

**THE PHILIPPINES: RECENT PERFORMANCE,  
PROSPECTS FOR 1989-90, AND  
POLICY AND DEVELOPMENT ISSUES**

by

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**I. INTRODUCTION**

When the Aquino administration assumed power in 1986, the most pressing items in its agenda were political stabilization and economic recovery. Since that time, the political normalization process has virtually been completed with the ratification of the 1987 Philippine Constitution, the convening of the Congress, and the election of local

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officials. Complete political stability, however, has not been achieved as the threat from extreme rightwing and leftwing elements has not been eliminated. Moreover, graft and corruption still remains a thorny issue, something that the government must address seriously in the near future.

Parallel developments were observed in the economic sphere. A series of reforms, which were initiated in 1983, were pursued more vigorously since early 1986. These include the dismantling of monopolistic market arrangements in the agricultural sector, the removal of interest rate ceilings and subsidized credit programs, the streamlining of the public investment program, and the simplification of the tax system making it more efficient and equitable.

Reprivatization has also been going on, albeit at a slow pace. As a result of these reforms and also because of the general restoration of confidence in the economy, positive growth rates were attained in 1986 and 1987, a marked improvement over the performance during the 1984-85 period. Preliminary data show a robust growth of 6.7 per cent in 1988 and this is expected to hit at least 7 per cent when the final data are tabulated.<sup>1</sup> While the performance of the economy is above the government target of 6.4, some

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<sup>1</sup>The data presented in the paper are based on a growth rate of approximately 7.1 percent in 1988 and not on the initial figure of 6.7 percent. Adjustments made in the preliminary figures have been in the upward direction during the past two years. Thus, while initial data showed a growth rate of 1.5 percent in 1986, at present it is 2 percent. In 1987 the corresponding figures are 5.2 and 5.9 percent, respectively.

economists have expressed doubt whether this trend, which is consistent with the government target for the next three years, could be sustained. The dwindling level of foreign exchange reserves, the external debt overhang, and the limited supply of power and energy are some of the factors that could undermine the drive towards high growth rates.

It is quite clear that government policy will play a vital role in determining whether the achievements of the first three years of the Aquino administration could be carried into the medium term. Several key issues come to mind. First, the economic managers must get their act together especially in the handling of the external debt problem. It must be ascertained that any solution to reduce the debt overhang must not be regressive in nature. Second, economic policy makers must emphasize the goal of equity in their programs as is the case with the Medium Term Philippine Development Plan. The Comprehensive Agrarian Reform Program (CARP) is a step in this direction. Third, the government must further streamline its infrastructure program so that it would be more responsive to the requirements of high growth rates without being inflationary at the same time. Fourth, the government must improve its capacity to absorb official development assistance (ODA) being offered by friendly countries. The utilization rate of ODAs has been very low since 1986. Lastly, the stage must be set so that the Philippines could play a significant role in the coming Pacific Century. The ability of the

country to attract foreign investment beneficial to the economy is a crucial factor in this case.

This paper discusses the recent economic performance of the Philippines, prospects in the economy for the next two years, economic policies undertaken in recent years and planned in the near future, and some development issues.

## II. RECENT ECONOMIC PERFORMANCE

### A. Economic Growth and Sectoral Performance

Based on the most recent data from the National Statistical Coordinating Board (NSCB), the growth rate of GNP in 1987 was 5.9 percent, up from a figure of 2 percent recorded in 1986.<sup>2</sup> While this was below the government target of 6.5 percent, it is a sign that the Philippine economy has recovered from the Balance-of-Payments crisis in 1983-85. The economic growth in 1987 is often described as consumer-led which is not without reason as personal consumption expenditures and government consumption, which comprise more than 80 percent of GNP, grew at a combined rate of 6.3 percent. The 10 percent hike in government salaries contributed substantially to this increase. Critics were quick to point out that reliance on consumption demand would not sustain the recovery as the economy would most certainly encounter constraints in the form of limitations in industrial capacity. Thus, one of the more crucial factors in the 1988 scenario would be whether economic activity had shifted towards higher investment and less dependence on consumption expenditures.

Preliminary data for 1988 have yielded encouraging figures for the Philippine economy. Not only has the annual growth rate climbed to 7.07 percent, the increase in consumption expenditures has declined to 5.9 percent, while

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<sup>2</sup>Unless otherwise stated the growth rates for the relevant variables will be measured at constant prices.

gross domestic capital formation remained steady with a growth rate of 26.5 percent. A more detailed examination of the data reveals that the second semester growth rates for consumption and investment were 5.4 percent and 49.7 percent respectively, a strong indication that demand has shifted towards the investment side.

Sectoral performance was more balanced in 1988 than it was in the previous year. The industry sector still led the way with a growth rate of 9.45 percent compared to 7 percent in 1987.<sup>3</sup> The agricultural, fishery, and forestry sector sufficiently recovered from the ill effects of the drought in 1987 to post a 3.1 percent growth rate in 1988. The performance of the service sector was relatively stable as the growth rates in 1987 and 1988 are almost identical at 7.35 and 7.5 percent respectively.

The country continued to experience a construction boom in 1988 and this was the main source of growth in the industry sector. In the first quarter of the year, the private sector accounted for most of the growth as government construction activity fell by 4.8 percent. The main reasons for the sluggish performance in government construction during this period was the election ban on public construction, and snags that hit the government infrastructure program due to poor availment of loans and grants, procedural red tape, and the poor start in

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<sup>3</sup> It must be noted that in this paper, the industry sector includes the Transport, Communications, and Storage subsector. In the National Income Accounts the latter is part of the service sector.

government housing because of prohibitive interest rates and the reluctance of private developers to support the government socialized housing program. On the other hand, the upswing in private construction could be traced to the increase in demand for commercial and residential centers and the greater availability of housing loans. Since then government construction activity has moved up significantly posting a 7.8 percent growth during 1988 compared to the 15.1 percent increase in the private sector. Manufacturing activity also contributed a considerable amount to the growth in the industry sector. Much of the 9.3 percent increase in this subsector could be traced to the rise in food manufactures which grew at the rate of 8.4 percent although, several manufacturing groups posted growth rates of more than 10 percent.

Agricultural crops accounted for a great deal of the turnaround in the agricultural, fishery, and forestry sector. From a decline of 4.1 percent in 1987, this subsector grew at a rate close to 1 percent in 1988. Actually, for the first three quarters of 1988, the agricultural crops subsector was growing at the rate of 2.25 percent but much of the improvement was wiped out by the devastating typhoons which passed through the Philippines in the last quarter of the same year. Crops which experienced relatively high growth rates were palay and sugar with the former having a 15 percent turnaround (from a decline of 7.9 percent in 1987 to a growth of 6.8 percent in 1988) and the latter experiencing a similar turnaround of 20 percent (from

a decline of 9.5 percent in 1987 to a growth of 10.9 percent in 1988). The Rice Productivity Enhancement Program (RPEP) which was instituted in 1987 may have contributed to the higher yield in palay while the rise in sugar prices may have stimulated production in this sector. Still the higher growth rates in 1988 could be attributed mainly to the low levels of output in 1987.

#### B. Employment and Labor Force

There was a general improvement in the employment situation in 1988. The unemployment rate was registered at 9.7 percent in 1988 compared to 11.2 percent in 1987, while the underemployment rate went down to 32.6 percent from 33.6 percent. Despite these figures, however, it is estimated that the full time equivalent unemployment rate in 1988 increased slightly to 18 percent from 17.2 percent in 1987. This was due largely to the increase in the labor force participation rate which rose from 65.5 percent in 1987 to 66.2 percent in 1988 reaching an all time high of 67.9 percent in April 1988.

The percentage distribution of employment across sectors was relatively stable although the share of agriculture, fishery, and forestry declined from 48.6 percent in 1987 to 47.3 percent in 1988. This is a manifestation of the greater increase in economic activity in the industry and service sectors. However, the change in the composition of the work force is only marginal compared to the difference in the growth rates among sectors. This

observation underscores the problem of the inequitable distribution of income in the country.

Overseas employment continued to be a source of relief to the unemployment problem as a total of 319,000 workers were deployed for the first eight months of 1988, increasing by 5.3 percent from the previous year's level.

#### C. Money Supply, Inflation, and Interest Rates

In spite of the efforts of the Central Bank to curb the inflation rate and keep it within 7-8 percent, the Consumer Price Index in 1988 averaged approximately 8.8 percent higher than the figure in 1987. Several factors accounted for this. There was initial confusion on how to implement the VAT system resulting in arbitrary increases in prices. The consumer-led growth in 1987 spilled into the first half of 1988 and since industrial capacity was near its limit, the result was inflationary pressure from the demand side. The deterioration in the international reserve position of the Central Bank led to the depreciation of the peso thereby increasing the costs of imports. Prices could have been higher if not for the decrease in the prices of petroleum products and the continued implementation of the import liberalization program which had a negative effect on the prices of some imported commodities. Central Bank intervention in the foreign exchange market helped prop up the value of the peso and this also mitigated the rise in

import prices. It is interesting to note that as a whole the implicit price index for imports fell by 10 percent in 1988.

In order to arrest any further depreciation of the peso, the Central Bank also adopted a tight money stance in 1988 by issuing short term reverse repurchase agreements at higher-than-market interest rates. This was reflected in the monetary base in 1988 (estimated to be 63.7 billion as of the yearend), which was roughly only 4 percent higher than the 1987 figure. This, however, did not prevent total liquidity to expand by 11 percent, as the money multiplier, which is driven by demand forces, rose from 2.72 in 1987 to 2.93 in 1988. Tighter money also resulted in higher interest rates. The 91 day Treasury Bill rate registered a high of 17 percent as of December 1988 to post an annual average of 14.5 percent, up from 11.4 percent in 1987.

#### D. Savings and Investment

Gross domestic capital formation at constant prices expanded at the rate of 26.5 percent in 1988 almost equal to the figure in 1987. However, as mentioned earlier this belies the fact that much of the investment activity was carried out in the second semester. Investment in durable equipment posted the biggest increase at 34.6 percent. Approved equity for the first three quarters of 1988 increased by 98.2 percent, from 6.7 billion recorded during the same period last year, to 13.4 billion. Of this total, local investments comprised 45 percent or 6.06 billion,

while the rest, which amounted to 7.34 billion, was accounted for by foreign investors. The latter represented a 186.7 percent increase from a figure of 2.56 billion in 1987. Taiwanese investment accounted for 2.26 billion (around \$107 million) of these foreign investments with 220 million going to the Petrochemical plant in Bataan, and it is expected that this figure could reach \$150 million for the whole of 1988. The increase in foreign investments partly reflects the greater confidence foreign businessmen have in the Philippine economy, and is also due to the huge current account surpluses the NICs have accumulated during the past few years and the efficacy of the new Omnibus Investment Code and of the debt-to-equity conversion program.

Much of the investment was poured into manufacturing concerns with agricultural endeavors ranking second and energy related products coming in third. Despite this surge in investment activity, the overall investment rate was only 16 percent of GNP, which is still substantially lower than the 20-25 percent rate recommended by the World Bank.

The present ability of the economy to mobilize domestic savings was still relatively weak. This can be gleaned from the national savings rate which was 15 percent in 1988 and 16.3 percent in 1987. And judging from the persistent deficit in the current account, the Philippine economy relies heavily on foreign savings to support its investment expenditures.

### E. Budget Developments

The estimated budget deficit in 1988 was higher than anticipated - P25 billion instead of the targeted P22 billion. As of November 1988, the revenue shortfall was P15 billion, with the Bureau of Internal Revenue (BIR) accounting for 6.6 billion and the Bureau of Customs having a collection shortfall of 3.6 billion. There were three major causes of the underperformance of the BIR in terms of revenue collection, namely: the non-implementation of ceilings on allowable deductions of corporations, the confusion regarding the implementation of the VAT system, and the lower effective rates on petroleum products. On the other hand, the Bureau of Customs attributed its shortfall to a lower than assumed exchange rate which prevailed during the first quarter, a refund of excess duties and taxes paid on past imports, and the continued defrayal of tax and duty payments on imports of government agencies and government corporations.

The revenue shortfall, however, will be matched by a similar difference between planned and actual expenditures. It is estimated that out of the P150.4 billion originally earmarked, only P139.2 billion will be utilized. Bureaucratic red tape that slows down the implementation of several projects is the culprit in this case. The combined shortfall in both revenues and expenditures will increase the budget deficit by approximately P3 billion.

## F. External Sector Performance

Because of the surge in economic activity in 1988, import requirements rose along with the demand for certain imported items. The latter was bolstered by the import liberalization program and an overvalued exchange rate, with both factors having a negative impact on the prices of imported goods. The net result was a 33.5 percent increase in imports of goods and services at constant peso terms. Exports of goods and services continued to lag behind imports, posting only a 13.5 percent increase. The Philippines again banked on the performance of nontraditional exports with semiconductors and electronic microcircuits posting a growth rate of 30.5 percent and garments expanding at the rate of 11 percent. Crude coconut oil continued its dismal performance with exports of this commodity declining for a second straight year at -25.8 percent.

The difference in merchandise trade in dollar terms was not as great. Merchandise imports grew by 21.7 percent while merchandise exports registered a 21 percent increase. Nevertheless, the difference was enough to widen the trade balance which stood at \$1.28 billion in 1988 compared to \$1.02 billion in the previous year. Despite higher workers remittances and the increase in net inflows from the transfer account (personal remittances and aids/grants from foreign governments) the current account is projected to deteriorate in 1988, ending up at a deficit of \$776 million

compared to a deficit of \$539 million in 1987. This was caused by the higher deficit in the trade balance and the increased interest payment on the external debt obligation that was attributed to higher world interest rates. The total debt service due in 1988 was calculated at \$3.36 billion up from last year's figure of \$3.06 billion. This represents roughly 30 percent of exports.

Overall, the balance of payments stood at a deficit of \$196 million in 1988, a figure which already incorporates rescheduling. It is expected though that there will be inflows of new money towards the end of 1988, some of which are from OECF funds, and these will be enough to offset the deficit resulting in a surplus of \$500 million. However, these inflows should not affect the performance in 1988 and hence should be considered as part of 1989 capital inflows.

### III. FUTURE PROSPECTS

#### A. Economic Growth and Sectoral Performance

Much of the growth in 1989 will be a spillover from the momentum generated in 1988. Investment projects started in 1988 will be completed in 1989 as businessmen adjust towards their optimum level of capital stock. A gestation period that must transpire before investments become fully productive will make for a deceleration sometime towards the latter part of 1989 and in the greater part of 1990. Furthermore, a recession in the U.S. is predicted in 1989 and the repercussions of this slowdown will have a similar timing in their effects on the Philippine economy. Foreign investment should continue to flow in with Japanese playing a more significant role. Part of this investment will arise as a result of the "investment indigestion" occurring in Thailand. The growth rate in real GNP should be about 6.4 percent in 1989, close to the government target of 6.5 percent. This figure should decline in 1990 as many countries will be reeling from the effects of a U.S. recession. It is estimated that the GNP growth rate in 1990 will be a respectable 5.3 percent.

While the projected growth rate in GNP is similar to the government target, it is significantly different from the 1989 forecast presented by the Center for Research and Communication (CRC) which is 5.4 percent. This figure is based on a probable increase in power outages, the

constraint posed by a limited amount of foreign exchange reserves, and the inefficient procedure in the disbursement of government expenditures. A senior vice-president of the same institution, however, has an optimistic view for 1989. His forecast of at least 7 percent rests on the assumption that foreign investments will flood the economy in 1989. The Bank of Philippine Islands has also come out with its own prediction. The latter is rather pessimistic though. The projected value of 4.5 percent growth in GNP is mainly a result of an unrealistic value of the annual average of the exchange rate, which is assumed to be P22.5/dollar. Judging from these various forecasts, the 6.4 percent growth rate would seem reasonable.

The industry sector should still be at the forefront as much of the investment in the past was in this sector. Barring any unforeseen catastrophes, the agriculture, fishery, and forestry sector will grow steadily. This sector should profit from the emphasis placed by the government on rural development and regional decentralization. The benefits of this growth should accrue to more people with the implementation of CARP.

Both the industry and service sector will be hardest hit by the economic deceleration. This is to be expected as the products in these sectors have the greater income elasticities.

## B. Employment and Labor Force

With a population growth that shows no sign of a letdown, the labor force is expected to grow and with it the full time equivalent unemployment rate. The latter will increase to 19 percent by 1989 and 20.5 percent in 1990. A danger arising from a world recession would be a drop in the demand for Philippine contract workers which would aggravate the unemployment problem. Hopefully, the investments made in these years would be in more labor-intensive industries which would then absorb a greater proportion of the work force.

## C. Money Supply, Inflation, and Interest Rates

So long as Mr. Jose Fernandez will remain the governor of the Central Bank, there will be no major change in the thrust of monetary policy. The peso will continue to depreciate at a moderate pace, from P21.1/dollar in 1988 to P21.96 in 1988 and to P23.06 in 1990. Hence, inflation in 1989 and 1990 will be at manageable levels, estimated at 7 and 8.6 percent, respectively. The numbers could easily change, though, depending on a number of factors. The oil price could very well revert back to \$18/barrel, 20 percent higher than the present assumption of \$15/barrel. If this event occurs sometime during the middle of the year, the inflation rate is estimated to rise by 1 percentage point while the GNP growth rate will decline by the same amount. The budget deficit could suddenly swell what with the inefficient tax collection system. This would either lead

to a further expansion in money supply or a hike in interest rates. Assumptions on the latter variable are already at a relatively high level of 17.5 percent for 1989 and 17 percent in 1990. The figures are consistent with an expected budget deficit of P23 billion in both years.

As it is, total liquidity is predicted to grow at 11 percent in 1989 and 14 percent in 1990. Part of this increase reflects the improved international reserves position of the Central Bank.

#### D. Savings and Investment

With the expected speedier processing of public projects, the government will intensify its pump priming activities especially in the rural sector. Gross capital formation arising from the public sector should post a hefty growth close to 22 percent. This is threatened though by recommendations from the IMF which are aimed at cutting down the budget deficit through a reduction in public expenditure.

Private sector investment, boosted by the steady stream of foreign investment should expand, by around 18.6 percent in 1989. The latter will be lower than the figure attained in 1988 because of the higher interest rates that will arise as a result of the government budget deficit and the desire of the Central Bank to control inflation (see section E).

A significant amount of the capital formation will flow into projects which were started in 1988. The general slowdown of the economy in 1990 will also affect investment decisions and this will translate into a fall in the growth rate of gross capital formation from 17.1 percent in 1989 to 14.2 percent in 1990.

The efforts of the government to enhance capital outlays will translate into a higher investment rate. The latter will increase from 16 percent of real GNP in 1988 to 17.6 percent and 19.1 percent in 1989 and 1990, respectively. Despite this improvement, the investment rate will still be below the 20 percent threshold level. The savings rate will fare no better, with the national savings rate consistently falling below the investment rate at 17.2 percent in 1989 and 18.2 percent in 1990.

#### E. Budget Developments

The programmed expenditures and revenue collections are projected to lead to a deficit of approximately P23 billion both in 1989 and 1990. Given the marginal improvement in the savings behavior, the reluctance of foreign creditors to pour in new money, and the conservative position of the Central Bank, the deficit spending of the government would most probably crowd out private investment. The crowding out effect will manifest itself in the form of higher interest rates, which in turn will have a negative effect on investment.

If the government agrees to the terms imposed by the IMF, it is estimated that the growth rate in GNP in 1989 and 1990 will dip to 6 and 4.8 percent respectively. On the other hand, a bloated budget deficit would be highly inflationary. It is estimated that a P1 billion increase in the government ~~deficit~~ would add 1 percentage point to the inflation rate.

#### F. External Sector Performance

The impending recession in the United States, the general deceleration in the economy, and the worldwide drift towards greater protectionism, all these factors would lead to a decline in both imports and exports. However, because of the structure of the Philippine economy, imports would decrease at a slower pace - 10.3 percent in 1989 and 8.1 percent in 1990, as compared to 8.5 and 4.9 percent for exports. The trade balance will thus continue its slide, reaching a deficit of \$1.6 billion in 1989 and \$1.8 billion in 1990. A parallel deterioration will be observed in the current account which will register a deficit of \$1.07 billion in 1989 and \$1.5 billion in 1990.

It is expected that the Philippine panel will come to terms with the IMF and the foreign creditors sometime early this year. Capital inflows will thus be augmented giving rise to a BOP surplus of \$1.46 billion in 1989 and approximately \$500 million in 1990. Debt-service payments

will increase further, reaching \$3.44 billion in 1989 and \$3.89 billion in 1990. This represents a debt-service burden of 27 percent in 1989 and 28 percent in 1990.

#### IV. MAJOR ECONOMIC POLICIES AND DEVELOPMENT ISSUES

Since the beginning of this decade, the Philippines has introduced a number of reforms. Some of these were started by the previous regime and pursued more vigorously by the Aquino government. In addition, the present government introduced new measures which the previous regime found difficult to implement given the interest groups that it sought to protect. This section briefly reviews some major economic policies undertaken in recent years and/or planned in the near future and some development issues.

##### A. Major Economic Policies

###### Monetary and Banking Policies

Recently, the Central Bank has shifted its emphasis from credit allocation function to stabilization function and has removed ceilings on deposit and lending rates. These are the most significant changes in the conduct of monetary policy since the creation of the Central Bank. In the past, the Central Bank tried to influence the flow of credit to highly favored economic activities by making available to them cheap funds. Beginning in November 1985, all rediscountable papers are treated uniformly in terms of rediscount rate and loan value. Since then, the rediscount rate has been aligned with the market rate.

The withdrawal of short-term Central Bank bills is in line with the current thrust of making the Treasury bills the primary instrument for open market operations. Beginning in the last quarter of 1986, Treasury bills have been auctioned to accredited financial institutions. This system enables the government to adjust the maturity pattern of Treasury bills with its annual cash budget program while the interest rates on its securities are aligned with the market rates. Thus, the era of low-yielding government securities has come to pass. Likewise, reserve eligible government securities are gradually being phased out.

The Treasury bills being auctioned at present have shorter maturities (i.e., not more than one year). There are now plans to issue long-term securities. However, the prevailing high interest rates may prevent the government from issuing long-term Treasury bills in the next few months.

Reforms in the banking system are being pursued more vigorously. The six commercial banks which the government took over during the height of the liquidity crisis in 1981 have now substantial private sector participation or are in the process of being sold to private investors. A rehabilitation scheme has been devised to revive the rural banking system. As of October, 1988, 522 out of 1,018

licensed rural banks applied for rehabilitation. So far, 473 applications were approved.

Some progress has already been made as regards the rehabilitation of the two large government banks, namely the Philippine National Bank (PNB) and Development Bank of the Philippines (DBP). The transfer of non-performing assets worth P108 billion for the two banks to the Asset Privatization Trust has enabled them to resume their normal operations with clean balance sheets. These banks have again realized substantial profits in the past two years. The government has forced these banks to be competitive by lessening special privileges given to them. For example, they are no longer sole depositories of government funds.

Monetary policy since 1986 has been generally tight. In particular, the growth rate in base money has been held in check and reserve requirement has remained high at 21 percent. But it is less tight than the crisis period. The same monetary policy is expected to prevail in the next two years in view of the precarious balance-of-payments position, low level of gross international reserves and of the below double-digit inflation target.

#### External Debt Management

One of the accomplishments of the present government was the successful conclusion of restructuring agreements

with both the Paris Club and foreign commercial bank creditors. This somewhat eased up the debt burden of the country and provided it with opportunity to divert resources for financing growth. For new borrowings since 1986, the government opted to obtain concessionary loans from official sources and multilateral agencies.

Simultaneous with the restructuring agreements was the introduction of the debt-to-equity conversion program to help reduce the debt burden. However, in view of the substantial liquidity effect of this program, the Central Bank recently has slowed down the number of approvals for conversion. In fact, the recent approvals are those that do not have liquidity effects at all.

At present, the government is still looking for a market-oriented debt management strategy that would protect the country from any adverse external developments, such as a rise in interest rate in the international market. At the same time, efforts are now made to avail of the Extended Fund Facility of the IMF. This is crucial in restructuring the currently maturing loans owed to the Paris Club and in negotiating new money from foreign commercial banks.

At Congress, the Senate recently has approved the bill imposing a limit on the country's debt repayments equivalent to 20 percent of the preceding year's net foreign exchange

receipts. However, the House has deferred its deliberation on a similar bill until after the government has completed a satisfactory agreement with the IMF, Paris Club and foreign private creditors.

#### Exchange Rate Policy

A sharp depreciation in the real effective exchange rate (about 26 percent) occurred in 1986. Thereafter, depreciation was kept below 10 percent per year. However, the nominal depreciation of the peso vis-a-vis the dollar was very minimal since 1986. Thus, the large depreciation in the real effective exchange rate was mainly due to the substantial depreciation of the peso vis-a-vis major currencies other than the dollar.

Although the Central Bank claims that the Philippines is following a freely floating exchange rate system, in reality, however, it has managed the movements of the exchange rate. That is, the Central Bank has been intervening to prop up the peso. Intervention has been done by directly purchasing foreign exchange from banks and/or offering higher interest rates for its borrowings from banks through the reverse repurchase window. Its heavy intervention in the foreign exchange market in the past two years has actually resulted in the deterioration in the gross international reserves and higher domestic interest

rates. That this strategy can cool off speculative attacks on the peso is indeed questionable. Although it saves the government from carrying heavier external debt burden since it assumes a large amount of foreign currency denominated debts, however, it does not free it from paying high interest on its securities.

### Trade Policy

The tariff reform program initiated in 1980 was completed on schedule in 1985. In particular, the average nominal tariff level was reduced from 41 percent to 28 percent and the dispersion in rates narrowed from 0 - 100 percent in 1980 to 10 - 50 percent in 1985 with a few exemptions.

Trade liberalization was reversed in 1983 when a balance-of-payments crisis struck the economy. It was resumed in 1986 when the economy showed some signs of recovery. The proportion of regulated items to total number of PSCC lines has been reduced from 36 percent in 1980 to 12 percent in 1988. Of the remaining 673 items, 114 items are regulated mainly for reasons of health, safety and security. The Subcommittee on Tariff and Related Matters has already recommended 104 items for liberalization. However, resistance from strong lobby groups seems to have succeeded in delaying the liberalization of these items. Up to now,

there is no definite schedule of liberalization for these items. The rest of the 673 items are still under review by the Subcommittee. These items include those under the BOI Industry Program and agricultural commodities.

Although tariff adjustments have been made to help smoothen the impact of the recent import liberalization, these, however, appear to be minimal judging from the fact that the average tariff rate remains almost the same.

Other significant trade policy reforms recently introduced include the elimination of the coconut and sugar trading monopolies, the abolition of the meat importation cartel, the turnover of wheat, flour, and soybean trading to the private sector, the breaking up of the fertilizer cartel and removal of export taxes on all agricultural products.

#### Fiscal Policy

Substantial policy reforms have also been made in the fiscal arena. Tax exemptions of government-owned and/or controlled corporations (GOCCs) have been withdrawn in 1986. This has actually forced those earning corporations to contribute to the National Treasury while subsidies to losing corporations are made more transparent. The Government Corporate Monitoring and Coordinating Committee is tasked with the strengthening of the institutional and financial capabilities of government corporations through

the introduction of improved corporate planning, computerized accounting, and the implementation of performance monitoring, evaluation and incentive systems.

To broaden the tax base, the value added tax (VAT) has been applied since January 1988. It has replaced the escalating sales taxes and other percentage taxes. The confusion in the initial implementation of the VAT has partly contributed to the increase in the price level in 1988. Moreover, the revenue generated by the VAT did not come up to expectations.

To encourage more direct foreign investments, the new Omnibus Investments Code has replaced the admittedly performance-oriented incentives provided by the previous law with the income tax holiday and the exemption from duties and taxes on imported capital equipment. Enterprises registered with the BOI are also allowed an additional deduction from taxable income of an amount equal to 50 percent of incremental labor expense. The corporate income tax has been reduced to a uniform level of 35 percent.

The on-going efforts towards decentralization and developing local autonomy demand that local governments be given greater autonomy in exercising their taxation powers. The National Government has now reviewed plans to this effect.

As regards expenditure, there appears to be a significant reallocation of resources from the economic sectors to the social services sectors since the Aquino government assumed power. This is consistent with its policy pronouncements. The infrastructure/utilities sector has also received much attention by the present government. However, the ratio of expenditure on infrastructure/utilities sector to GNP in the most recent past and in 1989 still cannot compare with that of the pre-crisis year which averaged 5 percent. Noteworthy is the high proportion of debt service to total government budget which is estimated to post at about 44 percent of the 1989 budget.

Recently, the Department of Budget and Management (DBM) has introduced a new disbursement scheme. Under this scheme, once DBM issues Treasury Warrant to a bank in favor of a particular government agency, automatically said agency has funds in that bank. To service the requirements of those agencies located in areas where there is no government bank, the DBM utilizes branches of accredited commercial banks as depositories of its funds. This scheme is thought to reduce red tape and accelerate the implementation of government projects. The old practice was for government agencies to get Treasury Warrants from the National Treasury upon authorization from the DBM.

The government is planning to introduce reforms in the budgetary process which will institutionalize regionalization of budgetary procedure. This is consistent with the thrust towards decentralization and accountability.

### Wage Policy

When the new government took over, it announced a policy on non-intervention in wage setting. Instead, it has concentrated its efforts in providing services to the labor sector to enhance their bargaining power. Lately, however, Congress passed a bill that increased the minimum wages of agricultural and non-agricultural workers. This is inconsistent with the avowed policy of the government. At present, the government is not keen in monitoring the compliance of such law. It must be recalled that compliance of minimum wage law has been very low even during the martial law years.

The present government has restored the basic rights of workers including the right to strike. The number of actual labor strikes surged in 1986 to 581 cases involving 169,000 workers. Since then, it has declined. In 1988, the number of strikes went down to less than 260 cases involving about 70,000 workers.

**B. Development Issues**

Increasing employment opportunities and incomes, alleviating the poverty situation and improving income distribution will continue to be the primary goals of the country for the next ten years. Unfortunately, the 1983 balance-of-payments crisis had set back the development process. For instance, the 1981 real per capita income of P1,933, the highest ever achieved by the country, will be regained by 1991 if all conditions outlined in the Medium-Term Philippine Development Plan 1987-1992 are met. Thus, the immediate task is to stage a rapid and sustainable economic growth in order to make up for the substantial welfare loss.

The new government has chosen to implement a rural-based development strategy. This strategy directly addresses the goals of increasing employment, poverty alleviation and equitable distribution of economic benefits. Moreover, a natural direction of the country will be towards agriculture and employment-based domestic and export industries to reflect comparative advantage and potential. (Medium-Term Philippine Development 1987-1992.) This is a big shift in economic strategy considering the fact that the previous regime emphasized an urban-based industrialization anchored on large-scale industrial projects.

Despite major reforms that have been recently introduced, still significant constraints to the attainment of the development goals exist. We will briefly discuss them here.

The external debt burden seems to be getting heavier each year. Worse is that over the past two years, significant net resource outflow had occurred. This is expected to continue in the next few years unless a new debt management strategy that would significantly lessen, if not completely reverse, the outflow, is found. For one thing, it has been proposed that a law making government debt service payments an automatic appropriation in the annual budget be reviewed. These resources could have been used to improve physical infrastructure and post-harvest facilities in the rural areas and to import much needed capital equipment to improve productivity and expand the productive capacity of the economy. The so-called "Multi-Year, Multi-Sectoral Aid Plan" is being seriously considered. However, the capacity of the government to absorb development assistance seems to be weak. At present, availments of official development assistance have been low. Thus, the capabilities of national and local government to prepare, implement and monitor projects needs to be greatly improved.

The appreciation of the currencies of the so-called newly-industrializing economies (NICs) and their graduation

from the GSP list of the United States is a welcome development to the Philippines since it makes its exports relatively more competitive. In addition, the currency appreciation coupled with rising cost of labor may prod NICs to transfer their industries, especially those that are labor-intensive, to the Philippines. This is a favorable development for the Philippines especially since more capital inflow is needed to service the external debt. In addition, the new industries can help absorb the growing labor force and also facilitate the transfer of technology.

There are, however, other developments that could deny the country from enjoying the benefits from currency appreciation and rising labor costs in the NICs as well as in developed countries. One is the growing protectionist attitude of the Philippines' major trading partners. So far, the response has been to shift emphasis from quota to non-quota export commodities and to further intensify market diversification. Another factor is the slowdown in the growth rates of the Philippines' major trading partners. Even if protection is dismantled, so long as the absorptive capacity of major trading partners is limited, the growth of the Philippine exports will be severely constrained.

Still another factor is the rapid technological development taking place in developed countries and the NICs. The increasing use of computer-based technology has

greatly reduced the share of the wage bill to total production costs. This makes exports of the NICs and even products of major trading partners more competitive again even as they continue to experience rising labor cost. Thus, the expected transfer of industries from developed countries and the NICs to developing countries would sharply slow down, if not completely, halt.

Advances in biotechnology in developed countries have also worked against exports of the country. Specifically, biotechnology improves productivity and gives rise to new synthetic products that replace traditional commodities. For example, sugar production and refining in EEC has been greatly improved, thus making EEC an important exporter of sugar. Enzyme technology makes the extraction of high fructose corn syrup from maize possible, thus replacing sugar as the most important sweetener. The impact of these developments on the country's sugar industry is already well known.

The Philippines will surely miss a lot of opportunities if these new international developments were not taken into consideration in designing economic policies and strategies.

While neighboring Asian countries, notably China and Thailand, have achieved a rapid reduction in population growth rate, the Philippines has accomplished only a very

minimal reduction in population growth rate. Unfortunately, the present government seems to encounter difficulty in arriving at a consensus on population policy and program. Thus, while budgetary allocation for social services has considerably increased, funds support for family planning program has been very minimal and inadequate.

The further development and efficiency of the financial markets need to be addressed. At present, banking regulations seem to be the greatest impediment. For instance, bank entry and branching are still overly restrictive which in effect grants oligopolistic power to existing banks. Thus, in 1988 while lending rates had been moving upwards, deposit rates had virtually remained the same and severely negative. Deposit mobilization is thus impaired. A study shows that increasing the number of financial institutions and high deposit rates attract more deposits especially in rural areas. Intermediation taxes, such as loan portfolio requirements, gross receipts tax and existing high legal reserve requirements need to be reviewed in view of their effects on lending rates. The deposit retention scheme is shown to adversely affect the profitability and savings mobilization effort of rural-based financial institutions. This too must be reviewed. Physical infrastructure and institutional support that can enhance the profitability of agriculture and small-scale enterprises must be in place to make these sectors bankable.

The securities markets have long been neglected by the government. Up until now, there is no clear policy nor program to develop the securities markets. The present policy environment is not attractive enough for companies to issue securities. For example, interest payments on debts are tax deductible while dividends on shares are not. Hence, companies prefer to borrow than to issue securities. Another example is that there is hardly any difference in the income tax paid by open and closed companies. A differential income tax rate that is attractive enough for companies to go public must be considered.

The growth of financial intermediaries engaged in the development of the securities markets should be fostered. As of this moment, only investment companies and universal banks can engage in underwriting. Unfortunately, both are relatively inactive. In fact, investment companies have increasingly emphasized lending in the recent past rather than underwriting. Underwriting could be deregulated to allow other financial intermediaries, like brokers/dealers, to engage in it.

A high interest rate policy designed to prop up the peso is not conducive to the development of the securities markets. Last year, several firms either postponed or reduced their issuances of corporate bonds and commercial papers in view of the high interest rate. On top of it,

they have to compete with short-term government securities which are high-yielding, risk-free assets.

The Comprehensive Agrarian Reform Program (CARP) is another new development in the country. It attempts to address equity concerns as well as poverty in the rural areas. The standard economic argument against land reform, i.e., economies of scale seems not to hold at the production stage. Interestingly, evidence seems to indicate that small farmers tend to use labor-intensive technology. Thus, land reform can help create job opportunities in the rural areas.

While it is recognized that institutional and infrastructure support are needed to make CARP succeed, promoting greater linkages in the rural areas is hardly mentioned. Available evidence examined by Ranis and Stewart (1987) showed that the strongest linkage of agricultural growth is with consumer good industries in rural areas. Accordingly, the elasticity of non-agricultural employment with respect to growth in agricultural output is greater than one. Greater rural linkages could certainly sustain the gains from CARP.

Privatization and re-privatization will continue to be an important issue in the near term. Whether the government should continue its direct participation in the production of goods, such as fertilizer, steel, etc., and the provision of services, such as hotel, commercial

banking, etc., should be re-examined. The pace of privatization and re-privatization has been disappointingly slow. The institutional framework to carry out such program should perhaps be reviewed.

Finally, the role of Congress in defining development issues must be taken seriously. Unfortunately, however, a number of bills filed in Congress seem to reverse newly-instituted policy reforms. Examples are those that propose to re-impose ceilings on interest rates and to compel banks to set aside a certain portion of their loanable funds to certain sectors, such as jeepney drivers and fishermen. There are, however, meritorious bills that tend to support the on-going reforms. Examples are the Central Monetary Authority Bill and bills seeking the abolition of intermediation taxes.

## V. CONCLUSION

Sustained economic growth and development in the medium term depends a great deal on two factors, namely: the success of reforms and the implementation of new policies, and a favorable world economic climate. Unfortunately, the prospects for positive developments in both areas are not too bright. The United States economy is headed towards a recession and the threat of protectionism has infected the healthy atmosphere that has pervaded in the international trade system. The present policy agenda of the government has mixed effects on the performance of the economy and it is expected that this will extend into the near future. On one hand, government programs have focused on rural development and greater equity, the removal of distortions and emphasis on efficiency, and the need for greater participation from the private sector. On the other hand, economic growth is bogged down by the lack of an imaginative solution to the external debt problem, the continued existence of monopolistic and oligopolistic elements in the economy that hamper the redistribution of wealth and income, and political maneuvering in the Congress that slows down the formulation of bills that enhance the welfare of the majority of the Filipinos. Added to this is the issue of graft and corruption which has a demoralizing effect on many people.

If the present trend will be carried over into the next two years, the Philippine economy is projected to experience a deceleration sometime towards the end of 1989. This slowdown will be further aggravated if the government agrees to the IMF demand to trim its budget deficit and if there is an increase in the oil price. Of course, if the multi-year, multi-sectoral aid plan pushes thru, then the slide will be averted. There is also the rapidly changing world environment that makes the situation very fluid. One interesting development is the increasingly closer relationship between the United States and the Soviet Union and the thaw in the Cold War. The socialist bloc remains a large market and a huge source of raw materials and finished goods. If reforms in these countries result in their closer integration with the world market then it may be that a recession in the U. S. will be less likely and in the event it does occur, the effects may be less severe.

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Table 1. Economic Growth, Employment, and Savings and Investment

	1986	1987	1988	1989	1990
<b>1. Economic Growth (annual growth rate in constant prices, %)</b>					
Agriculture	3.26	(1.02)	3.08	3.77	3.82
Industry	(1.38)	6.95	9.45	8.39	6.52
(Manufacturing)	0.82	6.68	9.30	7.48	6.04
Service	2.93	7.35	7.51	6.02	5.25
Consumption expenditure	0.79	6.32	5.87	6.16	4.56
Gross capital formation	(9.73)	27.88	26.48	17.07	14.26
Exports of goods and services	21.75	(1.11)	13.35	8.51	4.90
Imports of goods and services	12.91	26.62	33.46	10.30	8.06
Real GDP	1.40	4.71	6.99	6.32	5.37
Real GNP	1.84	5.94	7.07	6.44	5.30
<b>2. Employment</b>					
Unemployment rates (%) <sup>1</sup>	16.76	16.81	18.66	19.54	20.30
Wages (index, unskilled labor)	328.60	335.51	345.65	374.67	399.98
<b>3. Savings and Investment</b> (In millions of domestic currency)					
Domestic savings	17800.00	16100.00	15915.00	19109.00	21356.00
National savings	16124.00	15434.00	15273.00	18544.00	20680.00
Gross Capital Formation	10042.00	12842.00	16242.00	19016.00	21728.00
Gross Fixed Capital Formation	10057.00	11626.00	14242.00	17016.00	19228.00
Public	2843.90	3077.45	3529.84	4312.72	4813.94
Private	7213.20	8548.55	10712.70	12702.88	14414.16
Increase in Stocks	-15	1216	2000	2000	2500
<b>4. Nominal GDP</b>					
In millions of domestic currency	624429	705671	821316	932444	1064443
In millions of U.S. dollar	30630.74	34309.67	38924.93	42461.02	46159.71
<b>5. Nominal GNP</b>					
In millions of domestic currency	612003	700664	815926	927287	1057716
In millions of U.S. dollar	30021.19	34066.23	38669.48	42226.18	45668

1

Industry includes manufacturing, mining and quarrying, electricity, gas and water, and transport, storage and communication.

<sup>2</sup> Full time equivalent

Table II. Inflation, Money Supply and Government Budget

	1986	1987	1988	1989	1990
<b>1. Inflation (Annual changes, in per cent)</b>					
GDP Deflator	1.40	4.71	8.81	6.78	8.33
Consumer Price Index	0.75	3.79	8.78	7.03	8.62
<b>2. Money Supply (Annual changes, in per cent)</b>					
M1 (narrowly defined money)	19.10	22.10	6.79	12.27	15.42
M2 (broadly defined money)	9.65	14.21			
M3	6.21	12.82	11.24	10.57	13.96
T-bill rates †	16.90	11.39	14.50	17.50	17.00
<b>3. Government Budget (In millions of domestic currency)</b>					
Current Revenue †	79245	103214	114000	146300	165900
Current Expenditure †	110497	119907	139200	169817	189507
Capital Expenditure †	14022	17327	18427	29140	35319
Overall Surplus/deficit	(31252)	(16693)	(25200)	(23517)	(23607)

† Assumed values

Table III. Trade and Balance of Payments  
(In million of U.S. dollar)

	1986	1987	1988	1989	1990
Merchandise Exports	4842	5720	6923	7892	8749
Merchandise Imports	5044	6737	8202	9444	10541
Trade Balance	(202)	(1017)	(1279)	(1552)	(1792)
Workers' Remittances	696	809			
Current Account Balance	996	(539)	(776)	(1069)	(1527)
BOP	1242	264	(196)	1465	496
Exchange Rates (per U.S. dollar: annual average)†	20.39	20.57	21.1	21.96	23.06

† Assumed values

Table IV. Financial Flows and External Debt  
(In millions of U.S. dollar)

	1986	1987	1988	1989	1990
1					
Total Net Financial Flows					
Official development assistance: grant	516				
Official development assistance: loans	439.9				
Other official flows	176.1				
Direct investment (private)	81.3				
Portfolio investment (private)	188.5				
Export credit (private)	-283.2				
External Debt Outstanding					
Short-term	5378	3792			
Long-term	22878	24018			
Use of IMF credit		1342			
Others					
Debt-service Payments					
Principal repayment	998	1006			
Interest payment	1938	2051			
Total	2936	3057	3361	3436	3889
2					
Debt-service Ratio (%)	34	33.3	29.68	27.14	28.25

1

See OECD, Geographical Distribution of Financial Flows to Developing Countries, for definitions.

2

The ratio of debt service payments to exports of goods and services.



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