# Philippine Economic Growth: Can It Last?

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## Introduction

Philippine officials proclaim that in the year 2000 the Philippines will be Asia's next newly industrialized country. But the real message underlying the hyperbole of the administration shibboleth, Philippines 2000, is that the Philippines has turned the corner, that economic growth--and hopefully development--can be sustained. Several trends support this. In the brief period since 1993, a significant difference is apparent in the country's economic performance. Over the period 1993--95, gross domestic product (GDP) grew at an average of almost 4 percent annually, with a trend to acceleration: GDP growth was 5.4 percent in 1996 and 5.2 percent in 1997. This performance is certainly a large improvement over output growth of less than one percent annually in the immediately preceding three years, 1990--92. At that time, the economy was reeling from the effects of a recession caused by a budget crisis and crippling power shortages.

From a long-term perspective, however, recent improvements are far from dramatic. In 1995, Filipinos earned on average only as much as they did in 1984 (Figure 2.1), and it will not be until the late 1990s that Filipinos ultimately regain the average incomes they received a decade and a half ago. Indeed per capita income in 1995 was only 9 percent higher than that of the worst years of the 1980s, an improvement of less than one percent growth annually over an entire decade.

This is not the first time the country has appeared headed for a permanent recovery. In the period 1987--89 the economy also seemed to be growing out of recession (the worst in postwar history); GDP growth averaged 5.8 percent, more rapid growth in fact than in the recovery of the mid-1990s. Yet the earlier recovery sputtered--in part because of the December 1989 coup attempt--and gave way to a full-blown recession by 1991.

Indeed, economic growth in the Philippines over the past three decades has been dominated by a boom-bust cycle, according to local economists. Significant interruptions in economic growth occurred in 1958--60, 1970, 1974, 1983--85, and 1990--92. The past decade's record is shown in Figure 2.1 in which two recessions are evident: in 1984--85 and in 1991--92.

In the typical pattern, a few years of moderate economic growth are followed by shortages of foreign exchange, making it necessary to cut back on government spending and contract money supply, thus halting the growth episode. A period of partial adjustment follows, and the growth cycle resumes once the foreign exchange constraint is eased, with the government typically feeling freer to resort to deficit spending. As a result, the growth episodes have closely followed a periodization according to major balance of payments crises. Although different factors may immediately precipitate these crises, they are ultimately traceable to the economyís failure to earn enough foreign exchange to pay for the imports (both productive inputs and final goods) associated with rising output and incomes.

The most recent episode of the boom-bust cycle was the recession of 1991--92. Under the Aquino government in 1987--89, economic growth had begun to recover , led initially by deficit financing for rural public works and reviving consumption, then gradually by investment. GDP growth in this period was as high as 5.8 percent. The attempted coup díetat in late 1989 again shook investor confidence, so that growth fell to 3 percent in 1990. Apart from political uncertainty, however, fundamental economic problems continued to hound recovery.

This boom-bust pattern is often cited by those who contend that the present recovery is soon bound to end, the same way others did. This has led to a vigorous debate over the soundness and sustainability of the Philippinesí economic growth. Are things fundamentally different, or are they fundamentally the same? Put another way, what--if any--are the reasons to believe that the current growth trajectory will differ from those past? This question has been sharpened by the most recent turmoil which caused sharp depreciations and large drops in almost all Southeast Asian currencies and stock markets beginning in July 1997. Perhaps prematurely, the sustainability of growth in the entire region is being placed in doubt, and this only complicates the more limited task of assessing the extent, depth, and prospects of recent Philippine economic performance. The difficulty stems only partly from the gap between government aspiration and economic reality. Certain analytical problems present obstacles as well: How much credence should one lend to different sets of information, both of which are true? Is the recent past a more accurate guide to the future than the more distant past? Nor are econometric models of any use; they are after all based only on past data whose very validity for future trends is at issue.

Table 2.1 **Philippine GDP Growth Rates, 1984-97** (percent)

| Period | Average Annual GDP Growth Rates |
|---|---|
| 1984-86 | -3.73 |
| 1987-89 | 5.75 |
| 1990-92 | 0.93 |
| 1993-97 | 4.4 |

*Source of basic data: Philippine Statistical Yearbook*

This chapter will argue that, in many ways, the current recovery is better placed to succeed than previous ones. First, stable macroeconomic conditions have been restored. Second, some major economic reforms, which in the past have met with social resistance, are now firmly established. The final ingredient is the restoration of investor confidence. The succeeding sections discuss each of these aspects in turn.

## Solving the Fiscal Crisis

The main problem confronting the Aquino government was a fiscal crisis, wherein the government faced the following macroeconomic dilemma: Maintenance of a decent level of social and economic services in the face of low tax collections and a large debt-service bill meant enlarging the public deficit to be financed; but it was feared that monetizing the deficits would lead to inflation (and more important, it was disallowed under the International Monetary Fundís stabilization program).

As a result, the Aquino government initially resorted to domestic borrowing using short-term instruments. This, however, began to bloat the *internal* debt and in turn threatened recovery, since it tended to raise interest rates. More immediately, it also raised the governmentís debt service on past debt and worsened the deficit in nominal terms. The government was then caught up in a vicious circle of borrowing more in order to repay past loans. Debt service was taking up some 30--40 percent of the budget.

In 1990, the Aquino government addressed the fiscal crisis by drastically cutting back on public spending and quickly raising resources through indirect taxes. The Gulf war in 1991 raised oil prices and bloated the trade deficit, while its threat created an aura of national crisis that made calls for austerity more palatable. The government used this opportunity to push harsh crisis measures, including an engineered depreciation, contractionary monetary policy, and renewed fiscal austerity. A 10 percent levy across the board on virtually all imports was imposed, as well as a peso-per-liter tax on all petroleum imports. Mandatory cuts in spending were also ordered for all government agencies.

By 1992, the budget surplus before debt service had reached 5.2 percent of GNP. Because of the tight-money policy, however, interest rates rose and output fell, finally ending the growth episode. In time, the recession would ultimately moderate both interest rates and inflation, as well as exert pressure on the balance of payments. As interest rates fell, the recession also relieved the governmentís nominal deficit problem as debt service on accumulated borrowings fell. In a way, therefore, the 1991--92 recession did solve the immediate fiscal problem, but only at the cost of falling output and employment.

The recession was further prolonged by a shortage of power-generating capacity, lasting until early 1993, which was due to the governmentís failure to anticipate an increased need for power and put new plants on stream. The recession of 1991--92 and the crippling power crisis would do much to obscure most of the Aquino governmentís earlier achievements in the public mind and leave bitter impressions of its years in power. One lesson the recession taught policy makers, however, was the importance of holding the public sector deficit in check if the domestic debt treadmill was not to be cranked up again.

Often overlooked are the significant tax reforms put in place by the Aquino government. In 1986 the value-added tax (VAT) was introduced and the reform of the individual and corporate income tax systems began. These succeeded moderately in raising revenue without calling forth any public protest. Taxes rose as a percentage of GDP from less than 10 percent to 14 percent between 1984 and 1989, before the 1991--92 recession and the imposition of large indirect taxes. Nonetheless, these efforts were insufficient to overcome the fiscal crisis, chiefly owing to the large portions of the budget preempted by debt service, the significant loopholes (chiefly in the form of generous deductions allowed under the corporate income tax and the partial coverage of the VAT), and finally the poor collection efforts of the government bureaucracy.

After the 1991--92 recession, in one of its most significant accomplishments, the new Ramos administration managed to maintain a consistent budget surplus. This was done through a combination of means: first, by keeping the growth of government expenditures in line with the overall growth of the economy, a measure not without its costs, as will be seen below; second, by a reliance on build-operate-transfer schemes to implement significant infrastructure; and third, by an active resort to raising nontax revenues, primarily in the form of proceeds from privatization. The result was a slowing down of the growth of the internal debt and a reduction of internal debt service.

The realignments of the tax system under the Aquino government probably rendered tax revenues more buoyant, so that as economic growth resumed, tax collections improved more than proportionately. The tax effort (ratio of tax revenues to GDP) now stands at some 16 percent. This would be an accomplishment, except that the needs for government spending--especially on infrastructure--are much greater. Further attempts at a comprehensive reform of the tax system, especially under the Ramos administration, have been meeting stronger resistance from certain parts of the corporate sector. To provide essential infrastructure without bloating the budget deficit, the government since 1992 has relied on private sector initiative and financing in the implementation of some large infrastructure projects.

Another element in resolving the fiscal crisis was the aggressive resort to nontax revenues through the sale of public assets. On the one hand, this was an obvious recourse: The government had accumulated a large number of unprofitable (often overvalued) assets owing to guarantees it had extended in the past. Their maintenance was a drain on public resources, hence it was an easy decision to be rid of them. The Aquino government had begun in this manner; between 1986 and 1989, nontax revenues represented more than 20 percent of total revenues.

Since 1992, however, the idea that not only losing enterprises, but even profitable ones could be sold off became accepted within government. This realization was partly due to the exigencies of raising revenues through nontax means. Obviously, the proceeds from one-time privatization will moderate substantially as the supply of vendible government assets gradually runs out. Nontax revenues accounted for more than 23 percent of total revenues in 1994; this fell to less than 10 percent in 1995.

The last element in the return to macroeconomic stability was the rehabilitation of the central bank in 1993. Before then, the central bank could not function effectively, owing to a negative net worth caused by bad loans extended during the Marcos regime. As a result, the national government had to perform quasi-monetary functions, issuing T-bills in excess of its own needs for budget financing, bloating the budget in the process with higher payments on internal debt. Under a 1993 law, the government reestablished a new central bank and took over the bad-loans portfolio of the old one. This constituted a large step in allowing independent monetary policy to be conducted and in disentangling monetary from fiscal policy.

The effects of having gained control over the deficit were palpable, namely, lower nominal interest rates and a moderation of inflation. As the governmentís need for new borrowings was reduced, the pressure on interest rates was also lessened, which in turn also reduced the debt service on old debt. Falling deficits also tempered peopleís expectations of future inflation, and as a result actual inflation has declined significantly. The close relationship between this development and the fall in the governmentís budget deficits as a share of GDP is striking (Figure 2.2).

Inflation has also been moderated by the pesoís continuing stability, although this has been a mixed blessing, as the subsequent sudden depreciation in July 1997 showed. The peso had actually appreciated nominally since 1991, and the exchange rate had hovered since then at an almost constant P26 to $1. After the successful restructuring of the countryís foreign debt, inflows were sustained by an incipient export boom, overseas workersí earnings and other factor income, as well as large inflows of foreign capital, which have resulted in positive payments balances notwithstanding an increasing current account deficit. The central bankís net international reserves as a result increased dramatically from the negative balances of the 1980s to more than $11 billion by late 1996 (Table 2.2). By the middle of the 1990s, the country had restored both fiscal and monetary control, while the perennial problem of external balance that had been immediately due to the foreign-debt hangover had been addressed--at least in the short term.

Table 2.2 **Exchange Rates and International Reserves, 1990-96**

| Year | Exchange Rate (pesos/$) | Net International Reserves* ($million) |
|---|---|---|
| 1990 | 24.31 | 66 |

| | | |
|---|---|---|
| 1991 | 27.48 | 2170 |
| 1992 | 25.51 | 3661 |
| 1993 | 27.11 | 3495 |
| 1994 | 26.42 | 7121 |
| 1995 | 25.71 | 7762 |
| 1996 | 26.2 | 11467 |

Source: Bangko Sentral ng Pilipinas, *Selected Philippine Economic Indicators.*
* End-of-period balances; figure for 1996 is as of end-September.

The recent speculative attacks on the peso and other currencies of the region have unsettled the previous situation that was increasingly overly founded on continuing foreign portfolio inflows. In July 1997, the central bank attempted briefly to defend the peso against speculation by selling more than $4.5 billion worth of foreign exchange in one week. This explicit defense of the currency was soon abandoned, however, as reserves thinned out. The peso then depreciated sharply from P26 to P30 to a dollar over a period of days. The central bank next resorted to raising interest rates and controlling liquidity. This worked only briefly, and by the end of 1997 the peso had depreciated more than 50 percent against the dollar. In what could be a hopeful sign, however, inflation continued to be at single-digit levels, with business being worried more about the recessionary consequences of the central bankís high-interest ìcure,î which was worse than the depreciation itself. Indeed, notwithstanding its suddenness, the depreciation represented a badly needed correction of the one macroeconomic variable that had slowly strayed out of line. Its consequences properly handled, the depreciation could represent a shot in the arm for the flagging manufacturing (and especially export) sector over the next few years.

**Structural Reforms**

Determining the character and sustainability of economic growth requires an examination of regimes of trade and investment, since they affect the relative profitability of various industries and, in this manner, guide the flow of new investments. The repeated occurrence of the boom-bust syndrome in the past was due in large part to an industrial portfolio that consisted largely of uncompetitive or inefficient industries. ìAdjustmentî in those circumstances simply meant depressing the import demand of such industries through a contraction of output all around, i.e., a recession, enough to temporarily restore the external-payments balance. The so-called recovery phase, however, would subsequently revive the same set of uncompetitive industries, putting the economy on course for another crash.

There are indications, however, that this pattern is in the process of being broken. Aside from the restoration of macroeconomic stability, the most recent growth episode is distinguished from previous boom-bust cycles by its occurrence in a context of significant structural reform. Changes have been most far-reaching in the trade regime; the momentum for lowering the level and narrowing the spread of tariff protection has been maintained therein. The overall climate for investment, meanwhile, has also undergone dramatic changes, with formerly regulated, restricted, or monopolized industries being opened to competition from new entrants. These industries have included power generation, telecommunications, inter- island shipping, passenger and commercial air transport, banking, urban water and sewerage services, and oil trading and refining. The chances for a repetition of the boom-bust cycle are lessened by new investments entering industries and firms that are competitive and earn enough exports.

**Trade Reforms**

The system of protection has long been a bone of contention and has often been depicted as the epitome of the struggle between political and economic forces in the Philippine economy. It is in this area, however, that both the Aquino and Ramos governments may be said to have accomplished the largest changes, in a long but steady process of removing the protectionist bias of the trading regime.

After the fall of the dictatorship, the Aquino governmentís import-liberalization program of 1986 removed a large number of quotas and other nontariff measures, converting these into tariffs. One of the last acts of the Aquino administration was to put in place a large-scale tariff reform to narrow the spread and lower the average levels of tariffs over the years 1992--96.

The Ramos administration followed through on this commitment by remaining firm in the implementation of the reforms initiated under Aquino. The momentum was maintained by the promulgation of another phase of unilateral tariff reductions beginning in 1996 and ending in 2001, further narrowing the levels and spread of tariffs. The need to adjust tariffs in the context of the countryís participation in the ASEAN Free Trade Area (AFTA) partly justified this. Upon its accession to the World Trade Organization (WTO), the Philippines bound its industrial tariffs to those set under the Aquino administration and committed to converting remaining agricultural quotas--except for rice--into tariffs. (Japan and South Korea were the only other countries besides the Philippines that sought and were given exemptions from the require- ment of the General Agreement on Tariffs and Trade [GATT] to convert agricultural quotas into tariffs.) Finally, as a member of the Asia-Pacific Economic Cooperation (APEC) forum, the Philippines supported the Bogor Declarationís objective of attaining free trade in the region by 2020 and submitted a unilateral (albeit nonbinding) action plan that would attain a low uniform tariff by 2005.

This succession of initiatives has resulted in a more or less consistent increase in the countryís openness to trade. The average level of protection for importables has fallen from 47 percent in 1983 to 32 percent by 1995. For agricultural imports, tariffs decreased from 63 percent to 28 percent between 1983 and 1995, while for manufactured imports, average protection fell from 45 percent to 33 percent. The reduction in tariff rates for agricultural imports has been especially large in relative terms.

The long history of failure in trade reforms--and their apparent success in recent times--is interesting on its own terms as well as instructive for assessing the likelihood of success of subsequent similar initiatives. Previous attempts at trade reforms in the Philippines have suffered historically from a weak internal constituency--an understandable state of affairs, since the gains to be reaped by industries, firms, and workers appear amorphous and far in the future as compared with the reality of currently established interests. Most proponents of liberalization in the past came from multilateral agencies, the technocracy, and to a limited extent academe. This circumstance did not greatly help advocacy in a country that viewed external influence with suspicion and concrete interests as weightier than theoretical arguments. An articulate business advocacy (as opposed to academic and bureaucratic advocacy) for exports emerged only in the 1990s with the emergence of the Confederation of Philippine Exporters (Philexport). Even in this case, however, the interests represented were smaller and less influential than established ones. Organized labor has also viewed liberalization with suspicion, not merely due to ideology, but for the pragmatic reason that the bulk of unionized labor is concentrated at the moment in industries that are inward-looking or declining, i.e., the very ones threatened by liberalization.

It is helpful to distinguish at least two phases in the reform of the trade regime. In the early stages of trade reform in the mid-1980s, success was due primarily to the extraordinary credibility of the post-Marcos government and its ability to find an internal justification for these reforms. The Aquino administration removed a great number of quantitative restrictions, using for the most part the rationale of simply reversing patently unsuccessful intervention measures by the discredited Marcos regime. The depth and duration of the 1984--85 recession assisted the reform process by severely weakening import-substituting interests. Political resistance to such changes from the business sector was fortunately weakened by the fact that many interests affected were of political personae non gratae.

The tariff reforms of 1990--94 represent a second phase in the social justification for the trade reform program. The need to keep up with international commitments determined the pace of liberalization in the second phase. The countryís participation in AFTA, its accession to the WTO, and participation in the APEC forum may be seen as key events which cemented the social and governmental commitment to a liberal trade and investment regime.

In the case of AFTA, the Philippine government was caught up in a program of liberalization within the region where--for both economic and political reasons--it could not afford to be an outsider. The formation of AFTA in 1990 was initially thrust on ASEAN leaders by the lack of progress in the GATT Uruguay Round, the formation of the North American Free Trade Agreement, and the impending completion of the European single market. ASEAN leaders agreed in 1990 to reduce trade barriers among member countries by the year 2005, later accelerated to 2003. The Philippines did not push this process in ASEAN, since it considered itself to be in a weaker economic position than its neighbors. Furthermore, in order to keep pace with its neighbors it would need to reconfigure its trade regime. A significant element in facilitating social acceptance of AFTA-related changes was that the country was not under visible pressure from developed countries (particularly the United States since the withdrawal of U.S. military bases in 1991) or multilateral institutions to undertake tariff reforms--ASEAN was primarily an affair among developing countries.

Once the premise of joining AFTA had been accepted, further trade liberalization was inevitable. The Philippines could not risk having substantially higher tariffs on imports from the rest of the world than those it imposed on imports from ASEAN; otherwise trade and investment flows might be deflected to other ASEAN members with lower tariffs. To illustrate, suppose trade was free between Malaysia and the Philippines because of AFTA, but that the Philippines maintained higher tariffs on non-ASEAN imports. Then there would be a large incentive for foreign suppliers to penetrate the Philippine market through Malaysia, or for Philippine trade to be biased unduly toward sourcing from Malaysia over the rest of the world. Practical exigency dictated, therefore, that tariffs on imports from ìthird countriesî should also come down by the time the free trade area was completed in 2003. This logic provided a strong external justification for the proposal floated by the Ramos governmentís economic planners to reduce tariffs to a low uniform level (5 percent) by 2005, a standing proposal that has met with surprisingly little criticism, except for some argument over the exact level of the low uniform tariff.

The muted social reaction to the countryís participation in AFTA contrasts with the louder controversy generated by the countryís joining the WTO and APEC, both perceived as entailing liberalization under terms imposed by developed countries. The controversy over the WTO and APEC was surprising, since for the most part the Philippinesí offers under the Uruguay Round merely reiterated tariff reforms that the government had already determined to undertake unilaterally. In the same manner, the countryís offers to APEC (wherein submissions are voluntary and nonbinding to begin with) merely elaborated existing plans to implement a low uniform tariff by 2005. Opposition was muted by the realization that the countryís submissions were similar to the offers of other developing countries.

This description of the process of liberalizing trade illustrates the combination of internal and external factors that succeeded in nudging reforms along in the Philippines. An important factor was the rationale provided by an internal critique of previous failed policies, up to and including the dirigisme and control of the dictatorship. Another factor was the benchmark provided by the actions of the countryís economically successful neighbors. Even today, the Philippines defines its goals in terms of a broad emulation of the ìtiger economiesî of East and Southeast Asia. A final factor, however, in cementing reforms was the momentum of liberalization contained in multilateral organizations of which the country was a member.

**Privatization and Deregulation**

The same factors may be traced in the second set of structural reforms the government has undertaken, namely the deregulation of important sectors of the economy and the privatization of a number of important government corporations. This process also began as a turning away from the politically discredited policies of the Marcos regime, which had supported both private and parastatal monopolies in the economy and had extended large guarantees on foreign loans taken out on behalf of entities favored by the Marcos government. The financial distress of these corporations after the debt crisis and their bailout resulted in their ultimate takeover by the government.

Thus the first phase of privatization was easy in that it tread on no major constituencies tied to the retention of these corporations in the public sector. Indeed, the process was hastened for significant pre-Marcos interests (e.g., the Lopezes, Ayalas, and Sorianos) restored by the 1986 revolution that stood to benefit from a restoration of their assets. Even former Marcos associates eventually reacquired their assets, in a unique version of political reconciliation. Second, the assets involved in privatization were egregious acquisitions, which even by former rules were not considered legitimate areas of government activity. The subsequent disposal of these assets involved no major ideological change and required only the overcoming of political resistance among bureaucrats who had become attached to continuing government stewardship over such assets.

In the meantime, the stage had been set for the second, still on-going, phase of privatization, involving the disposal of other assets that had traditionally been owned or controlled by government for some plausible public purposes. The initial moves in this direction included the privatization through public listing of the Philippine National Bank, heretofore the countryís largest commercial bank, and Petron, the government-owned oil company. From a bureaucratic and financial angle, as previously mentioned, the rationale for privatization was found in the need to raise revenues and bridge the fiscal gap. It was to the governmentís credit nonetheless that it saw the opportunity to expand the agenda to restructure the economy.

Two significant measures affecting foreign investments enhanced the success of the governmentís privatization efforts. In 1991, the last year of the Aquino administration, Congress passed an unprecedentedly liberal foreign investments law removing minimum nationality requirements in virtually all sectors of the economy. In particular, the foreign investments law adopted a ìnegative-listî approach, specifying only those sectors where full foreign ownership was not allowed, implicitly allowing 100 percent foreign ownership everywhere else. Second, the newly elected Ramos government in April 1992 lifted a large number of foreign exchange restrictions in the entry and repatriation of foreign funds. These two moves played a large role in stimulating inflows of both direct and portfolio foreign investments in the country. The effect was to increase the number of actors in the privatization efforts and to encourage alliances between foreign investors and large domestic interests.

The first testing ground for ìtrueî or structural privatization was the power sector. To solve the crippling power shortages that had become the principal obstacle to growth, the Ramos administration in 1992 and 1993 aggressively opened up the power-generation sector--hitherto monopolized by the state-owned National Power Corporation--to both foreign and domestic investors wishing to build and operate new power plants. This created a large response, especially among foreign investors and subsequently among the large domestic conglomerates as well. The build-operate-transfer contracts were in all likelihood too generous to the contractors and expensive for the government, since they guaranteed not only against sovereign but also commercial risks through guaranteed sales to the government. On the other hand, this measure did solve the immediate problem of eliminating power outages and gave both the government and the public a positive experience with private sector entry into utilities. Moreover, the entry of serious foreign investors in the energy sector broke the ice and helped refocus the attention of foreign direct investors on the countryís gradually improving conditions.

The deregulation of telecommunications came soon after in 1993 (following a famous speech by Lee Kuan Yew, who carped at the state of Philippine telecommunications) with new entrants allowed in international gateway, cellular, and finally domestic telephone services. This momentum was sustained with the deregulation of interisland shipping (1993), domestic passenger and cargo airlines (1993), and banking (1994) following in quick succession.

The privatization deals that have caught the most attention (and attracted controversy) have been large sales of idle government real property (the sale of the Fort Bonifacio property in Makati, stockyards in Alabang, and reclaimed property on Manila Bay are examples). These deals have turned out to be the most lucrative for the government. Their impact on economic structure is less complex, although they have managed to stimulate domestic and foreign investor interest and allowed the government to bridge its fiscal deficits.

In 1997, the government undertook another major structural privatization by bidding out the concessions to operate the heavily indebted water supply and sewerage systems in the Metro Manila area. The full deregulation of the oil industry was also slated within the year, as was the privatization of some power-generation assets of the power company.

The hope underlying privatization and deregulation has been that these should provide new stimuli for both domestic and foreign investors, especially as compared with investment by government-owned or controlled corporations, which are typically indebted and strapped for cash. The principle involved is clear: encouraging new entrants and competition should induce new investments, either by the new entrants, the incumbents, or both. This has worked most clearly in telephone services, where the previously dominant firm, Philippine Long Distance Telephone (PLDT) was compelled to undertake a massive expansion and upgrading program with the entry of new competition.

**What Could Go Wrong?**

Philippine industrial structure has changed inexorably as a result of the reforms. But the effects of such changes on aggregate indicators of economic performance, though encouraging, are still modest at best. The reasons for this are discussed below.

**Low Savings and Investment**

Reflecting the importance of foreign investment, foreign savings (i.e., foreign investments plus foreign loans) have constituted an increasing part of total investment, rising from 18 percent in 1991 to 34 percent by 1995. But this improvement in foreign investment has been offset by a fall in domestic savings, which have dropped to only 15 percent of GDP in 1995, versus 21 percent in 1988. This performance is far below ìdragonî savings rates of 30 percent of GDP or more in other rapidly growing countries of the region.

Looking only at foreign investments, a distinct increase in both direct and portfolio investments may be dated from 1993 following the 1992 liberalization of the capital account and a spate of initial public offerings on the stock market from privatized government firms and hitherto closely held family corporations. Table 2.3 shows an almost simultaneous rise in both portfolio and direct foreign investments in 1993, more than double that of 1992 net inflows. By 1995, net foreign investment inflows had risen to $3.7 billion, buoyed up further by portfolio investments. The increase in the more significant direct foreign investments has been slower but steady.

For all that, total investment as a proportion of GDP has increased only from 20 percent to 23 percent between 1991 and 1995 (Figure 2.3). This figure is inferior to the pre-recession level of 24 percent, and some distance away from tiger-economy standards of 30 percent or more of GDP being invested. Ultimately this deficiency has been reflected in the relatively modest growth rates the economy has managed to achieve. If investment constituted as much as 30 percent of GDP in the Philippines (as it does in many other Southeast Asian countries), then the GDP growth rate of the country would have been around 7 percent or more per annum, rather than the mid-1990s rate of only 5 percent.Ü

The conundrum--and the fundamental problem for growth--continues to be the low rate of domestic savings. It is unlikely for foreign loans and direct investments to exceed 10 percent of GDP, so if domestic savings continue to remain below 20 percent, the investment needed to sustain GDP growth of 7 percent will not be forthcoming. As the economy first started to climb out of recession, the problem of low savings was thought to be due simply to low average incomes. As Figure 2.3 shows, home saving rose only moderately since 1993 and is still below levels of 1988--89, which are similar years of recovery. (Financial liberalization has failed similarly in bringing about improvements.) What is more likely, new measures will have to be found to solve the domestic savings problem. Institutions such as pension funds and housing schemes that tap small household savings have played a large role in the high savings rates in some countries of the region. By contrast, similar institutions in the Philippines such as the government and private pension funds have remained small and peripheral to the accumulation process.

**International Competitiveness and the Current Account**

A principal source of income growth is not even directly related to homegrown employment but to earnings overseas. Earnings from contract workers abroad and from property abroad made up 28 percent of all foreign exchange earnings in 1995, up from only 13 percent five years earlier. The true size of ìproperty income from abroad,î reflected as ìforeign exchange account withdrawalsî in the statistics, has been questioned for some time now; at least some of these are properly treated as investments, while some exports may actually have been booked twice. In either case, GNP would be overstated.

Partly reflecting the large gap between domestic savings and investment has been a worsening of the trade balance (the difference between exports and imports of goods; see Table 2.4), which now stands at almost 12 percent of GNP. Nonetheless, the current account deficit has *declined* owing to the large inflows of factor earnings from overseas, as earlier mentioned.

Notwithstanding the respectable growth of exports in current dollars, it is surprising that the countryís orientation to exports (of goods alone) in recent years has actually declined, while the share of imports has increased. Goods exports made up 23 percent of GDP in 1990, and this figure had *fallen* to 18 percent by 1995. Imports as a proportion of GDP, on the other hand, rose from 28 percent to 35 percent over the same period.

In one view, the worsening trade performance is merely due to the necessarily heavy imports the country must undertake in the course of industrialization and its catch-up on infrastructure, admittedly an import- and capital-intensive proposition. This cannot be the whole picture, however, since not only is it true that imports are growing rapidly; there are also signs that some of the countryís exports are losing competitiveness. Indeed, except for electronics--where direct foreign investments have fortunately facilitated some deepening and diversification within the sector--a good number of the countryís other export products are stagnant or in decline, with their export share or actual earnings actually shrinking. This is true for agriculture-based commodities (coconut oil, sugar, fruits, and vegetables), processed foods, furniture, and others. In 1996, garments, long a staple export good, experienced a fall in export earnings, as the government admitted that the country was being edged out by other suppliers with lower labor costs such as Vietnam, China, and Bangladesh, and that some U.S. demand had been lost as a result of NAFTA. Indeed, electronics now account for 70 percent of all goods exports.

Two factors bear on the question of current competitiveness, neither of which can be easily addressed: the exchange rate and productivity. By early 1997, the peso had strengthened to the point that the profitability of most domestic exports (both manufactured and traditional) was threatened. The authorities also appeared to have been lulled by the continuing growth of foreign investment--led exports, neglecting the fact that the productivity margins for the latter are much higher than for domestic exports.

The politically correct opinion about solving the trade deficit has now become that of ìraising productivityî in the export sector. This is already happening as direct foreign investments bring in superior technology. But more intensive support in terms of technology, infrastructure, and credit is required to raise productivity among small and medium enterprises enough to compensate for the penalty of a strong currency. Between the time foreign capital inflows ultimately weaken and the time a vigorous set of new export industries arises, the economy will be treading a narrow line. It would be in the economyís best interests indeed if such a period never occurred.

**Agriculture and Wages**

The concentration of investor interest (and especially foreign investor interest) in utilities, finance, real estate development, construction, and manufacturing has meant the relegation of agriculture--particularly small-holding agriculture--to secondary importance. A complicating factor has been the uncertainty of ownership caused by the agrarian reform program, which does not yet have a clear policy regarding lands of 50 hectares or less. In the face of more profitable competing uses for land, the natural slant of incentives is toward real estate and a reduction of land devoted to agricultural production. The governmentís inadequate capacity to support agricultural production through irrigation and other infrastructure facilities, R&D, and extension does not help. The pesoís continuing strength in real terms further erodes the competitiveness of domestic agricultural production.

For mainly these reasons, the domestic farming sector has remained skeptical and cautious about the effects of globalization and has adopted a highly defensive and protectionist posture. In the debate over the countryís joining the WTO, the government conceded that it would improve its support of agriculture as a condition for farmersí support for WTO accession. Among others, the country managed to exclude rice from the general WTO obligation to replace import quotas with tariffs.

The more worrisome consequence of this instinctively phobic agricultural posture is the possibility that the sector may unwittingly inflict damage on itself, and on the rest of the economy indirectly. The quotas on agricultural imports, removed as called for by the countryís WTO commitments, were replaced by import tariffs higher than the equivalent protection provided by the quotas on these goods. Although 50 percent tariffs on staples such as corn, rice, sugar, and others are still below the maximum WTO rates the country promised not to exceed, the levels are high enough to risk domestic producers outpricing themselves. For example, high tariffs and hence higher prices on corn feed will lead not to a shift from imported to domestic corn, but to a shift away from imported corn toward imported soybeans.

The fate of agriculture in and beyond Philippines 2000 remains unclear. One of the countryís clear disadvantages in its export drive is its loss of competitiveness in labor-intensive products, because wages have become high in dollar terms, relative to what other countries offer, even before full employment has been reached. Given the official reluctance to use the exchange rate as a tool to regain competitiveness, the remaining lever is to provide cheaper food to reduce pressure to raise nominal industrial wages by, for example, importing cheap food from abroad. The current inefficiency of agriculture and the high cost of food relative to prices from abroad represents a severe drag on industrialization. But importing food would definitely cause severe dislocations among those employed in traditional agriculture. Alternatively, the government could improve productivity in agriculture sufficiently to raise food cheaply at home. This approach, however, requires a large amount of public funds and an appreciably long period to realize, if at all. Neither case represents an attractive option for the government.

**Fiscal Management**

The fiscal picture in the Philippines has without doubt improved considerably, a main element of the restoration of macroeconomic stability. Nonetheless, permanent measures are needed to ensure regular sources of income to sustain--not to mention improve--government programs. The inability to mobilize public resources means the government cannot reliably provide social and economic services without worrying about their effects on macroeconomic stability.

The question, however, is whether enough revenues can be generated to support the huge catch-up in public spending required for the Philippines to become regionally competitive. Suppose, quite arbitrarily, that central government spending must be raised from the current level of 18 percent to a modest 20--23 percent for this catch-up to take place over the next five years. At the same time, one may anticipate that the proceeds from privatization would fall. The extreme case, with only tax revenues available (about 15 percent of GDP), would leave a central government deficit of some 5--8 percent of GDP. Running such a deficit, which is large relative to recent performance, would weaken the governmentís credibility and would probably be taken as a sign of a loss of macroeconomic control. To opt for maintaining the deficit in those circumstances would require severe cuts in spending and giving up the catch-up in infrastructure and social spending altogether.

Clearly, a greater tax effort is needed, a point that has not been lost on the Ramos government. Over the past two years, the government expended a good deal of political capital in pushing two tax initiatives, the expansion of the coverage of the value-added tax to remove exemptions and a comprehensive tax reform aimed at closing the loopholes in the indirect tax system and simplifying the income tax system. In both cases, however, the results have been mixed at best. After a great deal of debate (reaching the Supreme Court), the VAT coverage was indeed expanded, but intensive lobbying ensured that the odd exemptions remained (e.g., publishing, mass media, and cooperatives), defeating the original purpose of simplifying administration. The expanded coverage also allowed large businesses to claim deductions on purchases from small suppliers previously not covered by VAT. The net effect on revenues, therefore, has been ambiguous at best.

The governmentís other great stab at improving tax efforts fared somewhat better. The comprehensive tax reform program is intended to plug certain tax loopholes that had caused large revenue losses. For example, some producers had been able to evade specific taxes on tobacco and alcoholic products by setting up their own distribution networks and deliberately underpricing sales from the factory to these retail networks. In corporate income taxation, on the other hand, unlimited deductions for business-related expenses considerably reduced taxable incomes. At the same time, the governmentís tax planners hoped to rally some middle-class support for the entire package by including more generous deductions for individual income-tax payers to offset the income-bracket creep caused by inflation.

The entire process threatened to unravel when Congress seemed interested only in the more popular tax-losing parts of the package, while the proposed changes in tobacco and alcohol excise taxes became hostage to a narrow debate over whether the applicable tax should be specific or remain ad valorem. Ultimately, after lengthy negotiations, public relations blitzes, and executive intervention, a so-called compromise was forged with Congress, which the government felt would likely yield higher revenue in the short run but had sufficient ambiguity to give business interests leeway to maneuver in the future. This ìcompromiseî is a nightmare for anyone seeking uniformity of treatment and flexibility. Beer and cigarettes are classified according to several price-quality categories for purposes of determining the level of specific taxes. To overcome the inflexibility of specific tax collections in the face of inflation, the price categories and the level of taxes are to be reviewed and revised by Congress periodically. The system virtually invites future lobbying.

Nonetheless, for all its twists and turns, the tax-reform episode did end in a compromise that accomplished (if imperfectly) part of the reform agenda. This is at least a hopeful indication that with sufficient statesmanship and practical power politics, democratic institutions could lead to (perhaps small) steps even in difficult reform areas.

The main constraint to achieving a more significant reform in taxes will be the growing resistance to taxes in general, both among the middle classes and the poor who feel they pay a disproportionate share of revenues, as well as the business sector who demand more liberal tax treatment citing globalization. For example, the desire to attract and keep investments is putting pressure on the government to reduce corporate taxes and preventing the withdrawal of tax breaks for investors. Moreover, trade taxes, which currently make up some 30 percent of all taxes, are scheduled to be reduced drastically. Reflecting the Philippinesí commitment to a liberal trade policy and its international commitments, tariffs for most nonagricultural goods are due to be reduced to a low uniform level by the year 2003. (The current scenario calls for a uniform 5 percent tariff.) The commitment to implement a low-tariff regime will put additional pressure on the government to find alternative sources of revenue.

**The Challenge of ìSecond-Generationî Reform**

The variable fortunes of the tax package illustrate the difficulties likely to be faced in succeeding reform initiatives. Several factors can explain the uphill climb, which can be seen most vividly by comparing the proposed tax reforms with the successful trade reforms. A first difference is found in the fact that the locus of the initiative had shifted from the executive to the legislature. Compared to tariff reforms, which could be implemented by executive orders, tax reforms involved Congress and allowed a larger number of agents and interests (especially business interests) free play in influencing the decision. This lengthened the process and risked distortion if not defeat of the reform goals.

The second difference is a waning sense of crisis. The congressional conviction that raising additional revenues is an urgent task is weaker than the arguments against not joining the WTO or for the need to open power generation to foreigners and the private sector in order to resolve the energy crisis. It has certainly been no help that the Ramos administration has periodically portrayed its budget surpluses as permanent and the fiscal crisis as solved.

Third, while trade reforms involved the removal of bureaucratic prerogatives in certain areas, tax reform and others similar to it define and strengthen such privileges. The intellectual and social justification for any reforms relying on bureaucratic discretion will obviously be weakened if many parts of the bureaucracy are perceived as being inept and corruptible. Indeed, the success of second-generation reforms will depend less on sweeping policy changes and more on steadfast and reliable implementation of rules and regulations. Aside from the implementation of tax laws, new areas such as the regulation (including price- and rate-setting) of privatized utilities will require a highly competent and impartial bureaucracy.

Fourth, unlike trade reforms, second-generation reforms typically are not driven by externally determined targets or conditionalities. Furthermore, the specific policies adopted in fulfillment of their objectives can have vastly differing outcomes for social distribution. The overall objective of raising revenues, for instance, may be attained equally well through an increase in indirect taxes or through stricter enforcement of existing tax laws. But each has a different consequence on income distribution: the former would hit the poor the hardest, whereas the latter would hit mostly the affluent. In this instance, the only external pressure is for the government to raise revenues; how this is done is left to political leaders and policy makers. The formulation of these policies involves primarily a domestic struggle over redistribution whose features and final outcome may be shaped by either negotiation or the raw exercise of political power. By contrast, there is much less leeway for social renegotiation when implementing the countryís international commitments to AFTA and the WTO.

**Sustaining Reforms: Is There a Reform Constituency?**

By any standard, in terms of economic reforms the Philippines has traveled a remarkable distance over the past five years. A question that intrigues both Filipino and foreign observers, however, is how such large changes over a short period were possible in the first place and, related to this, whether in fact the momentum of such reforms can be sustained. In a political form such apprehensions have carried over to the question of whether a successor to President Ramos can be found to carry on the reform agenda. The underlying issue, however, is whether there is a constituency in Philippine society that wants further reforms and is influential enough to see to the election of a government that will implement them. The answer to this question depends on whether the entire reform episode up to now has been a fluke peculiar to the Ramos presidency, or whether the process reflects lasting changes in the balance of interests in Philippine society.

Many observers of Philippine policy making see the lack of a reform momentum, especially in regard to removing protectionism, dismantling monopolies, and resolving the agrarian question. For example, some have used the dominance of landed clans and local elites to explain past opposition to agrarian reform. The involvement of landed families and their diversification into import-substituting industrialization in the past, combined with their dominant position in local and national politics, has explained the lasting influence of protectionism (both agricultural and industrial). Under the resulting conditions of small protected markets and the availability of monopoly privileges, ìrent-seekingî (the exertion of efforts to obtain favored economic positions) has served as an important means of accumulating wealth; but by drawing on otherwise productive resources, it has diminished the potential for development. Formal institutions have provided no checks to such vested interests. In particular, the bureaucracy has been a weak institution relative to the influence of dominant industrial and commercial interests bent on preserving monopoly privileges.

The immobility in the social structure and the consequent policy stasis that may be derived from such analyses have certainly helped to explain some of the countryís backwardness relative to faster-growing countries in the region. For example, such factors may reveal why export interests have been weaker and entrepreneurship less defined in the Philippines than, say, Thailand. The derived result appears to be that no significant (or lasting?) economic reforms are conceivable without a countervailing social coalition to overcome the resistance of vested interests. Such interpretations--termed ìclosedî or ìrounded-offî models--have also discomfited a number of people by making the necessity of revolutionary change more plausible.

The problem for such closed readings of the Philippine situation, however, is explaining how the rapid pace of economic (though not yet social) reforms in the 1990s can have occurred without the occurrence of large social conflicts or realignments. There are two options: one casts doubt on the profundity or permanence of the changes that have taken place, since the winning coalition to support them is absent or weak. The other--admittedly less theoretically elegant--admits the possibility that vested interests are fluid and can be redefined by changing external circumstances, as well as simply by learning.

Without claiming to be exhaustive, this paper takes the latter view, namely, that recent structural changes in the Philippines do stand some chance of being sustained, since they have come to correspond with a changed perception of national interest and purpose, especially among the elite. These changes were occasioned by a deep sense of national crisis, a reconstructed strategy for emulating the success of the newly industrializing economies, and no less important, some real opportunities to accommodate incumbent interests in a liberalizing environment.

**A Sense of Crisis**

A crucial ingredient that started the process of liberalization and has periodically sustained it has been the element of crisis. The shock of the deep recession of 1984--85 was an unmistakable signal for the wholesale abandonment of the *dirigisme* of the Marcos regime and a cause to experiment with its opposite, namely liberal trade and investment policies. It also helped that the import-substituting industries promoted by the previous regime were substantially weakened by the crisis itself. The realization that the country had fallen behind in a rapidly growing region heightened this sense of crisis. The oft-repeated hyperbole describing the Philippines as the ìsick man of Asiaî and the equally exaggerated idea that, with some effort, it could become a newly industrialized country (NIC) by 2000 illustrate the lengths of national self-persuasion involved.

The same sense of national crisis has time and again assisted the system in overcoming the typical malaise of most democracies, namely the costly (often lengthy and occasionally inconclusive) process of making decisions and its susceptibility to lobbying. This is compounded in the case of the Philippines by the dominance of particularistic interests in government, especially in the legislature, which have adversely affected the content of economic decision making in the past.

External threats often lead to the kind of solidarity or consensus needed to take major economic decisions (South Korea and Taiwan, both of which faced external threats, easily come to mind). In the same manner, deep crises have time and again resulted in the grant of sweeping powers to the president to address an urgent situation. The resolution of the power crisis is one example. Congress at that time granted President Ramos special powers to augment energy supply expeditiously, powers that allowed the executive to enter into negotiated contracts and to shortcut some stipulated processes of environmental impact assessment. The Ramos administration utilized this opportunity to open up the power-supply industry to build-operate-transfer schemes. As seen above, that move not only addressed the immediate problem of the power shortage, but also rehabilitated the country as a major field for foreign investments in general.

**Emulating the Newly Industrialized Countries**

A second factor facilitating change was the example of the newly industrialized countries in successfully pursuing a high-growth path based on strong manufacturing exports. In the Philippines, however, the NICsí experience was interpreted as consisting primarily of an agenda for liberalization, that is, a reduction of state intervention and participation in the economy in general, and in particular an abandonment of selective industrial promotion of industries through either tariff protection or fiscal or credit incentives. This has led some writers to worry about the discrepancies between the Philippinesí own strategies and the highly interventionist approaches of such NICs as South Korea. The apprehension concerns whether the Philippines has not in fact gone overboard in its liberalization strategy, using the NICs as a benchmark. The concern is fair enough. But in fact, there is no single NIC experience: neoliberal and interventionist approaches are two ends of a spectrum.

Comparisons seeking to show similarities or discrepancies between the Philippinesí and the NICsí strategies (whether by the government or its critics) are quite beside the point. Industrialization strategies are unlikely to be directly transplantable across social and political systems; heavy economic intervention may possibly function differently between the fragmented elite democracy prevailing in the Philippines and the authoritarian governments in some other Asian countries. More important is whether the current strategy, however determined, is appropriate to the current social context.

Properly administered, a policy of discriminating among sectors (say, aggressively promoting industries determined to have the greatest technological promise) may conceivably be superior to one of uniform tariff protection. On the other hand, if (as the literature suggests is true in the Philippines) lobbying is rampant, the bureaucracy is weak relative to the business sector, and mistaken democratic decisions are difficult to overturn, the same policy may carry possibilities for large mistakes and waste. Indeed the same argument can be carried over to questions of administered pricing, government-owned monopolies, and heavy regulation, all of which could be justified in a perfect world. Thus the neoliberal strategy now pursued by the country might be justified not because it yields the best results of all possible strategies when properly applied in a perfect world, but because it is less liable to huge abuse or costly failure than any other strategy under existing conditions.

**Opposition and Policy Instability**

Recent economic growth distinguishes itself from past episodes by drawing in larger sectors of the population both in terms of social strata (e.g., the middle classes) and geographically (e.g., the development of regional centers other than the metropolitan Manila area). As a result, the recent growth episode has built a constituency for measures that will sustain that growth. It is also noteworthy that structural reforms have been put in place with relatively limited adjustments and dislocations. The unemployment rate has remained fairly stable at less than 10 percent. A number of social indicators, including poverty incidence, have continued to improve; there is a good chance of achieving the goal of reducing poverty incidence (which stood at 35 percent in 1994) to 30 percent or less by 1998. These characteristics augur well for the sustainability of liberalizing policies.

Nonetheless, this is far from saying there has been or will be no opposition to reforms. There is, owing to extremely uneven distribution of the gains from the liberalization program. The first source of opposition is from those sectors of the economy that are being left behind. Wealth has been concentrated in the services sector, especially finance, real estate, retail and wholesale trade, telecommunications, and construction. By contrast, new private investment and technological change have been much slower in small-holding agriculture and in small- and medium-scale manufacturing enterprises, with continued low incomes and productivity. The resistance of the farm sector to the countryís accession to the WTO was already discussed.

In addition, economic reforms threaten implicit social safety nets in specific areas. Recent examples are the reassertion of private or public property rights (motivated by high real estate prices) on hitherto idle lands where squatter occupation was tolerated and the reduction of redundant employment in privatized government corporations. Because the grievances and interests involved are disparate and sectional, but more importantly because the ideological and organizational split in the Left leaves no workable ideology to unite them, the resulting protests have delayed but not prevented the governmentís liberalization. Both to enhance the credibility of its actions and as part of its social policy, therefore, the government needs to respond by putting in measures that ease the transition for marginalized sectors and draw them into the mainstream of development.

**Accommodating Established Interests**

Internally, the congruence of interests between foreign investors and domestic landed and financial interests has consolidated social receptivity to liberalization. The recession of 1984--85 led to the collapse of most industry. Fortuitously, it will be recalled, the subsequent recovery took place after an agenda for tariff reforms had been set. The incentives would gradually be changed so that industries would no longer be as heavily oriented to the protected domestic market. The vocal social advocacy of the exporter interests also contributed significantly to changing the social climate for policy making, shifting it in favor of outwardness.

Nonetheless, it has not been the domestic export sector but foreign investment, both direct and indirect, that has constituted the dynamic element that is proving crucial in consolidating social support for a globalization strategy. It is foreign investment that has generated the competitive exports (especially in electronics), provided access to capital and new technology in various projects, and provided the new buyers for initial stock offerings and privatizations.

The benefits derived from the entry of direct and portfolio investment have managed to coopt most elite economic interests and reshape them. The more ìmodernî urban business classes represented by the financial circles in Makati have a large stake in the continuing openness of the economy, especially to foreign investors. The dependence of land values on foreign demand is an obvious link. Higher demand for real estate, as a consequence of both industrial relocation and rising incomes, has brought about rising land prices, especially in the metropolis and adjoining rural areas, including the provinces in the path of Metro Manilaís expansion: Cavite, Laguna, Batangas, Rizal, and Quezon, known as the CALABARZON region. Similar booms in real property are also being experienced (or at least expected) in other areas.

Outside Manila, several other urban centers have sought to emulate Manilaís and the CALABARZONís example of presenting alternative sites for relocating firms. This has been helped along by the decentralization and devolution process, the emergence of a sharper breed of local executives, and the governmentís promotion (uneven at times) of other urban centers such as Cebu in the Visayas, the former U.S. bases Subic and Clark in Central Luzon, and Davao, General Santos, and Zamboanga in Mindanao. An important point is that land and property prices in these areas are tied up with demand for land as industrial sites. This development is significant if, as the canonical analysis of Philippine political economy suggests, a good amount of the social basis of wealth and political influence is based on landed property. From a political-economy viewpoint, the gain is clear: Traditional local elites are looking for a stake in the globalization process and giving up their orientation to a purely local economy.

The spate of new strategic alliances between large domestic conglomerates and transnational firms also ties up a large part of the domestic economy with foreign investor interest. This has occurred largely in the deregulated utilities, including telecommunications, shipping, infrastructure, and power. It has allowed other established local groups to diversify into different businesses, often in strategic alliances or joint ventures with foreign firms. The bidding for concessions to operate the metropolitan water and sewerage system was won by firms associated with traditional names in Filipino big business, namely the Lopezes and the Ayalas. It can be argued, therefore, that the liberalization strategy, through deregulation, privatization, and the increased demand for land, has become smoothed, since it has permitted a retention of some of the value of the already wealthy.

A further element that has made for policy stability has been the greater prominence accorded the Filipino Chinese business community, whose upper echelons (locally known as the taipans) have recently attained a social recognition (though not yet political prominence) that has never been accorded the Chinese in Philippine history. The international connections of Filipino Chinese businesses to other large ethnic Chinese business interests in the region have allowed them to mobilize funds readily and attract large investments from related interests in Taiwan, Malaysia, Indonesia, Singapore, and Hong Kong. In a significant development, Filipino Chinese interests with strong foreign connections have won over the traditional ìoligarchyî in several huge public bids for privatized government assets (notably urban real estate deals).

Nonetheless, the distribution of the benefits of the economic boom has been far from even. Mainly the larger, more established conglomerates have benefited most readily from the process. By contrast, there appears to be much less correspondence between agriculture-based interests and foreign investments. The structures of protection and exchange-rate policy have shifted incentives away from agricultural production in favor of services, utilities, real estate, and to a lesser extent, manufacturing.

However, the struggle among private interests seeking to dispute the gains from liberalization by attempting to change the rules threatens policy stability. The most prominent example was the Supreme Court decision in 1997 overturning the results of a bidding process for the privatization of the historic Manila Hotel. A Malaysian-led consortium had earlier won the bid. The losing Filipino consortium argued, however, that the hotel was part of the ìnational patrimonyî and could therefore not be awarded to foreigners, an argument that the high court sustained. Other large public-private deals, including the port-services concession for Subic Bay Free Port and the privatization of reclaimed portions of Manila Bay, have also been the subject of legal or procedural disputes, with some reaching the courts or the level of congressional inquiries. In these cases, losing bidders have sought to change the arena of competition by having recourse to political solutions, using the courts, congressional influence, or the media.

In hindsight, the use of political means to resolve economic disputes is merely a carryover of previous rent-seeking behavior. It is true, of course, that the liberalization process itself would remove the means for rent-seeking by narrowing the scope for government intervention. Nonetheless some processes in a liberalizing agenda, especially deregulation and privatization, yield substantial rents as well, and no great technological shift is required on the part of dominant groups--including those well-represented in government--to use customary rent-seeking methods to win such battles.

**Presidential Succession**

Notwithstanding the more or less conscious desire to avoid the negative experience of the Marcos dictatorship, the 1987 Constitution still left a good deal of leeway for presidential prerogative (e.g., line-item vetoes, discretion over budgetary releases, legislation through executive orders, appointing power over the bureaucracy and the military, and so on). The role of a strong presidency has been crucial in the current reform episode. As already seen, these prerogatives have thus far served the reform process well by helping to overcome resistance by disparate local interests through the combined use of a dominant position and patronage. In other words, the dominant presidency has served to check possible abuses by local interests. In the pre-election year 1997, however, this pattern was in danger of being broken, as circles close to President Ramos engineered attempts to extend his term beyond the six years set by the constitution, on the ostensible basis that none of the likely winners in a presidential election could carry through the balance of economic reforms with the same zeal and competence. First, ìmass petitions,î then calls for turning a beholden Congress into a constituent assembly were attempted to set turning the wheels of constitutional revision. Rather than reassure investors of policy-continuity, however, these all-too-transparent attempts only managed to increase uncertainty and raise fears that future policy would be severely biased to favor exclusive groups, as happened under the Marcos regime. Because of this, the ìmodernî business sector joined with the Catholic Church and other social groups to vociferously oppose any charter change.

What the vocal and negative public reaction to charter changes really illustrates is the social value placed on maintaining the arduously attained modus vivendi among competing interests, an accommodation that has been cemented by the recent and prospective moderate economic gains. Conforming with the established ground rules for succession--imperfect though they may be--is obviously regarded as more important than securing business-friendly policies, since the cost of violating the social consensus would be worse--palpable unrest. In initiating moves to extend its stay, the Ramos government seriously overestimated the value of its own contribution to the economic climate, as well as miscalculated the modern business sectorís fear of a less than ideal electoral outcome. Indeed, to the extent the reforms it presided over prove lasting and the business sector feels able to fend for itself and strike an independent deal with the rest of society, the Ramos administration becomes an increasingly superfluous guardian.

**Conclusion**

Economic reforms in the Philippines found a starting point in the crisis that prevailed since the economic collapse of a decade ago and successive tests thereafter. The economic collapse weakened hitherto protected interests, while the governmentís cash-strapped position reduced the scope for redistributing largesse. As a result, the perceived scope of rent-seeking also declined, permitting the two successive post-Marcos governments to introduce large-scale changes--mostly in the direction of liberalizationsimply as part of undoing politically discredited economic approaches, and subsequently as part of a national goal of catching up with the industrializing economies of the region, summarized, if vaguely, in Philippines 2000. The countryís involvement in international economic arrangements, as well as the approval its policy measures have found among foreign investors, have also positively reinforced the governmentís resolve to see through the entire liberalization program.

Improving economic indicators due to the moderate economic growth over the past four years may have weakened the sense of urgency and crisis that initially provided the atmosphere for consensus. The unequal distribution of benefits has also led to some dissatisfaction over the way the ìspoilsî from liberalization are being divided.

Legitimate dissatisfaction understandably comes from socially marginalized sectors, whose immediate poverty and association with declining or less dynamic sectors prevents them from participating meaningfully in any restructuring of the economy. Dissatisfaction is also found among elements of traditional elites whose bases of wealth and local power have been bypassed by a process that, left to itself, tends inherently to concentrate wealth geographically and socially. In addition to these, however, the entire ìmodernî business community, the Church, the political opposition, and other mainstream sectors with no particular reason to oppose the direction of economic changes found common cause in opposing attempts to change the constitutionally ordained process of transition.

A real danger exists that such dissatisfaction could lead to implosive tendencies, in which rent-seeking battles, combined with social protests, reverse the policy direction or sufficiently poison the investment climate. Until recently, however, the continuation of even moderate growth has held such tendencies in check, with the public mechanisms to redistribute resources functioning reasonably satisfactorily (this includes the pork-barrel mechanisms that have kept Congress pliant). There is, obviously, no guarantee that the delicate balance between economic growth and social consensus will not be tilted too far in either direction. There is also no guarantee that the quality of the governmentís bureaucracy and other institutions of governance will be sufficient to implement second-generation reforms, including changes in the tax system and the effective regulation of private monopolies. There is, finally, no guarantee that the favorable global economic forces that have sustained moderate growth in the Philippines thus far--especially inflows of foreign investment--will last long enough to permit the economy to restructure itself. Strictly speaking, the Philippines will by no measure be any tiger economy by 2000 or perhaps even 2005. What it will have achieved is a recovery of incomes from a decade ago, though perhaps on a more stable economic and social basis. The experience of the Philippines thus far shows that further steps along the road of economic and social reform will be tedious and difficult--but not impossible.

Note:
Extracted from *The Philippines-New Directions in Domestic Policy and Foreign Relation*s (Edited by David G. Timberman)

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