

INTRODUCTION

Philippine Economic Performance

After two decades, Philippine economic performance leaves much to be desired. The Philippine economy posted low average growth rates in its Gross Domestic Product and Gross National Product of 2.7 percent and 3.0 percent, respectively. Further, the growth was uneven and not sustained for long period of time, and we have not regained our economic growth since the sharp reversal in the 1980s. (Refer to Figure 1.)



Our economic growth was only half of what most of our neighbors in Southeast Asia and the Pacific achieved. We were even overtaken by Vietnam, Laos and Cambodia in the last decade as shown in Table 1.

Table 1. GNP, GDP Across East Asia and the Pacific Region

Country	GNP growth rate 1965-1996 (in percent)	GDP growth rate 1990-2001 (in percent)
China	8.5	10
Hong Kong	7.5	3.9
South Korea	8.9	5.7
Singapore	8.3	7.8
Indonesia	6.7	3.8
Malaysia	6.8	6.5
Philippines	3.5	3.3
Thailand	7.3	3.8
Cambodia	na	4.8
Laos	na	6.4
Myanmar	na	na
Vietnam	na	7.6
East Asia and the Pacific	7.4	7.5

Source: Yue (2002)

Repercussions of low growth

After decades of moderate growth, the economy has not made a significant dent in poverty reduction. Posting the lowest growth rates since the 1970s, the country also registered the lowest decline in poverty incidence when compared to its Asian

neighbors (Refer to Table 2). This is supportive of what economists proved that economic growth is the main driver of poverty reduction.

Table 2. GDP Growth (%) and Poverty Incidence, 1970-1996

Country	GDP Growth 1971 -1996	Poverty Incidence (national poverty line)		Percentage Reduction
		1970	1996	
Korea	8.03	23.0	9.6	58.3
Taipei China	8.04	30.0	3.0	90.0
Malaysia	7.51	49.0	8.2	83.3
Thailand	7.61	39.0	11.4	70.8
Indonesia	7.37	58.0	11.3	80.5
Philippines	3.51	**52.0	36.8	29.2

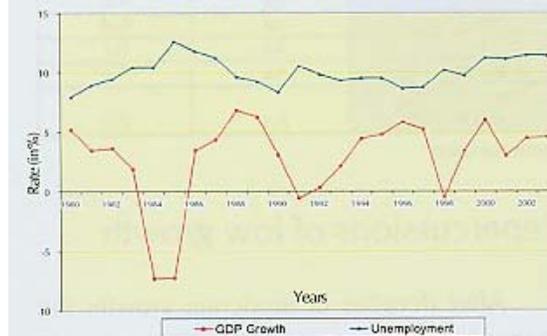
Note: *1985 figure

**1975 figure

Source: Quibria (2002); Percentage reduction is SEPO's computation.

Moreover, the economy has not been able to provide sufficient employment to the growing number of labor participants. Figure 2 below presents the close link between employment levels and GDP growth rates. In times of economic deceleration, unemployment rises.

Figure 2. Philippine GDP Growth (%) and Unemployment Rates (%), 1983-2003



Source: National Statistical Coordination Board

Reasons for Underperformance

Government's inward looking policies of the past have played a critical role in shaping the economic growth process in the country.

During the 1970, and 1980s, policies were mainly characterized by import substitution, strong interventionist stance through fiscal incentives, directed credit and the promotion of capital-intensive industries in a labor abundant country. Our export and industrial sectors suffered from these policies. Growth of industry stagnated at an average of 1.8 per cent in the past 20 years. Thus, industry's share to GDP declined from 41 percent in 1981 to 33.5 percent in 2003. Likewise, agriculture did not develop as natural resources were depleted because of neglect. The agriculture, fisheries and forestry sectors which contributed 23.5 percent of GDP in 1981 declined to 19.8 percent in 2003.

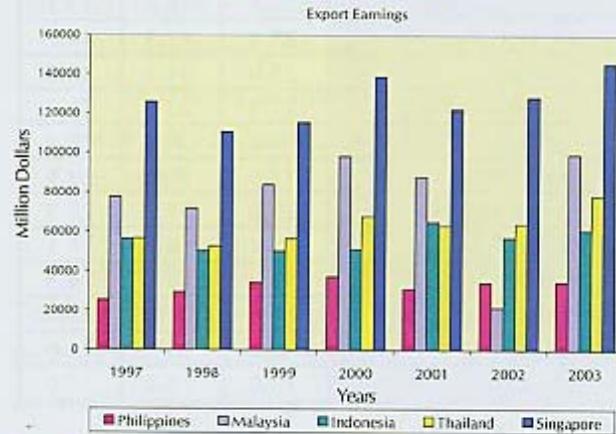
Economic growth in the 1970s and 1980s was primarily financed through external debt which eventually became very difficult to sustain. Consequently, growth became uneven and the economy suffered episodes of macroeconomic imbalances that resulted to a balance of payments crisis, increasing debt, staggering fiscal deficits, and periods of high inflation. The consequence of our inward looking policies was the insufficiency of foreign exchange for an economy dependent on foreign capital to finance growth.

Given the weak macroeconomic fundamentals, the country became very vulnerable to external shocks such as the oil crises in 1971 and 1982. Our economic performance was also strongly linked to major economies of the world such that any slowdown in these economies affects our growth. Financial crises such as the Mexican and Asian crises also adversely affected our economy. Domestically, episodes of political instability slowed down investment in the country and had derailed our growth.

After the 1986 EDSA revolution, significant policy shifts opened up and deregulated the economy and eased the government's protectionist stance. The Aquino administration started to liberalize trade and reduce government intervention in the economy. These reforms continued into the next administrations as we deregulated and liberalized many sectors of the economy such as telecommunication, investments, banking, foreign exchange market and retail trade. Trade liberalization doubled the ratio of exports and imports In GDP. Our economy, however, was hounded by military uprisings and major financial crises. These tempered growth and inevitably led to deceleration of growth in certain periods.

The vulnerability of the country to external shocks is a sign that the macroeconomic fundamentals of the country were weak. First, the fiscal sector exhibited drawbacks as the government continued to face deficits. The country had budget surpluses only during the years 1994 through 1997. This led to increasing debt and crowding out of private investments. Second, our exports have not grown significantly to finance our foreign exchange requirements. The country remained highly dependent on foreign capital to finance growth. In the ASEAN 5, we have been the worst export earner since 1997, as shown by Figure 3. The income from Overseas Filipino Workers, however, greatly boosted our foreign exchange earnings.

Figure 3. Merchandise Exports in Southeast Asia, in Million US \$, 1997-2003



Source: Bangko Sentral ng Pilipinas

Third, entry of foreign investments decelerated and ran short of increasing the productive capacity of the economy. the investment climate has not met up to expectations of foreign investors, as competition from other countries further slowed down their entry.

Table 3. Net Foreign Direct Investment, Average Growth Rate (%), 1992-2003

ASEAN	'92-'97	'98-'00	'01-'03
Philippines	64.9	11.3	-20.1
Malaysia	5.3	-14.8	84.6
Thailand	16.2	20.0	-6.8
Indonesia	27.0	-307.8	-206.2
Singapore	27.6	145.9	92.1

Source: ARIC-ADB, World Investment Report

In addition, the low savings rate has not helped finance growth as national savings continue to be below international standards. (See Table 4.)

Table 4. Gross Domestic Savings (% of GDP)

Country	1980	1990	2002
Southeast Asia (ave.)	28.3	31.2	30.2
Indonesia	29.2	32.3	21.1
Malaysia	32.9	34.4	41.8
Myanmar	17.7	11.7	11.3
Philippines	26.6	18.7	19.5
Singapore	38.8	43.3	44.7
Thailand	23.0	34.3	32.0
East Asia (ave.)	21.5	22.8	21.4
China	34.1	38.7	39.4
Hong Kong	34.5	36.0	33.9
Korea, Rep. of	23.8	37.2	29.3
Mongolia	15.7	8.0	4.1
Taipei, China	32.6	28.1	24.3
Nepal	11.1	7.9	11.6
Pakistan	7.8	13.5	13.6
Sri Lanka	12.0	13.2	14.6

Source: Asian Development Bank

Moreover, growth in the recent years depended too much on consumption. The proportion of consumption to GDP increased to 73 percent in 2003 from 65 percent in 1981, while investments' share to GDP declined to 18 percent in 2003 from 26 percent in 1981. While a consumption-driven growth is not at all bad, the productive capacity of the economy must be increased in order to sustain growth.

The 'right' policies

Thomas et al. (2000) explained that during the 1980s to the 1990s, economies with high growth registered larger dents to poverty incidence than those with moderate growth. More striking is the observation that within the same period, low growth economies registered a substantial increase in poverty incidence. These underline the role economic growth plays in reducing poverty. Table 5 below illustrates the relationship between growth level and poverty incidence

Table 5. GDP Growth and Poverty Incidence

	Period	High Growth	Moderate Growth	Low Growth
Poverty (%)	1990s	24.1	31.4	36.9
	1980s	31.0	32.1	30.2
Percentage				
Improvement		22.3	2.2	-22.2
GDP Growth (%)	1990s	5.3	4.2	0.3
	1980s	6.5	2.3	2.1
No. of Countries		13	53	39

Source: Thomas, et al. 2000

Quibria (2002) outlined the set of policies that provides an environment conducive to growth. Using the experience of Asian economies, she argued that the economic growth is supported by economic openness which brought in investments and access

to new technology, and finding a niche in the unlimited opportunities in the world economy. She rightly argues, however, that for an economy to prosper in a liberalized environment, the domestic economy should have a stable macroeconomy, flexible labor markets, and legal and political institutions that provide good economic governance, encourage investments and efficient use of resources.

Indeed, economic growth is necessary but not sufficient in reducing the incidence of poverty. *Ceteris paribus*, growth that concentrates on labor-intensive sectors, is sustainable or environment-friendly, and anchored on the creation of stable and rule-based institutions makes more substantial dents on poverty.

As Thomas et al. (2000) reiterates in their document for the World Bank, the quality of growth matters considerably in reducing poverty.

A sustained and balanced growth is the best approach to reduce the incidence of poverty. The World Bank reinforces Quibria's conclusion that sustaining growth involves "right" policies.

Using the same tripartite classification system of countries, Thomas et al. (2000) identified policies and factors that positively contribute to high economic growth:

- (1) as a major component of stabilizing the macroeconomy, they observed that the budget deficit of governments as percent of GDP in high and moderate growth economies is at 1.4 to 1.8 percent, substantially lower than the 3.4 percent budget deficit posted by low growth countries;
- (2) for both high and moderate growth countries, there is a marked observation of lower financial repression, greater financial depth as measured by M2-to-GDP ratio, and larger international reserves as a percent of imports compared to low growth economies;
- (3) economic openness, as measured by trade-to-GDP ratio and capital openness index, provides a positive relationship to growth;
- (4) good governance plays a role in achieving higher growth rates. Indicators for rule of law and control of corruption show the watershed that separates the high growth and moderate growth economies from those achieving low growth; and
- (5) environmental action showed a good correlation with the level of growth an economy achieves as it accounts for how well an economy manages its natural capital.

Moreover, the World Bank (particularly Thomas, 2000) underscored the appropriateness of interventions in education and health as modes of reducing poverty and promoting equity in the long run. It seems appropriate to focus on health and education policies as they are more politically acceptable to create new wealth through human capital investments than to redistribute existing capital like land or taxing those earning higher incomes. Larger spending and better program implementation on health and education provides the poor better opportunities in the labor market, levels out intergenerational equity by ensuring better access to

education, reduces political conflict and boosts social cohesion which feeds back into the electoral process, among others.

Quibria, using Asian countries' experience since the 1960s, and the World Bank providing the larger global picture, provides a consensus on the role of economic growth and the "right" policies in, higher and sustained growth which Consequently reduces the incidence of poverty.

Moving the Philippines forward

We have identified the policies that boosted growth and consequently reduced poverty in other economies. It is in this light that the country's next development agenda must be anchored on the pillars of growth pillars which in the past have been weak in supporting a sustained and balanced growth.

First, it is imperative that the country provides a policy environment that stabilizes the macroeconomy, primarily through better fiscal, financial and monetary management. This is not sufficient, however, as there are microeconomic interventions needed to create a better business environment to support the micro, small and medium enterprises

(MSMEs) and export-oriented industries. Good governance-by creating institutional arrangements that makes policies predictable across administrations, preserves the sanctity of transactions and contracts, and provides an efficient bureaucracy that oversees policymaking and enforcement-is the third pillar. Finally, the fourth and fifth pillars focus on investing in human capital and environmental management. these two are vital to the poor as they affect those employed in rural areas specifically in the agriculture, fisheries and forestry sector, and as labor is argued to be the poor's primary asset.

The components of these five pillars will he discussed in great detail in the chapters that follow.