The Philippine Economy: A Conspectus of Recent Developments

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In 1988, the economy registered a moderate but respectable growth rate of 6.7 percent. This has been the highest growth recorded so far under the Aquino administration, and represents the latest episode in the country's long pull out of a period of deep crisis, beginning in 1981. During that time, per capita incomes declined continuously. The average income of Filipinos stopped falling only in 1987.

The problem in assessing economic developments has always been one of separating what is structural from what is conjunctural, and reviewing the past few years' experience is not spared this difficulty. Nonetheless, this article shall try to sort out which aspect of growth is lasting and which is fleeting.

To a large extent, the recent achievement appears impressive only because the past record has been so dismal. Indeed, the growth of the last few years only restores to the average Filipinos their income of 1978. Even if the present growth trend of 6.5 percent would continue (something which cannot be blithely assumed), per capita income would merely regain its 1980 levels some two years from now, or in early 1991. (See Table 1.) In effect, therefore, even going by gross economic measures, and despite the growth of the last few years, the economic crisis will have meant a decade of stagnation and suffering for most Filipinos. A crude sense of this deprivation may be gained if one views the performance of other countries in the region for purposes of comparison. Perhaps indicating the characteristic modesty of our national ambition, if not a certain lack of imagination, our leaders find a 6.5 percent growth rate, as Gustav Ranis puts it, "a satisfactory definition of the 'promised land'".

As welcome as the news regarding "recovery" might be, there are serious barriers to this growth which lead us to doubt whether it can even be sustained in the next few years. Indeed, in the first quarter of 1989, the celebrated growth rate has been flagging, and preliminary estimates indicate a real growth rate of only 4.1 percent on an annual basis.

Our reasons for being less than wildly enthusiastic have to do with two main themes:

First, the recent growth record was premised on a very short- sighted strategy of continuing foreign and domestic borrowing, the viability of which is open to question. Either the funds will not materialize in the desired amounts or their availability is subject to such conditions as will jeopardize growth itself. Examples of the former are the base-rental talks and the Philippine Assistance Programme (PAP) pledging session; an example of the latter is the stringent commitments the country made in the most recent negotiations with the International Monetary Fund (IMF), as embodied in the memorandum on economic policy.

And second, the recent growth has been highly unequal and has not directly addressed the problem of distributing its gains to the masses. This is not yet even a moral argument, merely a technical one. This studied blindness to the direct alleviation of the plight of the poor is bound to undermine the social basis of its legitimacy and cause it to fail. We cite the process and results of the last wage negotiations as our example.

Table 1. Real GNP and GNP Per Capita (1972 pesos).

Year	Real GNP (billion pesos)	GNP Per Capita
1980	92.5	1,913
1981	95.7	1,932
1982	97.5	1,921
1983	98.6	1,890
1984	91.6	1,718
1985	87.8	1,605
1986	89.1	1,591
1987	94.2	1,682
1988	100.5	1,752
1989	107.0*	1,821*
1990	113.9*	1,893*
1991	121.4*	1,970*

*Projected, assuming an annual growth rate of 6.5 percent and a 2.5 percent population growth rate.

To place these arguments in context, it would be well to go over the factors proximately responsible for the country's recent economic performance.

Sources of Recent Growth

▪ Consumption

It has often been pointed out -- and the government itself concedes to the fact -- that the expansion has been led primarily by a reviving consumption. If at all, investment has only followed. The reasons for this pattern, as well as their implications, are easily grasped. The recession of 1984 brought down incomes and laid capacity idle. Throughout the period when average real incomes were falling, consumption expenditures were stagnating despite a growing population. Real consumption per head was actually declining from 1983 to 1986.

In 1987 and 1988, however, the government embarked on a classic "pump-priming" exercise by decreeing bonuses and salary increases for its personnel (notably also for the military to boost morale for the "total war" effort), and implementing local public works. Without doubt, pay hikes, bonuses, and local projects were also politically expedient in an election year. As a consequence, government spending for compensation grew in real terms by 6.32 percent in 1987 and almost 16 percent in 1988. In addition, legislated minimum wages were increased by 10 pesos last year. Largely as a result of these, consumption expenditures rose rapidly in real terms by 5.72 and 6.02 percent in 1987 and 1988, respectively. (The important items were food, clothing, household operations, and furnishings.)

Much of the increase in consumption, therefore, have simply been "pent-up" demand, or an attempt by people to regain customary levels of spending. To the extent that there are no concurrent major changes in the way incomes are distributed (and our general impression is, there have not been any), the increases in consumption spending will not represent a continuing source of growth. Rather, one might expect that as the per capita GNP of 1980 is approached, the unusual growth from this sector will decelerate, as the "catching up" effect is exhausted.

▪ Deficits and debt

As mentioned above, an important part of the expansion of consumption was due to government spending, mainly as pay-increase or bonuses to government employees and the military. One consequence of the government's "pump-priming" strategy, however, has been the large public deficits it has had to run and a chronic tendency to incur increasing debt.

Table 2. Real Growth Rates of Components of GNP (1986-1988) in percent.

	1986-87	1987-88
Consumption	5.72	6.02
Government Consumption	7.17	11.34
[Compensation	6.32	15.99]
[Others	8.67	3.32]
Investment	30.26	19.24
[Construction	15.31	7.69]
[Durable Equipment	16.06	29.04]
Exports	-1.34	14.76
Imports	26.48	36.98
GNP	5.91	6.72
Inflation (GDP Deflator)	8.03	9.72

Source: 1986-1988, NSCB, April 1989. National Income Accounts of the Philippines

Here, the link between the deficit and the debt problem first becomes apparent and turns into a vicious cycle. It is well known that total debt service, both foreign and domestic, takes up more than 40 percent of the national budget. The government's refusal to consider reducing debt-service payments, especially to foreign commercial banks, makes it lose effective control over its budget. In order to perform its functions, therefore, it has had to borrow additional money from abroad or from the domestic economy by issuing Treasury Bills bearing high rates of interest. Already, the public foreign debt rose from 13.56 billion dollars to 16.2 billion dollars between February 1987 to February 1989. Domestic borrowings have also risen several-fold under the Aquino administration, rising from 15.8 billion pesos in 1985 to 58.6 billion pesos in 1988. It is evident that by refusing to face up to the problem of reducing debt-payments and simultaneously expanding its own spending, the government is digging itself into a deeper debt hole.

Contributing to the large deficits is the government's inability or unwillingness to collect the amount of taxes due, especially from the propertied classes. Taxes as a share of GNP actually fell in 1988, despite the fact that the wealthy have been able to "recover" their incomes. Apart from making brave speeches, the Aquino administration has fallen short of implementing existing tax laws, going after tax evaders, and imposing taxes on property to make the rich share in the burden of financing the recovery (as they enjoy a disproportionate share in the benefits).

There may be disputes regarding the wise use of public funds, but what is not at issue is the greater scope of choice and the capacity to respond to the people's needs that would be available to the government if it were only able to reduce its debt service payments. Likewise, if one were intent on fully repaying the debt, a recovery programme anchored on deficit-spending would be the worst possible approach, since it would place the country at the mercy of its creditors. One will suffer the worst of both worlds if one is coerced into paying submissively for the actions of a spendthrift.

■ Investments

What were registered as hefty increases in investments (Table 2) were largely construction activities in 1987 and durable equipment in 1988. Intense construction activities are to be expected following the revival of consumer demand (e.g., for housing, shopping malls). People's casual observation regarding a building boom, especially in Manila and Cebu, is likewise reflected in the data. The rise in investments in durable equipment, however, overstates the actual increase in productive capacity since much of this were actually expenditures on transport equipment. The important question regarding investment, however, is whether it will come on time and in the right composition to meet any rising demand; otherwise, further increases in consumption could simply find their resolution in inflation.

It is important to note that past increases in output, especially the high growth in manufacturing (nine percent in 1988) were possible without much pain owing to the existence of unused capacity. For this reason, one should be cautious in regarding the resurgence of domestic manufacturing as marking the eve of a renaissance. What has happened is that capacity was unused owing to the recession. It is only natural to expect a rapid output growth in this sector without new investments as existing plants and equipment only need to be dusted off. With plants working flat out, however, additions to capacity will henceforth be necessary, and further growth will have to be paid for more dearly. The price trends in Table 2 suggest that double-digit inflation is almost certain (although the LOI-MEP unrealistically projects the maintenance of a single-digit rate). And indeed, first quarter figures for 1989 show inflation running at some 10 percent on an annual basis.

■ External factors

From the foregoing, it seems that, despite the recent growth, the domestic side of the economy runs up against certain limits. These are to be found in the debt, in existing capacity, in the existing income distribution, and in the impending achievement of "recovery" itself. For this reason, we suggest that -- unless the present income distribution and configuration of policy are drastically altered -- no further impetus to the economy may be expected from its purely domestic elements. Under these circumstances, we must regard the behavior of these elements as "conjunctural".

Ironically (or perhaps logically), however, the more "structural" aspects of the economy's recent performance have been influenced by external factors rather than internally generated sources of growth.

One such factor is the increase in the inflows of foreign investment, which doubled in 1989. While documentation is not perfect, it is believed these new flows are dominated by Taiwanese capital, with some renewed Japanese interest also being shown. For both Japan and Taiwan, the motives for investment are primarily the need to recycle trade surpluses and the exploitation of advantages offered by the Philippines, e.g. a cheap labor force, natural resources, trade preferences vis-a- vis the developed countries, and wishy-washy environmental regulations. Substantial amounts of Taiwanese capital have gone into both tradeables (e.g., garments and textiles) and non-tradeables (e.g., real estate).

Another external factor which helped fill in the financing gap was exports, which rose rapidly in 1988 by 14 percent in quantum terms. (Imports rose faster, however, so that the trade balance worsened nonetheless.) In the meantime, the composition of exports has changed with the majority being made up of non-traditional exports (semiconductors, garments, prawns, etc.).

Finally, official development assistance also influenced the country's economic performance.This shall be discussed below in the context of the Philippine Aid Plan.

One cannot, of course, take the continuation of the favorable external trends for granted. We only need mention the mounting calls for protectionism in the developed countries; the emergence of preferential trading blocs (e.g., free trade between US and Canada, or Europe's "internal market"); and a possible slowing down of the economies of the members of the Organization for Economic Cooperation and Development (OECD) as worries over inflation mount. All these impose obvious limits to a development strategy that is dependent on external factors.

From the foregoing analysis of the sources of growth, it is apparent that most of the permanent or "structural" features of the growth have originated from the outside. These have come in the form of loans, official assistance, and the expansion in world markets. By contrast, the internal sources of the recovery have taken place mainly through a reaffirmation of the existing structures. In other words, the elite of the country have not taken an active and autonomous role in the country's further development. Rather, the impetus has come mainly from without. This lack of internal dynamism is one of the most worrisome of the features of the present recovery.

■ Reforms from without?

The pre-eminence of external factors indicates a further abdication by the country's elite of their leading role in the economy. Not merely have the more significant factors for growth originated from outside; whatever significant policy-reforms towards the transformation of existing property rights and the political economy have also been pushed from without. Among the most important ones have been import-liberalization and privatization, which have been propounded since the 1970s by multilateral institutions such as the World Bank and the IMF.

It is all too facile to take one or another theoretical or ideological position with regard to these "structural reforms". This article argues that for one to understand the process of transforming policies as conceived into policies as implemented, one must be sensitive to the relevant political economy. Several scholars have documented the internal debates on these issues that took place under the Marcos regime. [1]

What is clear is that these attempted changes from without, by their nature, have not always been implemented voluntarily. For example, the Marcos regime acceded to the import liberalization and tariff reform programmes only in the late 1980s, when it was beginning to meet financial difficulties and was compelled to apply for a structural adjustment loan from the World Bank. At that time, and up to now, import-liberalization (the removal of non-tariff barriers) and tariff reform (the narrowing of the tariff range) were met with stiff resistance from entrenched business interest which, being politically represented, have eventually determined the pace and pattern of these reforms, giving them an unequal and arbitrary character. For example, given the peasantry's lack of political clout, agricultural products were on the average liberalized ahead of industrial products. In contrast, some industries, such as those in the "progressive manufacturing programmes" which constitute large sources of monopoly rents, have been spared.

All in all, it seems not one among the major actors in the economy, certainly not the heads and statesmen of the manufacturing sector, is in support of import liberalization. This lack of enthusiasm presumably results from a fear that the unimpeded flow of imports into the domestic market would wipe out our local industries.

This is pathetic. For two generations, starting from the late 1930s when President Quezon initiated the establishment of the National Economic Protectionism Association (NEPA) to the present, local industries have been given one of the highest protective rates in this part of the world. The idea behind these high rates of protection was to nurture local industries from infancy, when they could not stand on their own feet, to adulthood, when they could successfully confront international competition. But instead of growing up to responsible adulthood in terms of management, capitalization, and technology, they have remained managerially inefficient, resource-poor, and technologically backward – paying their employees starvation wages and selling high-priced, poor-quality products to the consuming public. Hence the current fear of import liberalization.

One can argue, as many orthodox economists have done, that the industrial sector should now be exposed to the gales of international competition through the liberalization of imports. If liberalization is for the entire sector, this would be a serious mistake, as serious as the one demanding a perpetuation of protection. What seem needed, at this moment, are a vigorous determination of which industries should be "kept" owing to their strategic nature, an unambiguous identification of which local industries deserve a lease on life by reason of infancy, and a clear warning to all non-strategic industries that after a reasonable period of time, say five to six years, all protection will go. Five to six years is a period long enough to permit an expansion of the capital base, the enhancement of marginal techniques and the modernization of technology. From then on, local industries must prove that they are as good, if not better, than their international competitors. If they cannot do that, they will have to be declared unworthy of protection.

The difficult but nonetheless necessary task of those who support an autonomous economic strategy is to accept the fact that the response of the local elite to the challenge of industrialization has been historically anemic, and is likely to remain so. One must resist the notion, however, that a complete abdication of economic sovereignty and decision-making to foreigners is a desirable, or even a viable, path to take. This does not mean that these authors do not see the theoretical possibility (admittedly remote) of foreign-sponsored "structural reforms" ultimately ushering in neocolonial development; only that, as Filipinos, we reject this notion. But then again, this is not to say that a largely indigenous industrialization is no longer possible; only that its bearers may not be the elite.

Problems of Distribution

▪ Redistribution

The country's economic decision-makers have hitherto acted as if the problem of poverty and income distribution will just "go away" or will be "outgrown"; as a result, there have been no particularly bold initiatives to redistribute incomes and property. The agrarian reform law which was supposed to have been the cornerstone of the administration's programmes is in a state of limbo, following massive scandals under a defective law. This is in stark contrast to the vigor with which a redefinition of property rights is being pursued in favor of big domestic business and transnationals, as cases involving privatization show.

The benefits of the recent growth have gone mainly to the rich and middle classes and foreign investors, much to the detriment of the poorer majority. The irony in all this, of course, is that the working classes cannot simply be regarded as passive observers of growth, but in fact should be expected to demand a share of this growth. The fallacy of the thinking that the masses can be regarded simply as bystanders is vividly illustrated by the recent issue of the minimum wage, a matter immediately related to the memorandum on economic policy (MEP) submitted by the government to the IMF.

In the MEP submitted to the IMF, the government committed itself to undertake policies which would effectively lower workers' real wages (e.g., reducing rice subsidies, raising the costs of power, water, etc.); it implicitly assumed a rate of inflation that would further threaten the incomes of the working classes. This was a clear signal to labor that it would be left behind again, or in other words, that growth this year would again be at their expense. It was therefore to be expected that labor should resist this and demand a wage increase. Unless the authorities are entirely cynical and make no effort at all to enforce the law, there is no doubt that the 40 percent increase in nominal minimum wages recently won by the workers will have a significant impact on prices. In the process, of course, the government's own plans will have been thrown out of kilter; in particular, the inflation targets will not be met. For this, the blame should not be laid on the workers but rather on those financial and economic managers who coldly set targets and commit themselves to economic measures without considering the latter's effects on social redistribution. As the late Joan Robinson so aptly put it, "It is commonly said that trade unions cause inflation: however that may be, it is quite clear that inflation causes trade unions." [2]

But it should have been realized that the legitimacy of the plan itself was endangered, since it did not proceed from an enforceable consensus with the workers. In brief, therefore, there are many things which are technically wrong with the Letter of Intent (LOI) but the most serious one is the assumption that the problem of poverty and distribution can wait while "growth" proceeds and benefits only a small sector of society.

▪ Employment

Employment is one direct means by which members of society participate in production and gain access to its benefits. Deprived of it, affected members of society are reduced to being mere spectators to the consumption activities of their more fortunate countrymen. For decades, the problem of unemployment in the country has been acknowledged by most analysts to be one of the most serious problems affecting Philippine political economy. As early as 1973, the International Labor Organization (ILO) conducted a comprehensive analysis of the problem. The previous regime adopted a policy of promoting labor-intensive manufactured exports and small- to medium-scale industries (also thought to be labor-intensive). It nevertheless failed to create employment opportunities.

One disturbing aspect of the current "recovery" has certainly been the slow response of employment to growth, despite the government's declaration that the generation of employment was one of its most important aims. The level of employment created by the government through the "pump-priming" activities it engaged in under the Community Employment and Development Programme (CEDP) was 25 percent below the target. "Also the projects did not really absorb the unemployed members of the rural labor force, since about 40 percent of those employed in these projects were in fact already initially employed." [3] The weak response is evident in the low elasticity of employment with respect to growth.

This situation is consistent with our hypotheses that growth has not permeated to the lowest income levels, that growth based on pump-priming tends to be transitory, and that investment has entered areas with low risks and low value-added and not in those areas with more impact on future output and employment. Some will judge this assessment unfair, owing to the short period during which positive growth has actually taken place. They would be right if our concern and that of our people were simply to "recover" past income levels or to reaffirm past patterns of asset distribution, that is, if one were talking about a "restoration" and not a "revolution".

Debt and the PAP

There is no more eloquent testimony to the present problems than the burden of foreign debt the country inherited from the past regime. The magnitude of this debt (some 28.0 billion dollars as of February 1989) has been both a cause and a consequence of the crisis. The debt became a problem because, under the Marcos regime, large amounts of foreign public borrowing were expended by the government in unproductive projects or were dissipated in investments riddled with graft and corruption and which benefit only narrow private interests.

In the end, the government became saddled with bad debts and could only repay them out of its own budget. The foreign debt service now takes up fully 44 percent of the total budget. This preemption of a large share of the budget has meant a reduced capacity of the government to provide social services to the people.

Despite a change in regimes and a vigorous opposition from both within and outside the government, the Philippine official debt policy has been to continue to honor and repay all foreign obligations and to comply with all conditions imposed by the IMF. As of now, the country devotes some 29 percent of its exports to debt repayment alone. Over the period 1988-1992, it is estimated that a net-resource outflow in the order of 16.3 billion dollars will occur. That is, over the period, the country will be effectively paying out an equivalent of 7.1 percent of its GNP, more than what it receives in new loans from the creditor banks and governments. In this situation, it is really our country which is providing "aid" to the richer creditor countries. This resource transfer represents the single most important obstacle to growth and development for the country: in order merely to sustain present growth levels of 6.0 to 6.5 percent, the country will incur an external financing gap of 8.45 billion dollars (or some 1.7 billion dollars annually) as estimated by the National Economic and Development Authority (NEDA).

The link between the foreign debt and poverty is clearly seen in the large net resource outflow which takes place. If these funds had not been given over to the foreign banks, more resources would have been available for meaningful social services. The budget deficit is caused largely by the masochistic choice of deferring to the foreign banks in its stringent demands for payment. This preempts the budget for health-care and education, which, as the World Bank report acknowledges, are crucial to the eradication of poverty.

The Philippine Aid Plan (PAP) is directly related to this financing gap and to the pliant stance on the debt issue which the Philippine government has chosen to adopt. This Plan, or more exactly the promise of such a Plan, became the ubiquitous excuse for not undertaking a more judicious management of the debt problem.

The problem with the PAP solution is that it is an assistance made on a government-to-government level. Much of the financing gap, however, is private in nature, in the sense that the debt burden actually penalizes the private sector in the undertaking of projects. This is because, save for a few, they cannot raise money directly from abroad, since the commercial banks have voluntarily ceased lending to the country. In addition, the government must borrow domestically in order to cover its budget deficits and to service public debts. In so doing, the government raises interest rates and "crowds out" private investors.

The incongruity in the PAP is that it means to cover an essentially private financing gap with public debt, funnelling this somehow to support or directly finance private investments.

The inappropriateness of the PAP solution to the financing problem becomes apparent in the following respects:

First, the government has difficulties in presenting well-thought out public projects for financing. In the Philippines, local officials and the big business sector have typically blamed the recent "slow" rate of approval of feasibility projects on the planning agency, NEDA. Actually, what the NEDA does in this respect is merely to ensure that the conventional standards for feasibility studies are met. In fact, the rate of availment for foreign-assisted projects as of December 1988 was 77.1 percent, and for OECF (Overseas Economic Cooperation Fund) loans, 71.0 percent.

Second, this "solution" generates a strong incentive for graft, corruption, and rent-seeking. The recently installed set- up for official development aid (ODA) disbursement invites comparison with the one that existed during the Marcos regime, under which government took out large loans and re-lent them to big private interests.

Even before the PAP pledging session, there was already a clear indication that the private nature of the financing gap was making itself felt, since even parts of current ODA are being re-lent to the private sector. That this trend will be a prominent part of the PAP may be seen in the dispute within the government over who should be in charge of ODA funds. As is probably well-known, the PAP Council formed by the Philippine government has sought to distinguish itself by forming tight links with domestic big business.

The prominent presence of private sector-interests in the PAP Coordinating Council (CCPAP) was initially explained with the excuse that it was supposed to approve and oversee only loans over and above existing ODA commitments. It was understood that NEDA would continue to take charge of the bulk of ODA. This was changed radically. All ODA funds were removed from NEDA's responsibility and entrusted to the CCPAP. This development provoked a serious division within the government's aid-disbursing institutions and was a significant factor in the recent resignation of the NEDA Director-General, Solita Collas- Monsod.

Later, in a purely cosmetic move, ODA was "restored" to the NEDA through the creation of the Committee on Official Development Assistance (CODA), which is more malleable to private sector interests. This is evident from the fact that the same interest groups prominent in the CCPAP have now been given the cloak of legality in the CODA under NEDA.

The repercussions of this should not be underestimated. It was precisely such a strategy of public support to big businesses which led to the Marcos debt crisis in the early 1980s. At that time, large private projects were favored with government money obtained from foreign loans. Many of these failed; their private owners made money, but the government was left holding the bag.

The financing gap is primarily a private one and the government sector can only generate new but feeble projects. The bureaucracy's capacity to efficiently absorb new money should be seriously questioned.

The most important long-term effect, however, is that, in underwriting the government, the PAP allows the elite and the government to become complacent and avoid undertaking seriously needed reforms. Among others, these policies of complacency include avoiding serious agrarian reform; avoiding a serious tax effort that is especially directed at the big property owners; avoiding having to undertake well-thought out industrial and technological plans; avoiding a clearcut political decision on the presence of US bases and nuclear arms; and finally, avoiding a debt strategy that involves a reduction of our debt-payments.

In the end, we will merely have growth that does not ameliorate, but which provokes social conflict; growth without economic maturity and which compromises sovereignty. That is, if we have growth at all.

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Notes

1. Robin Broad, *Unequal Alliance.* (Quezon City: Ateneo de Manila University Press, 1988) and Walden Bello, *Development Debacle* (San Francisco: Institute of Food and Development Policy, 1982).

2. Joan Robinson, *Contributions to Modern Economics* (Academic Press, 1974) p.260.

3. E.Reyes and E. Milan, "Employment Strategies for Accelerated Economic Growth: The Philippine Experience", *Philippine Review of Economics and Business*, 25 (1-2), March and June 1988, pp. 151-185