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A Federal Structure Is Costly and Does Not Guarantee Progress

by

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Abstract

The paper discusses the suitability of the federal form of government as a replacement for the centralized structure of government in the context of Philippine economic and political conditions. The answer is depicted in the title of the essay. In providing a review of the main question, different countries in East Asia and countries are assessed. In all of them, economic performance is not due to the form of their government but to the use of correct economic policies. The federalist program proposes seeks to divide the Philippines into separate states to form a federal union. This is contrary to the historical experience of modern and successful federal states where the separate states first evolved as self-governing regions before they decided to form a federation. There are many disadvantages of the federalist proposal in the context of existing Philippine conditions. Changing to a federal structure does not promote international competitiveness since the restrictions on the movement of specific factors of production – foreign direct investment in some sectors in this case – will continue to exist without an amendment of the economic provisions that is not in the federalist agenda. A federation will strengthen the power and political hold of local political dynasties and warlords and this can result in the incidence of monopolies. A federal form of government can create the basis for balkanization of an increasingly divided nation. The nature of central -local government sharing of burdens and resources is a continuing agenda whether in a unitary or federal government. Even in a federation, these problems will not go away. The condition of an impoverished central government is due to the inability to improve the economy's performance. In the Philippine context, this is due to the restrictive economic provisions of the Philippine Constitution.

Key words: Federal government, Constitutional change, Economic Development, Philippine economy, Politics

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I. Introduction

The proposal for a federal form of government is a not an academic issue. President Gloria Macapagal-Arroyo has considered the matter as one of the issues to be considered by a study commission that she has appointed to draft proposed amendments to the Philippine Constitution.

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* The author is Professor Emeritus of Economics, University of the Philippines. This paper is based on the presentation he made before the 44th Globalization Lecture Series: "Impact of Federalism on the Economy," presented on October 26, 2005, at the AIM-World Bank Development Resource Center, Asian Institute of Management. The occasion was the second forum at the AIM that dealt with the topic of Constitutional Change in which the author made a presentation. The first of these two was on the topic of the economic provisions of the Constitution, which is cited elsewhere in this paper. I am therefore grateful to the AIM Policy Center for challenging the author to express his thoughts on these issues.

The review of this question is as follows. First, the federalist proposal is presented. Second, different countries that have made remarkable economic progress are briefly surveyed, appraising them from the point of view of the relevance of the federal structure to their achievements. This is done for the country's ASEAN neighbors; the Asian economic tigers; and from a sample of large developing countries with federal forms of government. The historical experience of modern federal states is then examined concerning the sequence of the events prior to the federation. Third, the specific Philippine context is brought to bear on the potential outcomes and problems associated with the federalist structure. Is the federalist proposal likely to promote a change in Philippine international competitiveness? Within the country, will it improve local competition among the new states or will it encourage the growth of local monopolies by political dynasties and warlords? The likely outcome in terms of regional growth and development is analyzed. The issue of *imperial Manila* is examined from the viewpoint of central-local government relations. Is Manila imperial or simply impoverished in meeting the multifarious demands of the nation and the local governments? The condition of an impoverished central government is traced to the failure to raise the economy's performance. Finally, the problem of economic liberalization is exemplified by using a counterfactual on what might happen if a dynamic part of the national economy seceded and took advantage of the opportunities open to the nation that it had failed to adopt for decades.

II. The federal government structure proposal

The serious discussion of Constitutional change in the country ushered in a revival of the proposal to reform the presidential system to a parliamentary system. This has further given impetus to those who look toward a federal structure of the system of government to govern the national-local government relations. Actually, in 1973 the constitutional convention adopted a parliamentary system of government. This was however further revised to conform to changes that were incorporated prior to its implementation in 1981. This system was put to an end after EDSA 1 and the system reverted essentially back to the 1935 features of government with the 1987 Constitution.

Political reforms of the constitution of the government structure incorporates a proposal to change the presidential system to a parliamentary government. Jose V. Abueva,[1] former UP president and political scientist, articulates the proposal for the federal system. A group calling themselves the Citizens Movement for a Federal Philippines (CMFP), in which Dr. Abueva is the chairman of the governing board and its guiding spirit, has drafted a proposed federal constitution, which is integrated into a parliamentary form of government.[2]

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[1] J.V. Abueva, "Some Advantages of Federalism and Parliamentary Government for the Philippines," via Internet.

[2] CMPF Draft Constitution for a Federal Republic of the Philippines via a Parliamentary Government, edited by Jose V. Abueva, pdf file, from the Internet.

Based on public discussion of the issue, especially among members of Congress and the statement of some national leaders,[3] there appears to be acceptance of the parliamentary system as a potential replacement of the presidential form of government. The federal proposal is however controversial. It is being sold to local leaders as a means of obtaining greater control of their regional destinies. In the manner it is proposed, the federal structure seems like it is a rider to the parliamentary proposal.

According to Dr. Abueva, the *federal-parliamentary system* is proposed to raise the human and institutional capabilities of the Filipino:

- to solve our problems, meet our challenges and achieve our goals as a nation;
- to effect needed change and reforms faster; and
- to sustain our development and modernization.

In trying to isolate the advantages of the federal system, he emphasizes improvements to be expected of the country's progress among others, to (italics supplied):

- (3) empower our citizens by enabling *to raise their standard of living* and enhance their political awareness…
- (4) improve governance by *challenging and energizing state and local leaders, entrepreneurs, and citizens of around their country* to [improve their lot by releasing] them from the costly, time-consuming, stifling and demoralizing effects of excessive central government controls and regulation….
- (5) stimulate and hasten the country's political, *economic, social* and cultural *development.*

The italicized phrases appear to suggest an improvement of the country's economic performance. These advantages are very general in nature. They are mixed with the advantages that are claimed for the parliamentary system. It is not easy to identify which advantage arises from the parliamentary or the federal system.

The national government as proposed consists of a national parliament (bicameral in his proposal) that is popularly elected. The prime minister heads the national government through a cabinet made up mostly of members of parliament. The majority party in the parliament appoints the prime minister. The head of state is a president with only ceremonial functions and therefore without political power. He is to be appointed by the parliament and the state assemblies. An independent judiciary is vested in the Supreme Court. There is also a provision for a federal civil service.

The governments at the state level (or the local governments) have each a state assembly. The state governor is chosen from the majority party controlling the state

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[3] For instance, in his public utterances, former President Fidel Ramos has spoken about the need for a parliamentary form of government but has not spoken enthusiastically about the federal proposal. Speaker Jose de Venecia is known to be spearheading the tactical moves for the adoption of the parliamentary government and also remains silent most of the time about the federal proposal.

assembly. The state governor will head the state council (similar to the cabinet at the national level), The state council is composed from the membership of the state assembly. The state assembly members choose the governor, like the prime minister at the national level. The structure is parallel to the national government.

According to the proposed constitution containing the federal proposal, the country will be split into eleven new states grouping many provinces of the land, based on language, cultural, and geographic proximity. These groupings are similar to those used to regionalize the administrative regions of the central government.[4]

Two major points need to be made before a critique of the federal proposal is made.

First is that the proposals for constitutional reforms that are predominantly discussed refer to the change in the form of government. But the economic accomplishments of the nation are constrained by specifics of economic policy lodged in the constitutional framework. The economic policy provisions are likely to lead to an improved economic outcome, but the changes in the political structure are the ones hugging the headlines. As will be clear in the discussion below, the main problem is linked to the economic provisions of the Constitution. These are the specifics in the Constitution that have limited the country's ability to expand the entry of capital in the country. The evidence is clear. The flows of capital to the Philippines have been less than to those countries in the region that have done very well in raising their economic growth rates.

Second is the nature of institutional development. The unitary form of government, and the institutions that go along with it, has evolved for a long time, not only starting from the independence period. The government has been unitary in nature since the Spanish colonial times, an evolution that took place for almost four centuries. The American colonial experience in the Philippines continued the centralized government tradition. Since independence, the centralized political system has been in operation for six decades. What the federation proposal tries to undo therefore is a long evolution of almost five centuries of governmental experience. To put the new system in place, a period of ten years is suggested to undergo a transition of institutions to a federal system. How short and impractical this is!

III. Economic performance and the form of government

First, the economic performance of neighboring countries is discussed and ranged against the nature of their governmental system – whether or not they are federal in nature. These are Southeast Asian developing countries that are co-members in ASEAN and the so-

[4] These are: Bangsamoro (ARMM), five provinces; Davao Region and Central Mindanao, 8 provinces; Western and Northern Mindanao, 12 provinces; Central and Eastern Visayas, 10 provinces; Western Visayas and Palawan, 7 provinces; Bicol, 7 provinces; Southern Luzon, 8 provinces; MetroManila or NCR, 13 cities and 4 adjacent municipalities; Central Luzon, 7 provinces; Cordillera (CAR), 6 provinces; and Northern Luzon, 9 provinces.

called tiger economies of East Asia. Following that, a look at the experience of very large developing countries in Asia and in Latin America is made. Third a comment on the historical experience of established federal states is undertaken, noting the sequence of the birth of the states of the federation and the forming of the federal union itself.

These examples establish that economic performance relies on sound economic policies rather than on the specific political structure. The desire to form a federal union to improve economic performance does not raise the country's economic performance directly. More attention has to be paid toward improving economic policy rather than to changing the form of government for successful economic performance to be realized. For the case at issue, the attention has to be on improving the constitutional framework that contributes toward adopting sound economic policies.

Southeast Asian neighbors

Malaysia. Malaysia is often suggested as an example that demonstrates the case for a federal structure of government. The Malaysian Federation arose from the traditional control that the British government developed over centuries of balancing empire and local control. The British empire ruled many regions under its jurisdiction by dealing with the ruling *datus* who were the principal means for political control of the population. When the country became independent, Malaysians used the datu or regional kingdom as the symbolic ruler of the nation. The datus of various regions were given rotating terms to serve as as ceremonial king. But political power resided in the prime minister who headed a parliamentary government. This government controlled the national policies – from taxation and expenditure, monetary and exchange rates, national security to foreign affairs.

Originally, the Philippine social structure was the same as Malaysia's. But the four centuries of rule by Spain made the Philippines essentially a government by unitary rule of the representatives of the crown. When the Americans took over from Spain, the country was ruled from Washington, as part of a department of the government. It was centralized rule. The British colonial style was to deal with local potentates, the type associated with "divide and rule on a political basis." This was how the British ruled their vast empire from Africa to Asia and the Americas and Australia. Sometimes, those potentates were representatives of the crown, as in the settling and peopling of America and Australia by European settlers or designated officers of the crown. In the case when the local population was large and there were no strong presence of English settlers, the rule by settlers was impractical. In this case, the use of local potentates was most crucial. This is why Malaysia's sultanic rule of the region survived under British colonial rule.

The Malaysian federation demonstrates the case of a political break-up within the union. This is an event often forgotten by those who propose the federal structure to keep the nation together. This was the case of the expulsion of Singapore from the federation. Luckily, this breakup did not foment a civil war or political quarrels of long duration. The uniqueness of the Singapore as a city with very distinctive commercial and predominantly ethnic Chinese traditions did not mix well with the Malaysian federation.

It led to inconsistencies in the approach to government that made the idea of federal union mismatched. The Malaysian nation was essentially the hinterland to Singapore's more advanced economy. Singapore was forced out of the federation because of these inconsistencies.

Malaysia's good economic performance since its independence is due to sound national economic policies and possibly the accident of good leadership. During the twenty years of his strong political rule of Mohammad Mahathir conceived a vision of an economic future, oversaw its strategic details, and implemented the economic policies that sustained the growth process through the years. Malaysian economic policies contrasted with Philippine economic policies in that the former had no qualms about welcoming foreign capital in all sectors of the economy, so long as they provided new jobs, exports, and domestic benefits. In the Philippine case, the screening of foreign direct investment had been the foremost feature marking our behavior towards foreign investments. This attitude was due to the Constitutional provisions that defined economic policy with respect to the entry of foreign capital. Malaysia was not bothered or guided by Constitutional guidance, because their constitution mainly did not cover details of policy related to foreign capital.

Since its independence, Malaysia has depended on *more open market economic policies*. Every now and then, they had employed tariff protection for some industries. Malaysians did not use protectionist weapons as much as we have done, and their tariff levels were much lower than ours. Malaysia did not overuse protectionism and highly regulated markets the way we have. The industries that they promoted thrived under more open availability of foreign capital, a greater desire to adopt technological innovations that accompany foreign capital.

Malaysia's manufacturing export growth was the result of an open welcome to foreign direct investment that was not as hostile as Philippine policy as embodied in our constitutional framework. The Constitutional framework that we employed to control foreign capital seeped into our national industrialization policy. Malaysia's regulations involving foreign direct investment were based on the legislation that the parliament exercised, rather than make rules about foreign investments in their constitution similar to ours. As a result, Malaysia could devise their foreign investment incentives law freely. They were not limited by the preconceived restrictions that were first stated in a political constitution. During the great flow of new foreign investments from the late 1970s to the 1980s, a lot of investments that should have located in the Philippines went straight to Malaysia (and to Thailand). The Philippines had so many complicated rules in the Board of Investments. Their own promotion agencies opened their doors and gave the investors the usual incentives that had to be haggled hard with the Philippine authorities.

Malaysia's labor laws also were much more reasonable on the issue of how to protect labor and jobs. Their attitude was to give leeway for labor unions to express themselves, but these unions themselves were educated about their larger responsibilities toward the nation and the rest of the labor force. The unions became cooperative with government development policy instead of obstructing it in attaining development objectives. In Malaysia, you would find responsible union leaders advocate for a reduction of wages when they discover that labor costs and other conditions made it impossible to keep employment rising. Labor union leadership was supportive of government policies that assured industrial peace to be held. Another feature of their policies was that they kept a fairly steady exchange rate policy that was attuned to the market over the years.

When Malaysia undertook exchange controls in 1997 to avoid the fallout from the economic crisis that was engulfing East Asia, they did it only temporarily and served notice that they would resume the old policy of open capital accounts as soon as possible. As soon as the situation stabilized, the government lifted those controls, thereby gaining credibility for the seriousness of the open economy stance as an economy. Malaysia was not limited by restrictions the way our Constitution has hampered the entry of foreign investments. The government guided industrial and trade policies to allow foreign capital to flow in. A reasonable tariff regime mad possible the competition between domestic goods and foreign goods. In short, economic policies were made to be responsive to the market. In fact, being latecomers than us in industrialization, they monitor Philippine mistakes in economic policies and avoided them explicitly in guiding their own programs.

Thailand. Throughout the early postwar period and until only recently, Thailand's government suffered from political turbulence. The government was unstable, but the Kingdom of Thailand remained stable and serene. This unique condition of Thailand enabled her to pursue her development efforts continuously despite the political turmoil. Thailand developed its agricultural sector robustly. When Thailand launched their move into industrialization, the government even copied our institutional structures.

Thailand has been more open to foreign capital than the Philippines. Like Malaysia, it was not hampered by constitutional restrictions. Thailand made more changes in their constitution than possibly any other country in the region -- more than 22 times! Military governments staging political coups made changes in the Constitution as frequently as they came. One thing that those coups did not mess around with concerned those provisions related to the economy. They did not touch them but allowed the parliament to deal with economic matters of policy details.

The Thais are a practical people. Perhaps because their educational system has not produced as many lawyers as ours have produced, their constitutions are so much simpler in structure, making it possible to encourage business and industry to thrive without excessive regulations. They are not subject to litigations based on constitutional or legal provision of Philippine projects involving large investments tend to be. They have a great advantage over us – like other countries not hampered by the economic provisions of our basic law – so that once a decision was made and it conformed to their laws, they could proceed without being subject to a legal suit that could hold up the project especially when the case is led to the Supreme Court. This is a very costly process to Filipinos. A case before the Supreme Court could kill a project. When the country tried to setup a petrochemical project with Taipei Chinese capital, many local partisans dragged the project to the courts, eventually reaching the Supreme Court that surprisingly took jurisdiction and ruled (wrongly) on a business issue. Eventually, the proponents of the project abandoned the investment. Today, the Philippines does not have a petrochemical project in production. In Thailand, they planned the petrochemical project and then they built it without any major harassment.

Despite the instability of their governments for years, the Thais could bring to conclusions projects that involved foreign capital without much extraordinary problems arising. The Thais welcomed foreign capital. Many of their industrial investments were foreign direct investments, bringing to their country product sophistication and technological improvement. They pursued more liberal economic policies compared to us. Eventually, they sustained the growth of their economy both in agriculture, industry, tourism, and other services. Today, Thailand's per capita GDP is almost twice that of the Philippines. During the 1950s, Philippine economic performance was initially not only better but the level of per capita GDP was even higher than Thailand's.

From the 1940s to the 1990s, Thailand had many governments under diverse political and military leaders. The one constant that the country enjoyed was to have a monarch – the Thai King – who brought political stability to the whole country. In addition to the kingdom, Thailand was able to foster the development of its own civil service bureaucracy to take care of running the government despite the political changes at the national level.

Indonesia. When Indonesia became an independent nation, the government structure was based on a federal union. In the 1950s, it was the so-called United States of Indonesia. Within a short while however, and for unique reasons to Indonesia, the government decided to revert back to a unitary framework of government. Fear of breakup of a nation of big island archipelago led to the consolidation of the nation into a unitary state.

During the early years of independence until the mid-1960s, Indonesia appeared like it would become a candidate for a basket economic case. Hyperinflation and lack of order marked Indonesia's experience. Then, Suharto took over the realm of the government. For nearly twenty five years, Suharto dominated the political stage and the economy progressed slowly but surely. Initially, it was as protectionist as many economies in the world. But gradually, the economy prospered. Since the 1970s, Indonesia's progress has been impressive more than that of our country. By the 1980s, Indonesia began adopting more market reforms that opened the economy to foreign direct investments. They opened sectors of the economy for competition.

Starting from a very restrictive import substitution regime of development, Suharto gradually adopted to expose the country's industries to greater competition – mainly from the opening of import channels. The other component of Indonesia's policy is that its Constitution laid out elaborate principles of nationhood. It did not bother to adopt economic restrictions in their constitution that are any where similar to the restrictions that we built against foreign capital in certain sectors of the economy. When they had restriction in economic policy, they simply had to do this by domestic legislation.

As an energy producer and exporter like Malaysia, Indonesia did not suffer from the macroeconomic shocks that convulsed energy importers like the Philippines. Instead, they experienced economic booms as energy exporters. Their petroleum and gas fields were discovered before independence, but continued friendliness to foreign capital in the exploitation of natural resources extended the future energy reserves through new discoveries helped by foreign exploration activities.

Today, Indonesia's exports are wide-ranging. Indonesia was the laggard in the region from its independence to the late 1970s. Even though Indonesia has suffered political and economic troubles during the last decade, their government appears to have weathered the serious challenges that could have led to major political and economic collapse. Today, economic policies in Indonesia are essentially more market oriented that ours and they continue to have an open door toward foreign economic investments.

If we compare the various restrictions that have marked our policies compared to those of Indonesia today, Philippine policies are more restrictive in terms of foreign capital with respect to natural resources, to land, to public utilities in terms of participation of foreign direct capital. Indonesia was once very restrictive in the matter of trade and industrial policies. Indonesia has more open sectors sectors to foreign capital. There is wider economic participation of foreign direct capital in their economy than we do.

The long unitary state rule of Suharto helped to sustain economic policy that was liberalized gradually. This gave steady support to the various economic policies that strengthened the inflow of foreign capital into the country and enabled it to strengthen different aspects of industry. Indonesia started off with a very restrictive and highly protective economic regime of policies. Slowly but steadily, the government adopted economic liberalization. The commotion that happened in Indonesia that eventually caused Suharto's fall from power (after 1998) involved further reforms. The economy went out of kilter as a result of the economic crisis in Asia in 1997 to 1998. The crisis deepened the political and economic changes. Today, Indonesia is back to a course of continued economic reforms.

The four tigers: South Korea, Taiwan, Hong Kong and Singapore. There is little to say about the relevance of the federal structure in the case of the most dynamic developing economies of East Asia. These countries are now part of the industrialized world. They achieved their rapid economic development under a centralized political structure.

They demonstrate the principle that economic policies are important in pushing a country toward rapid progress. In the case of Hong Kong[5] and Singapore, which are small

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[5] This remark refers to Hong Kong before its return to China in 1997. Today, Hong Kong represents one part of China. Politically, if Hong Kong is to remain vibrant as in the past, it has to be given freedom in

city states, the federal structure is completely irrelevant. But South Korea and Taiwan are examples of centralized political systems with a relatively large economic base that is its hinterland.

Economic performance and the federal structure: summary. Among the cases of Southeast Asian countries discussed above, only one of them, Malaysia, has a federal structure of government. The federal structure did not play a significant role in explaining why economic development proceeded in Malaysia at a high rate. This was due to sound economic policy.

The two unitary states – Thailand and Indonesia – experienced solid economic growth under policies that their politically stable governments helped to support. Thailand's policies – hampered by basic inconsistencies of changing national governments – were brought to a stable outlook because the King, who assumed mainly a symbol of political power, was a revered political institution. He helped to guarantee national cohesion.

The four economic tigers of East Asia are all unitary governments. The federal structure had no role to play in their success.

Big developing countries

There are big developing countries that have federal governments. Their examples provide useful comparison of their experience. The examples discussed briefly are India, Brazil, and Pakistan. Again, the conclusion emerges that the economic progress of these big countries was more due to their national economic policies, and not to their federal structure. We also look to China as a major counter-example because the state is based on a unitary structure of government.

India. For instance, India's resurgence in current development discussion was the result of macroeconomic reforms that also caused economic liberalization measures during the 1990s. These changes enabled India to become a beneficiary of global developments. The new economic policy changes helped to situate India as a prominent new player in the worldwide technological revolution involving the applications of the computer industry. Gradual economic liberalization in the form of industrial and trade policies have strengthened the gains from the market opening policies that discarded her heavily protectionist and restrictive economic policies that had kept India insular with unimpressive growth for many decades.

As a result of these recent successes from the economic liberalization program, India is growing out of a period of long economic slumber. For decades, India was concerned with the adoption of policies that were inward looking. This slowed down her growth as an economy. The first decades of Indian development were interventionist in

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economic and political issues. It would fit a federal structure with China. But China's policy of one nation, two systems suits the political atmosphere. In this sense, although China's political commissars rule it, Hong Kong exists as a single political entity with some autonomy of its own.

the market, using high levels of protection for industry and essentially taking an anti-foreign investment approach to their economic policy. The reason was that the social and economic policies tended to be dominated by anti- market sentiments. Indian policy makers reasoned that theirs was a large domestic economy and that India could develop by its own internal mechanisms.

Not only did that economic policy stance produce slow progress, but the example of China's bold economic policies of opening to the world slowly but effectively had jolted Indian policy makers. Also, their comparative advantage began to show gain prominence in the outsourcing of labor-intensive but technically challenging business operations related to the use of computers and telecommunications.

Today's India has a different rhetoric in discussions of international trade and in discussion of investment issues with other countries. The policies that had encouraged the growth of India recently cannot be attributed to her federal structure. Instead, it is because India undertook major macroeconomic reforms and a restructuring of her economy, opening up some sectors to the world economy and aligning her industries toward accepting more foreign direct investments into the country. India's foreign investment today has turned very positive.

Brazil. Brazil is a country that has undergone growth. But this has been bumpy. The uneven economic achievements have been marred by macroeconomic instability arising from large budget deficits, high inflation and exchange rate volatility. To study the problems of federalism and the division of expenditure and taxation between the state and the federation is likely to produce the impression that federalism does not solve the so-called independence of the state in fiscal and other matters of economic autonomy. The internal politics of a large federation had been contributive to the volatile macroeconomic experience of Brazil. The government of Brazil during this period was also intermittently headed by a military dictatorship or by civilian presidents with weakened political powers.

The federal structure of Brazil could not have contributed to the overall growth of the economy in any special way. The control over economic policies has been mainly at the federal level. The inter-state relations of the major regions might not be the source of its overall economic performance. It is really the economic policies and political decisions at the federal level – plus of course the changes in leadership fostered by the over-all electoral regimes – that are the critical to the economic performance of Brazil as an economy.

Federation breakup of Pakistan: Bangla Desh and Pakistan. Pakistan provides an example of a country that was initially a federal government. That federation broke up decisively after a quick war of secession in the mid-1970s. The result of this war gave birth to two independent countries. Out of the original federation of East and West: Pakistan, the eastern part became Pakistan and the western wing, Bangla Desh which gained her political independence after the war. The grievances of East Pakistan (now Bangla Desh) had been that its exports of commodities provided the West and the national government more than the national government gave to the eastern side of Pakistan.

The danger of break up became clearer as time went on, because the economic grievances became more severe. Pakistan's own problems of not being able to raise sufficient resources for the national development and the large distance that they had with the east to facilitate an effective dialogue to smooth their problems led to their breakup. India's political interest in a successful break up was also a factor. The desire of the east for self-rule gave reality to the birth of Bangla Desh.

China. The best example today of growth being supported by economic policies within a unitary form of government is China. Most of the steps undertaken in China had been through the realization that economic reforms in the direction of encouraging markets to grow will make the country produce a high rate of economic performance. China has a highly centralized government, but it is trying to give a greater role to the provincial economies in the form of nationally initiated economic policies that has transformed many provinces of China.

The first of these reforms were the agricultural revolution. From the late 1970s, China freed the village communes of the strict system of output production control. As a result, the communes – or village townships – prospered. Farmers began to reap rewards from their own efforts, a fact of life that the commune system of self-abnegation failed to achieve. Farmers improved their lot and worked even harder as their rewards improved.

Then in the 1990s, the next great Chinese policy change was experimentation with the special economic zone. In these special zones, economic freedom of enterprise managers was tolerated. Foreign investments were promoted. These special economic zones were also major successes. The Chinese state enterprise was allowed to invite foreign direct investments in joint ventures. The enterprises integrated capitalist methods of enterprise management and they tried to learn further from the foreign investments that went into China and build new markets for Chinese products. Eventually, foreign direct investments operating wholly owned were operating in the Chinese economic zones, undertaking a wide variety of manufacturing.

These were all economic reforms from the center of the government. They have little relevance to the issue of whether a federal structure or a unitary structure leads to greater economic efficiency and more economic growth. The success of China's reforms demonstrates the effectiveness of economic policies within a centralized form of government.

A historical lesson: Before federation, the states of modern nations were strong entities

The federal structure of government in Western countries began slowly with self-governing regions discovered that they could take advantage of customs unions and similar grouping of administrative functions among themselves. The sequence of events was that the states developed first for long periods of history until, one day, they formed a wider dominion by unifying. In short, the states were already strong and well developed before the idea of union among them took place. The self-governing states ceded to the union many functions involving the fiscal budget, major elements of taxation, general economic policy, defense, and foreign affairs.

This was the case for the original thirteen states that formed themselves into the United States of America. The federal governments in Europe – notably the federations that today represent Germany and Italy were each composed of many self-governing states that decided to form into a single state, respectively. The more recent histories of both Canada and Australia also follow this example. At first there were self-governing provincial territories that were part of the British Empire. When they secured their independence, these nations followed their government structures as before. The old political structures continued except that now they had their own governments that were part of the larger polity. These political units ceded important policy areas to the central government. What they essentially ceded to the federal government were those policies that the British Empire exercised over them prior to the grant of their political independence.

IV. The Philippine federal proposal analyzed

This section analyzes the federal proposal in the Philippine context: (1) Whether or not the federal structure promotes competition is discussed in relation to the proposition that a federalist structure changes the behavior of the regions economic actors. The discussion of competition is compared with the country's need to make the economy internationally competitive. (2) Whether or not the federal proposal fosters monopolies controlled or subservient to political dynasties and warlords at the community level. (4) Whether or not the federation of a weak state into several administrative lines of political control will make worse and deepen the fault lines between regions and states that contribute to potential national disunity and possibly even breakup of the nation. (5) Whether or not a federation will create strong states or weak and dependent states. (6) The demonstration of a counterfactual – an imaginary what if situation – asking the question what an independent Cebu might do if it separated from the nation and became independent.

Internal, not global, competition

Proponents of the federal government argue that a change in behavior of leaders, entrepreneurs, and others can be expected from the shift to the federal system from the present one. The mechanism for this is that an increase in competition results from the change in behavior of these actors within and among states. To understand whether this view is correct, the concept of competition in an open economy needs to be clarified.

In a federal government, it is the federal government that undertakes the management and changes in national economic policies. Without any change of the economic provisions in the Constitution, the states are still governed by the economic policies that are imbedded in the restrictions found in the basic law. Even if they are self-governing on a lot of local matters, the states cannot undertake legislation that changes those economic provisions, which are matters of national policy. Hence, the states are held back to make changes in economic matters dictated by national policy.

Any cost reductions or gains in efficiency that arises from the federalist proposal can only be in the form of internal and local returns from competition. The domestic costs of production can only drop to the level allowed by internal competition among all the economic actors within the economy. The reason for this is that the country is effectively constrained still by what I have called the ‘original sin” of Philippine development strategy. That original sin I have called the Recto-Quezon *iron economic laws on the role of foreign capital*[6] which has been imbedded in Philippine Constitution since 1935 and carried on with wider coverage of other sectors to make them permanently protected from foreign competition – because it extended some of the restrictions to other sectors – in the 1987 Constitution.

The reason for this is that the country needs to stimulate foreign capital to make the Philippines an attractive place to make profits. Foreign direct investment is not a one-way street to the host country. If the host country earns major benefits from foreign investments in many ways, foreign capital, too, must be able to turn in a good yield from the ventures. That is not all. The ultimate test is whether the country offers at least as good a site for investment as other countries. That is what induces foreign for that foreign capital to move in. In the world of the last five decades of independence, the other countries have made their jurisdictions a better place for foreign direct capital to move in. Therefore, they moved to the other countries and not to ours.

As our nation tries to maximize the gains from globalization, there is need for the flows of the scarce productive resources to move into our jurisdiction. Capital is the scarcest of these productive factors. A flow of foreign capital can only accelerate the gains made. Our country has almost made the flow of labor resources free to move out of our jurisdiction through the OFW route and through immigration. The Department of Labor almost makes it a virtue to advertise jobs for Filipinos abroad and to seek contracts for more exodus of labor. Of course, our main benefit rom this effort is that the OFWs bring into the country much needed foreign exchange.

It is a *paradox* that this very same principle of freedom of movement of labor is not applied to the movement of foreign capital in many sectors of the economy. Labor is abundant, so we let it move to other countries to find jobs. Capital is very scarce in our country, but we erect barriers so that it does not come in as freely. A greater inflow of capital into the country is a good counter-weight to the outflow of labor. With capital coming into the country, jobs are created at home and home-based production rises. The migration of our labor to our countries raises foreign output. In brief, the inflow of foreign direct investment into the country not only raises domestic the country’s output but also our capacity to employ our people at home.

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[6] See G.P. Sicat (2005), “The Economic Argument for Constitutonal Reform.” An extended discussion of the nature of the restrictive economic nationalism that has been fostered by the original sin of development strategy is contained in my essay (2002), “Philippine Economic Nationalism.” See annex.

Following from the education of our countrymen in the original sin of our development strategy, many restrictions were introduced in the domestic economy beyond even the original prescription of that strategy. Over the years, we imposed restrictions in other sectors – beyond investments in land, in public utilities, and in the exploitation of natural resources.[7] The country needs to lift the restrictions by removing the Recto-Quezon barriers in the Philippine Constitution and placing the responsibility to the legislature to enact the appropriate measures to enable the country to become more flexible.

To realize the benefits from the inflow of foreign direct investment, the liberalization of the measures linked to the Constitutional provisions is required. Why should we allow our workers to flee for better jobs abroad when we can make the conditions of the national economy improve the job conditions at home? Some of the gains obtained from OFW remittances can be obtained with more stabilizing effects on the quality of growth that is induced at home.

If foreign direct investments were free to move into the country, many of the country's major problems become more manageable. The fight against poverty will become more successful at home. With jobs being generated, the unemployment rate will become less bothersome. A further outcome will be rising wages and incomes for those who live in the country. Macroeconomic gains will strengthen the health of the economy. As argued elsewhere,[8] among the major macroeconomic benefits are the reduction of the fiscal deficit, the lessening of the external debt, the improvement of external trade and payments, the stabilization of the peso and the increase of the national saving rate.

The gains will be even bigger than those derived from the remittances of OFWs to the country. The quality of economic growth will be so much better than that which is fostered by the migration of Filipino labor through the OFW route.[9] Workers at home who find better incomes will be able to take care of their growing families within their personal supervision. One major social benefit is that families stay together and are not broken apart by absence of the breadwinner.

[7] The import substitution and other restrictive economic policies of the past led to the institution of retail trade restrictions to foreigners, strict joint venture arrangements in many fields of economic endeavor, and preferential rules allocation of credit and foreign exchange allocations. The restrictions on immigration and the employment of foreigners in the economy is another rule, not realizing that in many cases foreign human capital often carries a lot of intangible benefits that improves the host country's economy. In the course of time, some of these restrictions have been lifted because of their bad effects. The benefits of the lifting of the rule about 100 percent foreign owned equity in activities that are essentially designed for exports has demonstrated that the country could make enormous gains in foreign trade because the export winners were already identified as the foreign companies establish their base of manufacturing and assembly in the country.

[8] See G. P. Sicat (2005), "The Economic Argument for Constitutional Reform." See annex.

[9] The idea suggested in this argument is that there needs to be a balance in the promotion of OFW jobs with the promotion of attracting flows of foreign direct capital in the economy. This can only improve the choices faced by labor. Those who seek jobs have many more opportunities available at home while still having the choice of working elsewhere abroad.

Foreign capital augments the stock of domestic capital. In many ways; foreign and domestic capital are complementary resources. Foreign capital induces more build up of domestic capital accumulation especially if their markets are directed to the world rather than to the domestic economy (in contrast to the world of import substitution of the past). This means taking advantage of comparative advantage as the basis of development. It also means making use of international trade as a strategic tool for promoting specialization in production and seeking markets that can be expanded through economic diplomacy and the ability to supply the goods at competitive costs and at sustained levels. The country's posture in the international economy has to be founded on international competition.

In short, inducing domestic competition through the creation of internal and local competition is inadequate. By this reason, the federalist proposal is inadequate in creating the necessary and sufficient conditions to improve the country's economic performance. It takes but a little return to the examples of high growth countries in East Asia (see previous section) to realize that their dynamism is not due to their structure of government but to the economic policies that they promoted, which led them to raise their level of capital accumulation and the growth of economic productivity in their midst.

Monopoly outcome in many regions

The federalist program of producing competitive behavior at the local level is suspect if the region is very poor and in dire need of central government support. The leadership in the region will encourage the rise of political dynasties and the control of local warlords. The situation is more conducive to the manipulation and control of the local leaders.

A potentially perverse outcome therefore is that instead of promoting the competitive spirit among local executives, the federal system will lead to the growth of local monopolies. By their nature, some businesses would be monopolies by reason of market size and by natural tendencies. The perverse outcome will be for the ruling political clans to extend their control toward economic activities. The reach of the state may not be adequate when the local leaders have a strong hand in the control of the levers of state power.

The evidence on the ground reveals that monopolies in economic activities are strong where there are entrenched political dynasties in place. Those who control and own the public utilities and the major industries in these communities invariably belong to the ruling political dynasties and their extensions. These are the land and sea transport companies, the electric utilities, the ice plants, the market places, and key industries in town. Under a federal system that is only loosely influenced by the powers of the central government, the umbilical cord that allows the central government to reduce the control over political dynasties will weaken. That will strengthen the monopolistic control of families. That will help aggravate income distribution if what results is a concentration of monopolistic power in the hands of a few families. This will strengthen local political dynasties.

There is every reason to suspect that there will be forces that will strengthen the rule of dynasties at the local level. This is likely to foster the alignment of economic and political lines that reinforce the economic powers of those groups that have allegiance to the local leadership. This will support the growth of monopolies by the dominant political groups in the region.

Deepening social and political fissures that reinforce balkanization

A more dangerous outcome for a federal system is that it promotes the build up of natural fault lines that can divide a nation into many unique parts. The federal system of government facilitates the building up of social and political forces that promote balkanization, or the break up of a nation into smaller independent parts.

At the end of the First World War, the large Austro-Hungarian Empire was broken up into many countries along ethnic, cultural and geographic lines. Most of these countries were in the Balkan region. One outcome of that balkanization process was the federal republic of Yugoslavia that broke up further into parts during the 1990s. The Soviet republics of the USSR broke into 22 republics when communism collapsed. The defined boundaries of that old republic defined the manner in which the break up would happen.

Balkanization means that the breakup of a larger region into parts as a result of differences among the local communities. When the national state is weakened, the break up becomes easily defined. The potential for break up of a divided nation is easier when the boundaries of independent or subordinate units are clear-cut. Balkanization of a country tends to happen when a country's economic interdependence is made weak. In this sense, the country becomes dominated sharply in terms of social, ethnic and political forces that give accent to the regional differences rather than their similarities and their commonality of values. It also demonstrates the weakening of economic interdependence of the country's regions.

Balkanization works against economic integration rather than promotes it. It is the opposite of coming into union as an integral system – the idea of federation among mature states. The Philippines today needs to have a greater economic integration among the various regions to induce the productive resources to move more freely and seamlessly along the ethnic and geographic borders. This is one way to help promote greater competition within the country. Such a situation will encourage the factors of production to prepare to absorb a greater inflow of foreign factors to facilitate an improved level of economic activity at a higher productivity.

The unitary form of government certainly promotes a higher degree of unification of a country's social, political and economic values compared to what can happen in a federal state. The break up of Malaysia into the present federation and Singapore is an example. The more dramatic schism of Pakistan and Bangladesh is another example, although in this latter case, what made that schism possible was the great separation of the two regions in terms of geography. When the fault lines of a nation are clearly defined, and the nation wants to be a single whole rather than separate and independent parts, the existence of a unitary government will prevent near cataclysmic outcome like what happened in the US civil war of the 1860s and or the neat catastrophe to Canada of a breakup into two parts when in the 1980s the French speaking part tried to get out of the federal union.

Federalizing an unsuccessful state

One of the reasons for the proposal for a federal system is the belief that the current unitary system is not working. Is this simply myopia? The common belief is that the insufficient economic progress of the nation is due to this system of government. If poor economic performance is the reason for a failing system, the reason could be due to economic policy and not the system of government. Therefore, if a nation is wanting in accomplishment, the exact source of the poor accomplishment needs investigation.

Why would a breakup of the whole political structure be the solution? That might guarantee further breakup of the parts or the failure of the parts to produce the desired economic performance. Why should the solution be in the form of fragmenting a large failure into several self-governing parts? Is that not simply creating failures in all the fragmented new parts? The solution rests in examining the cause of the faults in terms of economic policy first.

Some observers of the Philippine scene describe the country and the government as a soft state. If a state is seen as failing to provide economic progress and security to the nation, dividing it up into more political units might simply repeat the mistakes at the national level. If the breakup succeeds in some parts of the union, the fate of the weaker local jurisdictions can aggravate further.

In the campaign for a federal program, the proponents offer a bounty to some local politicians in the form of new political structures that would provide an additional source of political patronage. An increase in the amount of new employment in state institutions can result, thereby increasing the possibilities of local political patronage. The duplication of many federal institutions at the state level increases the potential for the spread of this patronage as an outcome of the federal program.

Some successful high middle income economies and many little Africas

The division of the country into new states will benefit some regions but not necessarily all. Some regions will benefit largely from being lifted from the burden of a large nation. But the weak regions are left to become many little Africas, [10] unable to grow out of the burden of regional poverty.

The economically weak regions that are currently highly dependent on the support of the central government may find elevation into self-governing states unprepared for the responsibility. Based on the present economic structure, there are likely to be more weak regions than viable ones. This will aggravate the conditions of the weak regions further. The weak regions will be condemned to a state of deficiency in resources to finance their programs and projects.

Federation will make these regions lose some of their financial support from the national government. The hope is that independence from the central government will strengthen their internal capacity to develop well. The capacity to raise required internal resources for economic development is a very complicated process, and if one whole nation finds it hard to raise these for its own growth and development so would it be more difficult of a much weakened region to do the same.

An example is in the area of attracting new industrial and agricultural ventures. Local initiative here is quite important, but there are many factors that further determine success. The availability of infrastructure – roads, transport systems, power, etc. -- is often effectively weak if not absent. The states will find it difficult to generate the needed saving to finance new industries and development projects. The borrowing capacity of the new states would still be subject to the overall authority given by the federal government. The new states will not have the complete freedom to spend if they cannot get support for their activities.

The progressive regions will advance further and more easily. They will not have the burden of helping the poorer regions any more. These high growth areas will be liberated from the economic policies of the center. They can deviate from the restrictive nature of economic policies by taking advantage of their superior endowment of resources like better concentration of human talent and infrastructure. Since federalism raises the claims of the local governments against the national government, these well endowed regions will become even more progressive. They will accelerate their growth in incomes and output. Within the context of global income comparisons, these regions will even achieve higher income status under a federal system.

The past performance of regions offers the clue to the issue of federalism? These are Metro-Manila Region, the so-called Calabarzon (Cavite, Laguna, Batangas, Rizal, and Quezon), the regions north of Manila which cover Central Luzon and the access routes to Subic (when the Clark-Subic road in completed), the region around island of Cebu, and perhaps the Southern part of Mindanao, where a great deal of agricultural and agribased industries are located. The areas where mines are located can become prosperous for the time that the known resources are being exploited, subject to future discovery of minerals reserves.

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[10] I refer to some of the unsuccessful states of Sub-Saharan Africa, where domestic politics and inadequacy of resources, and an anti-foreign policies had impeded their progress after their independence.

Burden sharing of central and local governments: "*Imperial but impoverished Manila*"

The tensions between central and local government relations will continue to provide stresses whether the structure of government is unitary or federal. The rules of engagement in a federal system might be more sharp and to some extent more definite compared to the unitary system. That does not rule out the continuing struggles in the relationship among the two levels of government: Weak regions will demand services and funding from the supposed source of the bounty, which is the central government.

Local government activists have concocted the term "*imperial Manila*" as a political phrase to denigrate the unitary structure of the Philippine government and as a means of suggesting that the failure to develop strong regions in some parts of the country is due to centralization of powers in Manila. The Philippine government at the center (the so-called imperial Manila) has been under severe pressure to expand the resources at its command in order to attend to its responsibilities to the nation. The government's response to the problems of the local governments has led to a growing list of reforms trying to address the need for local autonomy.

The federalist proposal is an indication of the impatience for more government reforms in the area of local government. This does not mean that reforms are impossible in a unitary system. They will come and they will eventually improve the autonomy of the local governments from central intrusion and excessive commands. The response of the national government to the demands for local autonomy is often incautious and sometimes excessively optimistic. This is probably because part of the demand for change emanates from the local government sector that has strong political pressures on the legislature and the national government. The resulting changes can become radically different from what is required by prudence and practicality. This is demonstrated in the case of the latest local autonomy act.

When this expanded local autonomy act was adopted in the 1990s, many devolved functions to the local governments suffered both in quality and in volume. Lawmakers who crafted the local autonomy powers for the regions were too optimistic in their assessment of the new tasks requiring the devolution of a lot of central government functions. These new tasks were more complex and required not only additional money but institutional capability, which does not happen overnight. Additional duties and responsibilities implied the mandatory assumption of services once performed that were devolved from the central governments.

Even as these functions were not satisfactorily met by the central governments before, their transfer to the local units led to a deterioration of the quality of services. Of course, these required financial resources to be transferred from the national government. That too, was poorly executed, because the government had too many functions and expenses that would have suffered if the required tax allotments to the regions were met as obligated by law.

But that was not the whole story. The institutional capacity of each level of government has to be brought up. The process of raising institutional absorptive capacity requires a long-term process. This is all about economic development among the regions, not just transferring existing functions from one branch to another. As a result, many local governments asked to return to the national government some functions that were transferred to them, like the running of public hospitals and other health facilities.

On the other hand, the demands of the local government for their rightful tax allotments pressured the national budget in a way that was not within the calculated public expenditure program of the budget. To finance the allotments as well as the operation budget of the government would have meant even higher fiscal deficits. The solution was to postpone the tax allotments to the point that the local governments were unable to receive their required allotments. The national budget was already badly in deficit and indicated the relative impoverishment of the coffers. The required allotments implied that the very impoverished Manila would face a higher fiscal deficit and that was not feasible because the deficit was already intolerable.[11]

In short, the central government may appear "imperial" in its actions. But Manila is also impoverished with regard to meeting the demands of the local governments. Manila still has to perform its usual responsibilities as embodied in the running of the government. The more appropriate term appears to mean that Manila is both *impoverished and imperial*.

The break from unitary to federal structures will also create dislocations that will involve poorly prepared local governments suddenly faced with new duties and responsibilities. Institutional development takes more time than most people are prepared to admit. A ten year transition is completely inadequate.

Panaceas cannot solve the key problems. And it seems that the offer of a cure of the federal system is like a panacea to offer something different for age old problems that require evolutionary solutions. Changing from a unitary form of government to a federal system does not solve the problem if the regions and the national governments are afflicted with the problems of fighting over meager resources because both governments are impoverished. One way to reduce the magnitude of the problem is to reduce the demands on the national government for public expenditure by drastically cutting its various programs. It is of course always important to abolish wasteful programs. But one reason why the Philippine state is impoverished in providing for development services is that it is difficult to raise taxes. The Philippine lag behind other countries in the tax effort also speaks words about the lag in economic performance. The local government tax efforts are even more insufficient. Only the prosperous provinces, towns and cities are able to raise their fiscal coffers to finance their needs. The rest – the candidates for the little Africas in a federation – are in dire straits to improve their finances and therefore will require assistance from without.

[11] The monetary authorities would not have allowed this situation to happen. They would recognize the potential impact on inflation. A sudden rise of the fiscal deficit without the means to finance it with additional tax money would have surely cause price inflation far beyond what they can tolerate.

The division of revenues and the provision of public expenditure for specific activities of the government will always define the continuing allocation issue between national and local governments. This will happen whether or not a federal structure is in place. It is not a preordained outcome that the functions of the state (in the sense of the federal structure) will get the increased resources so that the additional public expenditure can be financed. The federal proposal appears to be just another panacea being offered to solve a truly import problem of raising the country's total development effort. Like all panaceas, they don't work.

With due care and planning and an effort to solve the major economic problems of the nation, an improved sharing of responsibilities and budgeting between the national and local governments is feasible under a unitary state. Some of these will move in an evolutionary way. But most of it can be carried by an effort to reform the country's economic policies so that progress is more quickly achieved.

In such an environment, local governments are able to take care of their financial needs. But this is premised on the national economy being more robust in its growth than it is now. A flourishing national economy will find a larger reserve of funds to transfer to the local governments as its fiscal coffers fill up with revenues. A robust national economy that has a sound tax system takes care of that growth in fiscal resources that are needed to furnish the wherewithal for the national government to undertake its part of the responsibility of supporting the nation's requirements and those of the local communities. This takes place whether the political system is federal or unitary in character.

These comments on central-local government relations depend therefore on the ability of the constitutional reformers to undertake the right changes in the Philippine Constitution. The most important of these – in fact, the only one that can have an immediate positive impact on the rate and direction of economic growth of the country – is an amendment of the economic provisions.

Constructing a counter-example: Suppose Cebu became politically independent….

Some examples are best illustrated through a counterfactual. This is constructing an example of what might take place if certain events were allowed to take a hypothetical course. Economic historians have often employed this method of analysis.

Suppose that an educational and political experiment were undertaken with regard to Cebu. This island is a good example of a successful and dynamic region of the country. As one of our vibrant island provinces, Cebu is likely to become even more progressive if it were made free to promulgate its own policies. (That's what independence means.) Cebu is an image of the country as a whole. Politically, it is as fractious as the nation. Perhaps because limited geography and lack of land resources for agriculture, Cebu if given a chance, could transcend the divisiveness of national politics and bring to order its economic house. The reason is that Cebu attracts trade, investment, and human capital from all over the nation. Its strategic advantage is its central location in the geography of the Philippines. Cebu is filled with human capital that is predisposed to business. Cebu is the center of the Philippine hinterland. It is like the Singapore which by choice made a bigger hinterland of countries that surrounded it – Malaysia. Indonesia, and Thailand – through its free trade policy.

Suppose then that Cebu became politically independent from the Philippines. Cebu would become free to achieve freedom to work itself out from the many mistakes that the nation in the past.

What might that agenda be in order to improve on the Cebu's prospects? Cebu will rewrite its own constitution by removing many items in that document that impede economic action among the important factors of production. As a result, it will simply strike out the restrictive economic provisions on foreign capital that had been vetted in the Philippine Constitution since 1935. Then it will be able to open its economy to a wider range of economic participants, including foreign direct investments. Entrepreneurs in the Philippines will be attracted to move a lot of their economic operations to Cebu. Also, foreign direct capital will notice the change in economic incentives it will bring in risk investments in various parts of the Cebu economy – in finance, trade, manufacturing, and infrastructure.

The economy of Cebu will then witness a sustained growth of its economy, leaf-frogging the rates that the country has achieved historically. Freeing many of the problems that has hindered Philippine development, Cebu will be able to attract foreign risk capital in many sectors – banking, communications, infrastructure, and most of all, new industrial activities. Along with this, Cebu's will witness a country development of its political institutions that facilitate economic growth. In due time the Cebu's government will become well-funded. The outcome of this will be to improve its public spending on education, public health, and infrastructure building. In all likelihood, Cebu's expansion in many directions will enable it to overcome the sense of frustrations that Cebu has felt as a member of the Philippine nation.

Cebu will open the entire economy of the province to international trade. It will abolish high tariffs and make them minimal across many goods so that there is competitive pressure on existing and new industries established in the province. It will open the participation to foreign capital in many areas of production. This will complement the expanding trade of the country.

An economic boom will happen and international trade will rise. An import boom will precede the prosperity in international trade. But to finance the imports, Cebu will have to develop domestic industries in order to earn exports and thereby accumulate dollar reserves after paying for imports. Its battery of foreign direct investments (already in place because of early success in bringing in foreign capital into the province through the various economiz zones located in the province, spearheaded by the Mactan Export Processing Zone) will expand further, raising the labor intensive industries, bringing in new investments related to technology, and creating enormous opportunities for improvements in investments in the public utility and infrastructure sector. Cebu will open up many more industrial activities along the lines of expansion of industries in the export processing zones. More foreign capital will flow in and speed up the creating of additional export and industrial estates.

In brief, there will be greater economic opportunities in Cebu using foreign capital and domestic capital. Cebu will allow the entry of foreign capital to build cheaper power plants and to improve the water system. The ports of Cebu will be expanded into ports for a wider share in international trade. Cebu will maximize the expansion of its entrepôt trading position in the region as a fulcrum for further attraction of industry. That development would suck in a lot of Philippine domestic output as imports. Philippine exports to Cebu will rise. And Cebu's role in the international scene will increase in significance. This is like Hong Kong and Singapore rising to new economic pre-eminence again. In small scale (but within the boundaries of a bigger state), it is the experience of the export processing zones of South Korea, Taiwan, Thailand, China, and the Philippines all over again!

The scenario above is mainly for effect – to demonstrate what can be accomplished when one region shows a willingness to deal with the economic restrictions that stifle national economic policy.

V. Conclusion

The introduction of a federal system is a step backward for the evolution of the Philippine state. Adopting it as a structure of government raises the cost of running the nation's governmental affairs. The supposed gains to be derived from federalism are not clear. But the various disadvantages are formidable. The structuring of state governments patterned after the national government under a federal system will contribute to the rise of fiscal expenditure for running the governments at the local level. The economic progress of many countries has little bearing on the structure of their government–whether or not they are federal or unitary in structure. What determines their progress is the soundness of economic policy.

Making sound economic policy implies removing the source of the original sin of Philippine development policy. Adopting the federal structure does not promote international competitiveness of the economy. The federal structure can increase the tendencies of local economies, especially those closely ruled by political dynasties, to be dominated by monopolies. The federal structure can deepen the fissures that destroy national unity. A federal structure of government cannot provide the proper solution to the problem of burden sharing between the central government and local governments in the Philippine context.

The federal structure in the Philippine context is high cost and it does not guarantee progress. Given the problems of the present economy, the proposal for a federal government appears like a panacea. A robust and highly productive economy is the way to solve the country's development problems. This can be achieved by adopting correct economic policies. In the current context, the bar to the remaining economic policies is the amendment of the economic provisions of the Constitution. This means removing the burden placed on the nation of the specific restrictions that has hindered substantial foreign capital to move into the country.

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Annex : Further Readings on Constitutional Issues from the Present Author

The present author's thinking on Constitutional issues is the product of studies that he is undertaking on the problems of Philippine economic development. Some of the articles below are (deliberately) not yet published, but they may be accessed in the internet through the website of the UP School of Economics:

http://www.econ.upd.edu.ph

Once on the website, try to access the Discussion Papers, or search by author's name.

Gerardo P. Sicat, *Philippine Economic and Development Issues*, Anvil, 2003. See *Appendix to chapter 33*, on the historical background of the policy affecting foreign direct investment. [This book is volume III of his textbook, ***Economics***, Anvil, Manila, 2003].

Gerardo P. Sicat, "The Market, Social Policy and Economic Performance," ***AKI Quarterly*** (La Salle University), Vol. 2, No. 2, October-December 2004.

Gerardo P. Sicat, "Reform of the Economic Provisions of the Constitution: Why National Progress Is at Stake," UP School of Economics Discussion Paper 0510, September 2005

Abstract: The Philippine Constitution contains many strong restrictions targeted against the flow of foreign capital in specific areas of economic activities. These restrictions were the same ones that were incorporated into the nationalistic provisions of the 1935 Constitution when its framers were anticipating future political independence. This paper discusses the beneficial aspects of lifting or liberalizing these restrictions on foreign capital in the Philippine context. Specifically, the restrictions relate to the prohibition of foreign individuals to engage in land ownership, in the exploitation of natural resources, and the ownership of public utilities. Corporations are allowed to participate in these activities only if they have equity ownership only to the maximum extent of 40 percent. In other words, foreign capital can only be a strict minority participation in corporate enterprises to be allowed in these economic activities. These provisions have hurt Philippine development over the years. Despite the liberalization of many aspects of the economy, including those in the area of trade, industry, and other aspects of the economy, these economic restrictions continue to hold because they are part of the Constitutional document. Some of these provisions of the Constitution could be relaxed through more liberal citizenship rules. But the basis of citizenship – *jus sanguinis* or blood relations– is also very restrictive. The need to improve the performance of the Philippine economy requires that these restrictions be examined and reformed. A direction of such reforms would be to place them out

of the Constitutional framework – as is the case with most modernizing countries – and put them within the realm of ordinary legislation. In this way, they can be debated more openly and the policies could be suited up to changing conditions and the need for change of the economy.

Gerardo P. Sicat, "The Economic Argument for Constitutional Reform," UP School of Economics Discussion Paper No. 0512, December, 2005.

Abstract: The Philippines requires the revision of the economic provisions of the Constitution if it is to become a major recipient of foreign investment flows like other high growth economies in East Asia. These economic provisions were adopted in 1935 and have helped to reduce the country's ability to achieve a strong economic development record for seven decades. Reforming these policies can be undertaken by making the specific policy issues the subject of ordinary legislation rather than through constitutional provisions that are hard to change. The most obvious benefits of such a constitutional reform are increased foreign investments, higher rate of economic growth and employment; rising incomes for the population; and sustaining the fight against poverty. The less obvious benefits affect the macroeconomic fundamentals of the country: reduction of the fiscal deficit; lessening of the external debt burden; improvement of trade and payments and stabilization of the peso; increase of the saving rate; and improvement of the country's financial markets.

Gerardo P. Sicat, *Philippine Economic Nationalism*, UP School of Economics Discussion Paper 0201, January 2002

Abstract: Not seeing that the power of taxation of the state is the true expression of national patrimony in economic matters, the framers of the 1935 Constitution introduced provisions on the use and disposition of land and natural resources vesting exclusive rights of exploitation to citizens. This also meant restricting foreign investments in public utilities. The provisions were not revised but even elaborated in subsequent revisions of the Constitution. These provisions set a train of restrictive economic policies that helped to compound the mistakes of early industrialization policies. By tying the hands of future generations of Filipinos to deal with specific economic issues in their own time, the Constitutional provisions provided barriers against solving economic problems with realism as called for by changing times and exigency. Judged as the most likely to succeed in the early years after independence among many East Asian economies, the Philippines became the economic laggard among a group of highly performing economies during the second half of the last century. The brand of economic nationalism that was fostered was exploitative and heavily protectionist in character. It built an economic and political framework that discouraged competition, enhanced monopolies and inefficiencies by nationals, inhibited the growth of international trade and hence postponed by a large margin of time the growth of economic specialization based on comparative advantage. A new kind of nationalism based on principles of competition and comparative advantage is needed. This will be helped greatly by the removal of stringent Constitutional provisions that affect foreign investments. An enlarged regional free trade within ASEAN and accession to the World Trade Organization are factors that will help to sustain this new ethos which will strengthen economic and national aspirations.

Gerardo P. Sicat and Loretta Makasiar Sicat, *An International Comparison of Constitutional Style: Implications for Economic Progress*, UPSE Discussion Paper 0412.

Abstract: Using the United States constitution as yardstick for its essential simplicity and completeness in describing the structure of government, the constitutions of twenty-two countries were studied for their language style, brevity and coverage of provisions. Most constitutions of later years have expanded coverage of institutions and the rights of citizens. The outcome is that constitutions became much longer because of broader content but also because they also cover details of institutional processes and structures. The expansion of concerns of constitutions also incorporated economic and social guarantees of citizens in addition to the guarantees of political rights and individual freedoms. Countries with simpler constitutional frameworks have experienced relative constitutional stability more than countries with long and detailed constitutions. The systemic collapse of socialist states in the 1990s brought about some return to constitutions that are simpler in coverage and which incorporate a balance of political and economic and social rights, including protection of property rights. The last part of the study comments on the implications of these constitutional structures to economic progress.

Gerardo P. Sicat and Loretta Makasiar Sicat, "*The Constitution and Economic Progress: When "More Is Less and Less Is More*", UPSE Discussion Paper 0413

Abstract: This study postulates some relationship between the attributes of constitutions – the style of constitutions regarding brevity, coverage, and presence of economic and social guarantees – with economic factors and the economic performance of countries. Utilizing quantifiable measures of these constitutional characteristics, these economic determinants are used to explain the differences in the economic performance of countries. A simple statistical model is set up to quantify this relationship. Expanded coverage and the presence of extensive social and economic rights in constitutions do not guarantee good economic performance. Extensive coverage of constitutional provisions tends to create a downward effect on the level of economic performance. Excessively detailed constitutional style provides a constraining effect on the level of economic performance. On the other hand, competitiveness of the economy, an economic attribute, raises economic performance.