that that Department can acquire the kind of credibility needed to turn the corner on this very important matter. It will perhaps be argued that the NALGU[4] funds already in existence constitute block grants; but they do not have, in my view, the critical aforementioned attributes. Instead, they are associated, like the BALGU[5] funds, with the customary type of political decision making, ad hoc refusals and approvals, concessions, etc., i.e., non-automaticity of the kind which would simply represent another iteration in the long, sad history of past "decentralization" efforts in the Philippines. One really cannot easily overemphasize the deep cynicism which exists in the Philippines on the subject of decentralization and with respect to the current efforts and intentions of the central government, given its long and checkered history on the subject. Calling something "structural adjustment" when it hasn't been very costly; calling something "decentralization" when it isn't is to spoil the market once again, especially costly after the presumably new start under the "people power" banner.

I would argue that the block grants to provinces and municipalities should be as general purpose as possible, i.e., restricted only to such broad categories as agriculture, health, education, infrastructure, science and technology, without any pre-allocation requirements or priority-setting. It would be my expectation that the provincial engineering officers and other equivalent central government

[4] [The National Assistance to Local Government Units was an umbrella fund that subsumed various sources from which the executive branch directly provided assistance to local governments. This system was replaced by the Internal Revenue Allotment under the Local Government Code of 1991—*Editors*.]

[5] [Under the Budgetary Assistance to Local Government Units, funds were released directly from the executive to local government units in a more or less discretionary manner. BALGU was part of NALGU—*Editors*.]

technical cadres would be available to assist local bodies with respect to the "how-to-do" aspects of infrastructural construction. Eventually, these officials might well (preferably) become creatures of the local government units; at present, only auditing and control-oriented types of officials are assigned to these local bodies. (But the distance we still are from such a reality is indicated by the fact that current Department of Public Works and Highways policy permits devolution to local bodies, *except* if foreign funds are involved in the project, i.e., there exists very little confidence in the quality of local body decision making).

Any viable autonomy program must also take into account the role of the newly elected congressmen who, quite naturally, would like to take credit for specific projects at the local level. In my view, once the budget has been approved, congressmen, through the consultative assemblies, should be able to make their views known at both the provincial and municipal levels but should not have the power to change priorities. At the same time, while there exists a natural conflict between mayors, governors, and congressmen, it should be possible to spread the credit and the photo opportunities in response to a very natural need. In addition, it may well be necessary to have a small "slush fund" at the disposal of each of the congressmen, which, again, should *not* be confused with a block-grant program.

Much of what is being proposed here is influenced by my reading of the experience of the Indonesian decentralization program, which, to the best of my knowledge, has worked extremely well. I would strongly urge that this experience be carefully reviewed by Philippine decision makers as well as by donors who want to be helpful and wish to be associated with an inherently indigenous routinized block grant program. I understand that a group of Philippine Government officials is, in fact, planning such a visit, and I would hope that the experience is examined in some depth.

A major benefit of authentic decentralization, in addition to enhancing the efficiency of the infrastructural allocation and prioritization process, would, of course, be on the fiscal side. Especially given the relatively low tax to GDP ratio in the Philippines, this is by no means a trivial issue. Currently, the so-called Internal Revenue Allocation, the proportion of central taxes to be sent back down to local authorities, has fallen substantially below the 20 percent indicative level of the past. But more important is the fact that less than 18 percent of the total property tax collection potential, a tax assigned to local government for its own retention, is currently being realized. Since the Philippines is one of the most undertaxed countries (relative to its level of per capita income), any really credible turnaround on decentralization can be expected to raise additional fiscal resources from taxes already on the books and under local control. Moreover, a really dependable block grant program could, over the years, add fiscal incentive schemes in terms of incremental allocations from the center and, more importantly, encourage the raising of additional funds locally and their retention for local purposes.

Finally, I would argue that decentralization should extend beyond the issue of public works prioritization and execution to the other members of the so-called "trinity", i.e., credit and technology diffusion. With respect to credit, this means, as previously emphasized, the willingness to establish rural branch banks, to be more concerned about speeding the rehabilitation of additional rural banks and, in general, to view with favor the establishment of local savings associations. Ultimately, local savings deposits rather than credit lines from above are the answer, both to augment the volume of total savings and the efficiency of its allocation.

Similarly, with respect to the activities of the so-called science and technology infrastructure, as has been mentioned earlier, both PCAARRD and PCIERD[6] represent highly centralized research networks for agriculture and non-agriculture, respectively, with their own internal incentive systems. I have already commented on the need to change these systems by moving member institutes gradually away from complete government subsidy on a descending scale of subsidization, either, in the case of agriculture, by incrementally forcing the sale of services to applied research institutes in the field or, in the case of industry, by forcing the sale of services to the private market. What needs to also be emphasized, however, is the need to regionalize this network and move it out of Manila, because adaptive research, especially in agriculture but also in non-agriculture, can only be done in the heavily differentiated provinces. A small and medium scale rural industrialist ought to be able to somehow obtain the kind of information he needs on appropriate technology variations, quality specifications, markets, etc., in both the alternative process and product senses. This can be best accomplished by a network which links dispersed science and technology institutes with branch banks, both of the commercial and development type. Supervised credit schemes which are part and parcel of the Grameen Bank in Bangladesh and the Aga Khan's experiment in the North-West Frontier Province of Pakistan might well be looked at as examples of packaging decentralized credit with technological tinkering capacity, especially in rural non-agricultural activities, which continue to be an important and neglected step-child in the Philippines.

## II. The Philippines, the Brady Plan, and the Philippine Assistance Plan: prognosis and alternative (May 1989)

This brief paper should be treated as an update of and afterthought to what I had expected would be my "swan song" report of January 1989. It will endeavor to address two main questions: first, what is the current prognosis for the Philippines, given its continued record of economic recovery, the successful

6 [Respectively, the Philippine Council for Agriculture and Resources Research and Development and the Philippine Council for Industry and Energy Research and Development under the Department of Science and Technology. Both agencies continue to exist under the same or similar appellations—*Editors*.]

conclusion of an agreement with the IMF, and progress towards the formulation of a Philippine Assistance Program or Multilateral Assistance Initiative; and second, if that prognosis is accepted, what, if anything, can and should be done about it.

## 1. The prognosis

Economists are often accused of a tendency to see the glass half empty and, moreover, of looking through it somewhat more darkly than the situation warrants. Applied to the present Philippine situation, so the argument goes, why not recognize the sustained recovery in evidence; the apparent recent calming of the political waters on the right as well as the left; a new confidence in the Government's ability to carry through with meaningful additional required reforms; the new willingness of Taiwanese entrepreneurs to invest in the Islands; and the prospective availability of substantial additional financial resources from the outside, i.e., the IMF, the World Bank, the commercial banks as well as bilateral aid, some of which is U.S.-bases related.

It is admittedly not difficult to weave a rather convincing, intrinsically optimistic, story out of the above ingredients. After all, there is no reason why the Philippines at some point in history shouldn't be able to turn the corner and finally make sustained progress towards a newly industrialized country status already achieved by many of her neighbors. The present constellation of events, internal and external, might indeed be just about right: a more confident, self-assertive stance on the part of the Aquino Government which has finally settled in and gotten its political and economic house in relatively better order; the withdrawal of GSP from some of the Philippines' more successful East Asian neighbors; and an international setting which puts the country right behind Mexico on the Brady Plan hit parade—and possibly even higher if the supposedly "unconnected" negotiations on the renewal of the U.S. bases should warrant.

Indeed, the record of the recent negotiations with the IMF, culminating in the, refreshingly public, March 1989 Letter of Intent, seems to provide some evidence that even a number of the more skeptical outside observers are beginning to see the proverbial light at the end of the tunnel. Whether or not the Fund agrees with Professor Dohner's [1989] judgement that "the Philippines has made extensive policy reforms", its willingness to accept the Government's 6.5 percent growth rate target (over its own, more modest, assumptions) presumably indicates the enhanced credibility of the current economic policy package, though the inevitable presence of political pressures to "gild the lily" cannot, of course, be discounted. President Aquino's personal involvement in the IMF negotiations, reportedly overcoming opposition in her Cabinet and overriding nationalist objections in the Congress, must obviously be given some weight—especially if it is viewed as signaling a basic shift in the Government's past inability to ensure timely implementation of agreed on policy changes during the three year period of the new IMF Agreement.

Turning to the contents of that Agreement itself, its more significant components are indeed unexceptionable, as far as they go:

1. an increase in the tax/GNP ratio from 11 percent in 1988 to 14 percent in 1992;
2. a rebuilding of the investment rate to 24 percent, with special emphasis on public investment;
3. a decline in the budget deficit from 2.8 percent of GNP in 1988 to the 1 percent to 1.5 percent range;
4. continued liberalization of the import regime, especially with respect to the remaining items on the B list; and
5. increased competitiveness for the banking industry via a phasing out of the gross receipts tax on financial institutions as well as the 20 percent withholding tax on interest income for inter-bank transactions.

According to the program as outlined, the Philippines would be able to recover, in per capita income terms, the ground lost during the recent crisis by 1992 and, having thus "grown back into its skin", be in a position to then move forward along a sustained growth path towards the goal of membership in the expanding club of newly industrialized countries.

Especially since this is scheduled to be my last report on the Philippines under present arrangements—and I can be as two-handed an economist as some of my colleagues—I would indeed have been happy to modify my earlier (as recent as January 1989) admittedly somewhat pessimistic assessment of the present situation and prospects. I consequently made an honest effort not to let one's natural unwillingness to have been in error stand in the way of a change of heart. Unfortunately, however—and perhaps not unexpectedly—I have to report that I couldn't quite manage it. The reason for my continued skepticism resides partly in what the Letter of Intent had to say but, more importantly, in what it did not say.

In the first category, I note with concern that, as part of the agreement to lower the real rate of interest, the only promise made is that the real rate would be positive (presumably marginally), therefore continuing to leave much of the official market to credit rationing and maintaining the historical large gap between it and the informal market. In the second category, again with reference to interest rate policies, absolutely no mention is made of the fact that a substantial number of non-agricultural credit lines, especially those under the auspices of the Department of Trade and Industry, continue to be non-market oriented, i.e., heavily subsidized.

With reference to the desired enhanced competitiveness of the banking sector, it must be noted that the commitment to phase out the gross receipts and withholding taxes is circumscribed by the phrase "consistent with the Government's overall tax revenue targets"—which has been the official reason for postponing action on this item for more than a decade. The same type of ominous "small print" appears in relation to the potentially crucial willingness to encourage (rather than continuing to discourage) additional rural branch banking when the phrase "by qualified institutions" is added. This caveat presumably will permit the Central Bank which has a well-tested "over-banking" phobia to essentially continue with its past policies.

Finally, in connection with the proposed continued import liberalization program, one can't help but note that a new DTI [Department of Trade and Industry] involvement in licensing, ostensibly "to improve the data base", is being contemplated. One can only surmise that this will, at a minimum, lead to a substantial increase in process protection at the very time when the enhanced liberalization of items on the list can be officially proclaimed.

But most telling of all is the absence of any mention of decentralization and related changes in the method of allocation of public sector infrastructural investments. In spite of the constitutionally mandated requirement for some form of decentralization and in spite of discussions at various levels encouraging some form of block grant program in the Philippines, these issues are not even referred to. Perhaps they are among those purely "supply side" items still relegated to the exclusive province of the World Bank rather than the Fund. But, whatever the reason or whatever the venue, the absence of a firm policy commitment by Government on this subject makes it difficult for me to take much comfort from the customary obligatory references to the importance of rural development included in the Letter of Intent.

What seems to be emerging from all this is the underlying [indiscernible] that the Philippines, and at least some of its creditors, are content to view a return to the reasonably high growth rates of the seventies as a satisfactory definition of the promised land. The focus of recent debate on a 5.5 percent versus a 6.5 percent projected growth rate, with little emphasis on changes in the efficiency of the economy or in its basic restructuring requirements, merely underlines this point. As I have noted earlier, such a return to the atmosphere of the '70s indicates to me a substantial misreading as to what basically still ails the Philippine economy and what needs to be done to ensure sustainable growth with equity down the road.

Let us recall that the Philippines had in the '70s—and still has today—one of the worst income distributions in all of Asia, as well as the largest percentage of its population in absolute poverty in Southeast Asia. Let us also recall that the Philippines, in spite of continued land reform efforts which can only be characterized as half-hearted, sports one of the worst land tenure systems, the largest mass of landless rural workers, and the most pronounced urban industrial bias. We are, therefore, fully entitled to ask: assuming the heavy foreign debt burden were lifted from the Philippines tomorrow, by some act of God—or Brady Plan—but in the absence of additional major policy changes, would the system's underlying development problem be materially closer to solution?

I am convinced that the answer is in the negative that the current debt problem really constitutes in large part a result of the failure to adopt basic changes in development strategy in the '70s. Others also borrowed heavily then but allocated these resources more effectively, e.g., Korea, enabling them to grow and export their way out of trouble. There is very little assurance that elimination of the debt tomorrow—while undoubtedly providing immediate and welcome relief—would do anything but provide additional support for the status quo—and indeed possibly sow the seeds for new difficulties ahead.

A major contributor to the wave of current optimism in Manila is apparently the feeling that there will be enough additional foreign capital around to permit a resumption of high growth rates. This only serves to reinforce my worst fears and it is, in this very context, that the proposed Philippine Assistance Plan, if not properly reconstituted, can do more harm than good. With or without the benefit of Santayana's warning concerning the lessons of history, we should recall that the Philippines grew reasonably fast in the '60s, fueled mainly by natural resource intensive exports, and ditto in most of the '70s, fueled by commercial bank debt. It would be an ironic tragedy if, after the considerable, very healthy, soul-searching which took place during the recent economic crisis, enthusiastic donors now endorsed a public debt-financed return to the same old discredited narrow growth path.

It increasingly looks as if substantial additional foreign resources will indeed be flowing into the Philippines over the next decade, even in the absence of any new major multilateral aid initiative, as a consequence of a presumptive new U.S. bases agreement, current Japanese recycling intentions, ADB, World Bank and IMF financing plans, etc. The underlying question that needs, therefore, to be addressed, as I have been at pains to emphasize in past reports, is whether there indeed exists a determination to use such additional inflows to materially change the structure of the economy as they undoubtedly could be—witness current negotiation with Mexico—or to ease the Philippines' return to a past failed pattern of growth. One of the few real benefits I could indeed see springing from the austerity of the '82-'86 period was the substantial debate concerning the merits and demerits of that past performance and of the alternative rails to which the economy might have to be moved. It is now, however, painfully clear to me that such reconsideration is currently moving onto a back burner—and that the return to a sense of complacency which I had begun to note more than a year ago is gathering steam. There can't be any doubt, moreover, that current discussion about all these additional potential resource flows, including the Philippine Assistance Plan—as vague as its precise contours may appear at present—is fueling this tendency. If I am right, this is a profound shame from a number of viewpoints, not least of which that the sacrifices incurred by lots of little people over the past few years are likely to have been essentially wasted.

More specifically, I would contend that the Philippines' well known tendency to "relax", either because of its good natural resources endowment or its good foreign friends, in combination with the absence of a strong cohesive nationalist spirit—at least in comparison with other developing countries—has traditionally meant a greater tendency for various interest groups to struggle to appropriate existing large rents, including, of course, those that come from the outside, instead of pulling together for mutually beneficial productivity gains. And, while this struggle goes on within the export-oriented and foreign capital recipient enclave, the domestically-oriented hinterland continues to be severely neglected, in spite of all protestations to the contrary. The hard fact is that very little attention has ever been actually paid in the Philippines to vigorous rural balanced growth, as between agriculture and rural industry and services, and even less to the public sector decentralization required for that purpose.

The forces arguing for the resumption of the 1970s posture of "business as usual" are thus formidable, and I recognize them to be such. On the one hand, in spite of the debt problem, the Philippine economy today feels relatively comfortable, with recovery from negative growth and an improved standing with its creditors and donors as a consequence of a number of factors, some fortuitous, such as the improvement in key cash crop export prices, some a natural result of picking yourself off the floor. Moreover, much of this resurgence in optimism is, I believe, based on reliance on the country's strong geo-political standing with the United States as well as Japan. The U.S. in particular is perceived as intent on not being a spoiler at a time when relations are naturally somewhat more tense, nationalistic rhetoric is reasserting itself, and the bases negotiations are just around the corner. Equally clearly, the Philippines, especially in its new democratic setting, finds it much easier under these circumstances to avoid additional major structural changes of a really substantive, possibly painful (at least over the short term) nature. In this environment, it seems clear that there will be an overwhelmingly strong tendency for the need to land for geo-political reasons; on the one hand, and for the "need to borrow" to avoid domestic adjustment, on the other, to sweep all else aside. As a consequence, as in the '60s and the '70s, the system will find it possible, most likely, to continue on its historical non-optimal growth path for some time to come.

## 2. The alternative

The concept of what still needs urgently to be done in the way of restructuring, incidentally, is not just one held by outsiders, e.g., by some within the international agencies or professors at Yale, but by many thoughtful people within the Philippines, as evidenced in such gradually obsolescing exercises as the U.P.'s "green" and "yellow" books of yesteryear.[7] With the pressure off, consideration of these issues has increasingly taken a back seat and, as a consequence, the very economic opportunity that the Philippines' geo-political importance provides is likely to be its undoing in the political economy sense. While the Philippines is certainly not alone in preferring "the quiet life" to painful structural change, it is undoubtedly also one of the foremost practitioners of that art.

Thus, I am afraid I see little reason to believe that the current golden opportunity of combining a ballooning of additional resources from the outside with some really major shifts in development strategy on the inside to bind up the wounds has much of a chance. It would certainly require at least a 90-degree shift in the way I perceive the major players' thinking at the moment. My only rather forlorn hope is that since the Philippines seems so frequently to look to Mexico as the country which gets a "better deal" on debt and is always a half of a step ahead of it in terms of winning the favor of the United States, it might also find it worth exploring just what Mexico is doing internally in terms of the rather heroic policy changes adopted over the past couple of years—in the expectation that the substantial international financial flows required to make them stick will be forthcoming. The Mexican case indeed comes close to what, in my view, is an ideal sequence: a developing society assesses, largely for itself, what it needs to do, negotiates an internal social contract involving a good deal of pain, and then asks the international community for the necessary support to ease the pain.

What would I do today that is different in the Philippines? I have already expressed myself along these lines several times, but will recap it briefly. I am convinced that there are many influential Filipinos, not only technicians but also politicians and businessmen, who basically agree with the notion that the country will never become a true newly industrialized country and catch up with its neighbors if "business as usual", now to be financed by public credit instead of private loans, is permitted to continue. It is no longer a question of knowing what to do, but rather a question of why it has thus far been impossible to get the proper political coalition focused on the need for change. This requires, on the one hand, a willingness by the international community to pause in its effort to force more money down Philippine throats, e.g., to find ways of somehow filling up a new, longer shopping list of projects and programs for the proposed May Consultative

[7] [These refer respectively to Agricultural Policy and Strategy Team [1986] and Alburo et al. [1986]—*Editors*.]

Group meeting to consider the Philippine Assistance Plan; both sides should instead view the additional resources possibly available under that umbrella as something to be negotiated, not with the primary aim of reaching certain politically attractive overall resource flow levels, but with a focus on associated major time-phased shifts in the fundamental policies of the Government. This would indeed require, in my view, an uncharacteristic willingness on the part of the Philippine Government to take time out to propose a carefully orchestrated five-year restructuring program focused largely on the mobilization of the rural economy, and on the part of the donor community, it would require an equally uncharacteristic willingness to hold off on any Philippine Assistance Plan until the Philippines is in fact ready to propose a thorough-going new program of time-phased structural reform.

The precise components of such a program, of course, still have to be spelled out, but its general contours are pretty well known. It is important that it be formulated by Filipinos, possibly with the assistance of a wise men's group from the outside, but responsible to the Philippine Government (I have discussed the dimensions of such a format in previous reports). The bottom line will be whether or not there are enough Philippine decision makers in high enough places today who recognize the opportunity that currently exists and are willing to do something about it—rather than follow the customary path of least resistance. This means focusing less exclusively on the short-run debt crisis and on how to negotiate most effectively on debt relief and new funds—and instead on such strategic issues as the implementation of effective public and private sector decentralization measures, accompanied by a national program of block grants to every municipio and, eventually, every barrio in the country.

It seems clear to me that many segments of the Philippine Government, the Congress included, are increasingly suspicious of the international community with its own changing fads and agendas, its presumed neo-imperialist interests, and unhappy with its occasionally demonstrated insufficient understanding of Philippine domestic political constraints. I also believe that there are members of the same Philippine decision-making elite who recognize fully the need for substantial additional policy change but want to make sure that any such proposal is fully domestically "owned", quite in contrast to an IMF or World Bank or USAID program which, in the tradition of the last 15 years, is signed off on but lacks credibility in terms of being implemented or even fully accepted in the first place. If the impending Philippine Assistance Plan is to be a different type of instrument, serving a different purpose at this particularly important point in Philippine economic history, I do believe that it ought to be shifted towards a five- or even ten-year perspective and that the policy conditionality attached to it be increasingly self-imposed before being proposed for negotiation with the international community.

This would indeed require something quite out of the ordinary in terms of the donor community being willing to be initially more passive, at least for the next six to eight months, willing to respond to requests for a major Philippine Assistance Plan-type initiative, but meanwhile keeping its powder dry and letting the Filipinos come up with a package which they consider to be in their own long-term best interests. But, most important of all, it would require something out of the ordinary in terms of the Philippine polity's realization that the present opportunity is special and must not be missed.

Most likely nothing will emerge out of the Philippine Assistance Plan beyond a large laundry list of projects and programs to be foreign-financed; that certainly seems to be the tendency at the moment as far as I can make out from this distance. Perhaps, however, there is still time for the challenge to be met by people who recognize the need for something much more fundamental to happen. If the donors could overcome their need to lend, by no means an easy task, we should also expect the Filipinos to consider more carefully this time around what they should be borrowing for—for example, precisely how additional foreign resources can assist in a well-focused decentralization effort aimed at the mobilization of the rural economy in a society which has been traditionally urban and central control oriented. We know that the success cases in development have all managed to increasingly rely on the mobilization of their human resources—using natural resource exports and foreign capital to help get them there. All the odds are against anything like this happening here; but I am forced to say that I believe it is the only way in which real progress can be made towards the common objective. Countries, of course, always manage to muddle through; but the large social as well as economic costs of missing the opportunity presented by the confluence of current, probably non-recurring, events should be recognized.

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