

**Civil Society Monitoring of the  
Medium Term Philippine Development Plan (MTPDP) <sup>1</sup>**

**Beating the Odds?:  
The Continuing Saga of a Crisis-Prone Economy**

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**Overview: 2004-2005**

Being an election year, it was commonly expected that the Philippine economy would grow faster in 2004 compared to the year before. In fact, the expectation was more than realized. Not only did actual economic growth as measured by growth in gross domestic production (GDP) exceed that of 2003, it also went beyond the targets set by the government for the year. Moreover, the economy's growth compared favorably with that of most of its neighbors in the region.

But GDP growth was only one yardstick for the economy. The quality of the growth achieved was put to question by a significant acceleration in prices and increased joblessness within the year. Meanwhile, the government's precarious financial position owing to heavy indebtedness continued to be the weakest link in the economy, prompting economists from the University of the Philippines (UP) to sound the alarm by the third quarter that the country was in the midst of a fiscal crisis threatening to turn into an Argentina-style collapse, unless government took prompt corrective actions.<sup>3</sup> The alarm resonated and dominated discussions and debates in the succeeding months. But by most assessments, including and especially by the international credit rating agencies, government response was far from adequate.

By year-end, Fitch Ratings and Standard and Poor's had announced widely expected one-notch downgrades on the country's credit rating, telling the world, in effect, that the country's ability to pay for its debts was getting more and more questionable. These moves were seen as formal expressions of the external audience's dissatisfaction with the way the Philippine government was addressing current threats to the stability of its economy.

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<sup>1</sup> The Civil Society Monitoring of the MTPDP is a continuing effort of the Caucus of Development NGO Networks (CODE-NGO) with other civil society organizations; for this assessment, CODE-NGO worked with the Citizens for ConCon (C4CC), Foundation for the Philippine Environment (FPE), Institute on Church and Social Issues (ICSI) People's Campaign for Agrarian Reform Network (AR Now!), Dr. Cielito F. Habito, Dr. Edsel L. Beja, Jr. and Mr. Roy Cabonegro.

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<sup>3</sup> Emmanuel De Dios et al. (2004), "The deepening crisis: the real score on deficits and the public debt." UP School of Economics Discussion Paper.

But contrary to most analysts' prognoses of dire effects arising from such downgrades, the opening weeks of 2005 saw a surging stock market and a fast appreciating peso, seemingly reflecting improved, not worsened, confidence in the domestic economy. In a moment of jubilation, President Gloria Macapagal-Arroyo declared that the economy was "on a roll." But the euphoria was promptly dampened by a severe two-notch credit downgrade from Moody's in February, further confusing the already mixed signals on the economy.

Indeed, the euphoria was to be short-lived. As it turned out, 2005 saw a reversal of the 2004 overall economic performance. A political crisis over the legitimacy of the president had erupted by mid-year, even as production sectors were already slowing down, a combined effect of the El Niño, the dramatic rise in world petroleum prices, a downturn in the global electronics industry, and declining competitiveness of the Philippine economy in the global markets. Still, the year ended with a mix of good and bad news on the economic front. On the positive side, the peso finished significantly stronger, the stock market was up, remittances were at a record high, and the year-end government budget deficit was well below what had been projected. But while the initially-reported fourth quarter growth rate of the economy was surprisingly stronger than most expectations, most production sectors had actually slowed down in 2005, and in contrast to the 2004 performance, most growth targets were missed.

The other two important economic indicators that matter most to common folk – prices and jobs – similarly turned for the worse. Inflation had accelerated further, and job creation continued to fall short both of the employment targets and of the growth in the labor force. Furthermore, more direct indicators of human welfare had further worsened. Reputable surveys and official statistics showed rising hunger and self-rated poverty incidence, declining consumer confidence, and worsening human development indicators like nutrition and access to education.

Thus, notwithstanding certain positive interpretations of the economic data, 2004-2005 were actually years of worsening economic conditions from the point of view of the people that matter – the ordinary Filipinos, especially the poor and near-poor.

### **The Half-full Glass**

*What goes up must come down?*

Economic growth in 2004 actually exceeded targets set for the year, as well as actual performance in the previous year. The 6.0 percent GDP growth and 6.2 percent GNP growth overshot the 5.0-5.7 percent targeted by the government for both indicators, and improved on the 5.5 percent growth achieved in 2003. A breakdown of growth performance by major sectors reveals the same situation. Services, which grew fastest at 7.1 percent, went beyond the target range of 5.7-6.6 percent, and improved from its 5.9

percent growth in 2003. Industry, with its 5.2 percent growth, reached the upper end of its 4.4-5.2 percent target and bested its 3.0 percent performance in 2003 (which at the time fell short of the targeted 3.2-3.7 percent). Even agriculture with its 4.9 percent growth was near the upper end of the targeted 4.0-5.0 percent range, and had accelerated from its 3.9 percent 2003 performance.

Particularly noteworthy was industry's substantial pick-up in growth, having improved by a hefty 2.3 percentage points. Manufacturing, a prominent part of the industry sector, performed well in 2004, ending the year with a solid fourth quarter growth of 6.9 percent. Capacity utilization had also improved to 80 percent from just over 78 percent the year before. This was a departure from the sector's relatively sluggish performance in recent years, widely blamed on strong competition from cheap imports, especially from nearby China.

**Table 1. GNP/GDP Growth (%), 2004-2005**

Indicator	2004	2005				
	FY	Q1	Q2	Q3	Q4	FY
<b>GNP Growth (%)</b>	6.2	4.8	5.0	6.1	7.0	5.7
Net Factor Inc fr Abr	8.5	7.6	2.3	27.5	20.0	13.8
<b>GDP Growth (%)</b>	6.0	4.6	5.2	4.5	6.1	5.1
Agri, Fish & Forestry	4.9	-0.1	1.9	1.9	4.0	2.0
Industry	5.2	4.2	5.6	4.7	6.5	5.3
Services	7.1	7.1	6.1	5.4	6.7	6.3

**Table 2. Production Performance vs. Targets, 2004-2005**

Indicator	2004					
	Q1	Q2	Q3	Q4	FY	Target
<b>GNP Growth (%)</b>	7.4	7.5	6.3	5.8	6.8	5.0-5.7
Net Factor Inc fr Abr	19.7	15.0	10.0	10.2	13.7	
<b>GDP Growth (%)</b>	6.5	6.9	6.0	5.5	6.2	4.9-5.8
Agri, Fish & Forestry	8.1	5.3	7.1	1.7	5.6	4.0-5.0
Industry	4.5	5.2	2.4	6.6	4.7	5.0-5.8
Services	7.2	8.7	8.3	6.5	7.7	5.5-6.3
Indicator	2005					
	Q1	Q2	Q3	Q4	FY	Target
<b>GNP Growth (%)</b>	4.9	5.8	4.8	6.9	5.6	5.5-6.4
Net Factor Inc fr Abr	12.9	9.4	4.9	26.9	13.5	
<b>GDP Growth (%)</b>	4.2	5.4	4.8	5.3	4.9	5.3-6.3
Agri, Fish & Forestry	-0.5	2.1	1.7	3.7	1.8	4.2-4.4
Industry	3.4	5.8	5.3	4.9	4.9	5.0-6.0
Services	7.0	6.4	5.6	6.4	6.4	6.6-7.0

All this positive news reversed in 2005, however (Tables 1 and 2). Growth slowed down almost across the board, with the exception of industry, which performed marginally better.

#### *Investment fizzles out*

The improved performance of the productive sectors in 2004 was likewise reflected on the demand side, with personal consumption and investment expenditures showing strong and faster growth. Personal consumption grew by 5.8 percent, better than its 5.3 percent growth in 2003, still supported by the purchasing power provided by brisk growth in overseas Filipino workers' (OFW) remittances. But more noteworthy was growth in real investment, which showed vast improvement from its stagnant 0.1 percent performance in 2003, to a hefty 9.5 percent growth in 2004. In particular, construction recovered from its negative performance in 2003 (-2.9 percent) to a positive 3.0 percent growth in 2004, with growth primarily coming from private construction.

**Table 3. Domestic Demand, 2004-2005**

Indicator	2004	2005				
	FY	Q1	Q2	Q3	Q4	FY
Personal Consn Exp	5.8	5.0	4.8	4.8	5.2	4.9
Govt Consumption	0.0	0.6	15.7	-2.0	-4.2	2.7
Capital Formation	9.5	-7.4	-5.4	-1.3	-2.8	-4.3
Fixed Capital	4.2	-4.4	-3.9	-2.1	-1.4	-3.0
Construction	3.0	3.3	0.9	-0.1	4.9	2.2
Public	0.0	4.6	-4.8	-6.2	18.7	2.6
Private	4.8	2.7	5.0	3.1	-2.7	2.0
Durable Equipment	5.8	-9.7	-9.2	-4.5	-7.8	-7.9
Brd Stock & Orch Devt	0.8	0.3	2.1	2.6	2.0	1.7

Private investments in durable equipment actually slowed down to 5.8 percent from 8.5 percent in 2003, consistent with the actual drop in foreign direct investment inflows reported by the *Bangko Sentral ng Pilipinas* (BSP). Still, the positive albeit slower growth rate indicates that domestic investors continued to place stronger bets on the growing economy. All this changed in 2005, however, as capital formation continuously declined through the year, with a full-year contraction of 4.3 percent. Investments in durable equipment particularly plummeted by 7.9 percent, reflecting the steep decline in foreign direct investments as well as domestic investments during the year.

#### *More inflows than outflows*

The balance of payments (BOP) targets for 2004 and 2005 were attained with the highest surplus in the last five years at \$2.4 billion in 2005, at least based on *Bangko Sentral ng Pilipinas* estimates. The remittances from Filipino overseas workers continue to increase in the past eight years, reaching at least \$8 billion in 2004 and at least \$10 billion in 2005. These amounts are enough to cover the trade deficits in the same periods. Consequently, the current account in these two years reported surpluses despite declining performance of manufacturing exports, from 9.8 per cent to 3.7 per cent in 2004 and 2005.

There were also significant increases in financial inflows, in part because world investments flows started to recover in 2003 and because investment prospects in the country appeared to have recovered as well. But most of these financial flows were short-term as implied by abrupt changes in flows. In 2003, for instance, there was a net portfolio inflow of \$ 562 million. Then, in 2004, there was a net portfolio outflow of \$ 1.6 billion, and in 2005, a net portfolio inflow of \$ 2.8 billion. One can conjecture that these

swings are motivated by speculative activities, which can only lead to asset and price bubbles (heightening risks of a financial crisis) with limited, if any, real production expansion in the country (and thus hardly any job creation impact). What all this implies is that the apparent improvement in the external balance has not been robust, putting to question government claims that the Philippine economy is on the verge of a takeoff.

**Table 4. Balance of Payments, Share of GDP**

	2001	2002	2003	2004	2005
Current Account	-2.3	-0.4	0.3	1.8	2.2
Export of Goods	41.4	42.0	41.6	42.1	38.2
Import of Goods	-49.6	-48.8	-48.5	-48.3	-45.4
Trade Balance	-8.3	-6.8	-6.9	-6.2	-7.2
Capital & Financial Acct	1.2	1.3	0.9	-1.8	0.8
Financial Account	1.1	1.3	0.8	-1.8	0.8
Net Direct Investment	0.4	1.8	0.2	0.1	0.9
Net Portfolio	1.4	0.9	0.7	-1.8	2.7
BOP Position	-0.3	1.0	0.1	-0.4	2.3
BOP Target	-3.0	0.9	1.6	-0.6	0.4

Source: Bangko Sentral ng Pilipinas; Asian Development Bank

### *Reducing poverty through statistics?*

Recent reports from the National Statistical Coordination Board (NSCB) of declining poverty and narrowing income gaps appear encouraging. The proportion of Filipino families that are poor has reportedly declined steadily from 28.1 percent in 1997, to 27.5 percent in 2000, and on to 24.7 percent in 2003. Furthermore, the ratio of incomes of the richest one-fifth to the poorest one-fifth of the Filipino population has also reportedly declined from 12.6 in 1997, down to 12.4 in 2000, and further down to 11.4 in 2003. However, these data have not gone unquestioned, as scholars have pointed to glaring inconsistencies in the relevant statistics.<sup>4</sup>

### **The Half-Empty Glass**

#### *Accelerating prices, lagging jobs*

Price increases accelerated in 2004, ending the year with a 7.9 percent inflation over 2003 year-end price levels. This brought average inflation throughout the year to 5.5 percent, a significant increase over the 3.1 average inflation rate of the previous two years.<sup>5</sup> The higher inflation

<sup>4</sup> A number of analysts have pointed out inconsistencies between the recently released poverty and income distribution statistics, and the Family Income and Expenditures Survey. See, for example, Solita Monsod (2005), "Careful with those statistics," Get Real column, *Philippine Daily Inquirer*, February 5.

<sup>5</sup> NEDA Weekly Economic Indicators, NEDA Website ([www.neda.gov.ph](http://www.neda.gov.ph)).

was induced primarily by the dramatic rise in oil prices, with international crude oil prices climbing above US\$55 per barrel, almost twice the level of the year before.

**Table 5. Labor and Employment Statistics, 2003-2006**

Quarter	Unemployment Rate (%)		Jobs Generated (Thousands)*				Underemployment Rate (%)
	Old Defn	New Defn	TOTAL	Agri	Ind	Serv	
Jan '03	10.6	-	414	144	-14	284	16.1
Apr '03	12.2	-	232	130	40	64	15.6
Jul '03	12.6	-	347	-313	276	282	20.7
Oct '03	10.1	-	1273	364	272	633	15.7
Ave '03	11.4	-	567	81	144	316	17.0
Jan '04	11.0	-	1,428	24	468	934	17.5
Apr '04	13.7	-	1,102	-76	279	899	18.5
Jul '04	11.7	-	1,181	619	-37	602	17.6
Oct '04	10.9	-	180	29	-66	218	16.9
Ave '04	11.8	-	973	149	161	663	17.6
Jan '05	11.3	-	87	185	-73	-24	16.1
Apr '05	12.9	8.3	684	-121	106	699	26.1
Jul '05	10.9	7.7	899	540	66	282	20.5
Oct '05	10.3	7.4	1,135	390	6	739	21.2
Ave '05	11.4	7.8	701	249	26	424	21.0
Jan '06	10.7	8.1	750	475	-95	371	21.3
Apr '06	11.8	8.2	803	427	0	378	25.4

\*Num

bers give net new jobs generated since same month a year ago.

Meanwhile, the “jobless growth” phenomenon persisted, with the 6.1 percent GDP growth accompanied by a perverse movement in employment rate. Unemployment worsened to 10.9 percent in October 2004, from 10.2 percent in the same month of 2003 (see Table 5), with close to 5 million Filipino workers unable to find jobs. As of October, only 180 thousand new jobs had been generated by the economy over the preceding year, with a net loss of 66 thousand jobs in the industry sector. Agriculture contributed 28 thousand new jobs, while services produced the most new jobs, numbering 218 thousand.<sup>6</sup> Still, all this falls far short of the minimum of one million new jobs targeted by the government per year over the next six years, to bring down unemployment rate to levels closer to those of its immediate neighbors.

*Narrow, shallow and hollow growth*

<sup>6</sup> Ibid.

The growth of the Philippine domestic economy over the past year and over recent years is propelled primarily by a narrow group of economic sectors, particularly information and communication technology (ICT), especially telecommunications, which continues to ride on the rapid growth in the cellular phone business, due to the wide popularity of text messaging. This sub-sector grew by a rapid 20 percent in the 4<sup>th</sup> quarter and 16.7 percent for the full year, fastest among all sub-sectors in the economy and far outpacing the rest of the economy. At the same time, more than half (56 percent) of domestic output and incomes are generated in the National Capital Region, and Regions III (Central Luzon) and IV (Southern Tagalog) alone. Growth in the economy is clearly proceeding from a narrow sectoral and geographical base.

Meanwhile, the bulk of the country's exports are accounted for by two industries heavily dependent on imported raw materials and intermediate inputs, namely electronics (64.9 percent of export revenues) and garments (6.4 percent). The thin slice of domestic value added on these products is almost entirely accounted for by labor. As such, there is hardly any linkage between these industries and the rest of the productive sectors of the economy. Thus, the benefits from growth in production particularly in these sectors are rather shallow.

Moreover, and as shown earlier, overall production growth had actually been accompanied by an increase in the unemployment rate in 2004. Growth of the economy has not been translating into commensurate growth in jobs for Filipino workers (thereby manifesting a "hollow" growth). Among the consequences of this is the large numbers of Filipino workers who seek employment overseas yearly. This is yet another indication that recent economic growth has led to limited benefits for a limited segment of the Filipino population. Through the years, a more broad-based economic growth and development has remained elusive for the Philippines.

#### *Government cannot repeal the debt penalty*

Despite the government's success in keeping its deficit well within target in 2005, it was unable to contain the debt problem of the country. While the need for massive borrowings has been mitigated somewhat by new revenue measures, particularly the expanded value added tax, the specter of debt persists, and the public must be aware that the debt penalties will be large and will again take a substantial portion of the national budget in the coming years, as it had in the past.

Table 6 shows that between 2004 and 2005, the outstanding debt of the national government rose to PhP 3.89 trillion, or about 72 per cent of 2005 GDP, compared to its 2003 level, which was PhP 3.35, or 78 per cent of 2003 GDP. But total debt servicing continued to increase over the years, from PhP 470 billion in 2003 to PhP 581 billion in 2004 and to PhP 674 billion in 2005, that is, ranging from 11 per cent of 2003 GDP to 13 per cent of 2005 GDP.

**Table 6. National Government Debt (in Billion Pesos)**

	2001	2002	2003	2004	2005
Total Outstanding Debt	2,385	2,816	3,355	3,812	3,891
Per cent of GDP	65.7	71.0	78.2	79.0	72.3
Total Domestic Debt	1,248	1,471	1,704	2,001	2,035
Per cent of GDP	34.4	37.1	39.7	41.5	37.8
Total Foreign Debt	1,137	1,344	1,651	1,811	1,856
Per cent of GDP	31.3	33.9	38.5	37.5	34.5
Total Debt Servicing	274.4	357.9	470.0	581.3	674.1
Per cent of GDP	7.6	9.0	10.9	12.0	12.5
Debt Servicing - Interest Payments	174.8	185.8	226.4	271.5	313.4
Share of National Budget	27.7	19.6	22.6	24.4	27.4
Debt Servicing - Principal Amortization	99.6	172.1	243.6	309.8	360.7
Share of National Budget	15.8	18.1	24.3	27.8	31.5
Total Debt Servicing to Revenues	48.7	63.1	75.0	83.1	88.9

Source: Bangko Sentral ng Pilipinas; Department of Budget Management

Note: Revenues mean total of tax and non-tax revenues.

In terms of the share of debt servicing in the total public expenditures, the figures were 46.9 per cent in 2003 to 58.9 per cent between in 2005. Projected figure for 2006 is 68.5 per cent. Put simply, total debt servicing is equivalent to at least half of the national budget while other public expenditure programs compete for the remainder (less than 50 per cent). Taken against the government's total revenues, debt servicing in 2003 is equal to 75 centavos for each peso of revenue. The figure increased to about 80 centavos to a peso in 2004, and rose further to 90 centavos to a peso in 2005. Although the projected figure for 2006 is 75 centavos to a peso of revenue, the reduction is due to new and expanded taxation.

The various debt indices in Table 7 further show the growing debt penalty to Filipinos. The indices mostly show a consistently rising trend, except for the ratios of interest payments and amortization payments to total financial flows. The latter ratios declined in 2005 mainly because there has been a rise in current flows (in particular, international remittances) and in financial flows (in particular, portfolio flows which also include debt flows). That is, while the debt servicing payments have been rising, debt inflows have also been rising faster, leading to a declining ratio. The shares of debt servicing to current flows have been fairly consistent in the last four years at about 3.5 per cent. This has been made possible by a rise in international remittances that is commensurate with the rising debt service payments.

Among the debt-related indicators, the most rapid rise can be seen in the debt servicing to revenues ratio, followed by the debt servicing to budget ratio. Debt servicing to exports ratio has been consistently rising, and now exceeds 10 per cent. The debt servicing to international reserves ratio has likewise been rising, and is likely to exceed 25 per cent in the coming years. These indicators suggest an increasingly heavier debt burden in coming

years; that is, the debt penalty borne by Filipinos will be rising for some time to come.

**Table 7. Debt Servicing Share in External Accounts  
(in Billion US Dollars)**

	2001	2002	2003	2004	2005
<b>Debt Servicing – Interest Payments</b>	1,220.6	1,276.6	1,454.6	1,622.1	1,987.0
Share in Total Current Flows	1.5	1.5	1.4	1.5	1.7
Share in Total Financial Flows	4.3	5.0	30.3	28.9	18.4
<b>Debt Servicing – Principal Amortization</b>	893.6	1,766.4	1,775.9	2,112.2	2,281.0
Share in Total Current Flows	1.1	2.0	1.8	1.9	1.9
Share in Total Financial Flows	3.1	7.0	37.0	37.6	21.1
<b>Debt-related Ratios</b>					
Total Debt Servicing to Total Ext. Debts	4.1	5.7	5.6	6.8	7.9
Total Debt Servicing to Exports	6.8	8.8	9.1	9.6	10.6
Total Debt Servicing to Remittances	34.3	41.2	41.0	43.4	39.7
Total Debt Servicing to Int'l Reserves	13.5	18.9	19.1	21.1	23.0
Total Debt Servicing to Budget	43.5	37.7	46.9	52.2	58.9
Total Debt Servicing to Revenues	48.7	63.1	75.0	83.1	88.9

Source of data: Department of Finance; International Financial Statistics

Note: Total current flows = sum of inflows and outflows of current account transactions.

Total financial flows = sum of inflows and outflows of financial account transactions.

Yet, even with the rising trend in the indicators above, it is pointed out by analysts that the Philippines is not in an imminent situation of a debt default or in difficulty of servicing its debts. Thus, the country is not seen to need nor qualify for debt relief from its creditors. The reality in the Philippines is that addressing the debt burden implies forsaking budget imperatives like social services, and finding ways to raise more revenues. In following this route, the government has in effect allowed its policy space to be reduced and defined by external interests. Consequently, the government's ability to address its debt-related problems and its capacity to provide for important social services and public infrastructures are seriously undermined (see Table 8). Ultimately, the debt penalty compromises the country's long term human development and economic growth.

It must be noted that the deterioration in government finances over recent years is a revenue problem, and has not been due to any sudden upsurge in budgetary spending. Total spending has in fact averaged only 19 percent of GDP, largely by cutting back some of the major infrastructure projects like irrigation. Net of interest payments, primary spending of the national government has actually declined significantly since 1999, and is now at its lowest level in a decade. The bulk of the national budget that remains after interest payments are already committed beforehand to salaries, maintenance and operating expenses, and the internal revenue

allotment to local governments, leaving very little for infrastructure spending and other development needs.

**Table 8. Sectoral Allocation of the Government Budget, 2004-2006.**

Sector	2004	2005	2006
<b>Economic services</b>	<b>19.40</b>	<b>17.20</b>	<b>18.72</b>
Agriculture & Agrarian Reform	3.28	2.82	2.61
Natural Resources & Environment	0.72	0.74	0.72
Trade & Industry	0.40	0.33	0.29
Tourism	0.17	0.15	0.17
Power & Energy	0.21	0.16	0.21
Water Resource Devt & Flood Control	0.87	0.70	0.78
Communications & Transportation	7.70	5.86	6.82
Other Economic Services	0.36	0.65	1.59
Subsidy to Local Government Units	5.69	5.78	5.53
<b>Social Services</b>	<b>28.86</b>	<b>27.68</b>	<b>27.91</b>
Education, Culture, & Manpower Devt	14.85	14.74	13.90
Health	1.67	1.41	1.30
Social Security, Labor, & Employment	5.16	4.36	5.56
Housing & Community Devt	0.18	0.19	0.26
Land Distribution	0.85	0.48	0.42
Other Social Services	0.12	0.39	0.62
Subsidy to Local Government Units	6.02	6.11	5.85
<b>Defense</b>	<b>4.92</b>	<b>4.81</b>	<b>4.98</b>
<b>General Public Services</b>	<b>16.07</b>	<b>15.44</b>	<b>15.33</b>
General Administration	5.25	4.49	4.59
Public Order & Safety	6.14	5.92	5.74
Other General Public Services	0.12	0.41	0.57
Subsidy to LGUs	4.55	4.62	4.43
<b>Net Lending</b>	<b>0.65</b>	<b>0.75</b>	<b>0.78</b>
<b>Debt Service – Interest Payment</b>	<b>30.09</b>	<b>34.12</b>	<b>32.28</b>
<b>Total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

What all the above suggest is that the government remains in a Ponzi (financial pyramid) type of situation, as recently pointed out by the Asian Development Bank. In other words, it needs to keep borrowing substantial amounts to meet debt servicing and public expenditures targets. But to obtain more borrowings, more tax initiatives need to be implemented. The debt penalties that Filipinos have to carry will therefore continue to be rather substantial. And given current realities in the Philippine tax system, this burden, unfortunately, falls disproportionately more on the poor.

### **The Ten-Point Agenda: A Cursory Assessment**

Gloria Macapagal-Arroyo's government has adopted a 10-point agenda, summarized in the acronym "BEAT THE ODDs" as its primary strategy for achieving economic progress:

- **B**alanced budget
- **E**ducation for all
- **A**utomation of elections
- **T**ransportation and digital infrastructure
- **T**erminating hostilities
- **H**ealing the wounds of EDSA
- **E**lectricity and water for all barangays
- **O**pportunities for livelihood and 6-10m jobs
- **D**econgest Metro Manila
- **D**evelop Clark and Subic

We comment below on each of these ten elements, primarily to assess how well each objective is being addressed, and how responsive each has been in turn to promoting broad-based economic growth and development.

*Balanced Budget.* The government has been vacillating between targeting a balanced budget by 2008 and by 2010. The ambivalence is understandable. Balancing the budget by 2008 is in fact a comfortable target as of now, especially given that the national government appears well on the way to achieving a budget deficit well below the target ceiling of PhP125 billion for the year. But achieving the target would come at the cost of foregoing potential increases in social services spending and/or investments in further economic growth (e.g. via infrastructure). It must be emphasized that cutting the deficit and balancing the budget is not an end in itself, but merely a means to achieving greater economic stability. Thus, the proper balance needs to be sought between achieving fiscal stability and providing for longer term needs of the economy and the people. This item merits an **A-** on the report card.

*Education For All.* Indications point to failure, so far, on this element of the agenda. The budgetary allocation for education has progressively dropped (as a percent of total budget) over recent years. Recent admission that a pupil-classroom ratio of 100 to 1 is the official target reflects the sorry state of public school facilities in the country. Thousands of our best teachers are being lost to other countries, especially the US and Europe. The importance (or lack of it) given to education by the national leadership has been reflected in the way the post of Secretary of Education was allowed to remain vacant for almost a year. And statistics point to declining school enrolment rates in many provinces of the country, as children are apparently forced to stay out of school by due to economic difficulties of their families. The government rates an **F** on this one.

*Automation of Elections.* This is another glaring failure of the administration. The Commission on Elections remains mired in the contro-

versy over the anomalous contract for the failed election computerization project that should have led to computerized elections as of 2004. No significant headway is being achieved towards ensuring that the upcoming 2007 elections will be computerized in a way that will inspire public confidence in the integrity of the electoral exercise. Another **F** rating.

*Transportation and Digital Infrastructure.* The roll-on-roll-off (Ro-Ro) program of the government is the most conspicuous achievement in this area, and has helped improve mobility of products from the countryside while increasing freight traffic across the regions. Fiscal difficulties severely constrain further public investments in these infrastructure facilities, however. In fact, first quarter economic growth figures revealed a decline (negative growth rates) in the land and water transport sectors, indicative of the problems besetting the transport industry. The policy framework on private sector participation in public infrastructure (the BOT Law) is in need of urgent reform, but is being held up by the virtual standstill in the legislative processes over the past year. Meanwhile, improvements in the digital infrastructure are being put in place primarily by the private sector. A **B-** mark appears warranted here.

*Terminating Hostilities.* The government's approach to pursuing peace with those engaged in rebellion against the state has clearly turned to one based on escalation of military action, including the "reign of terror" surrounding the murder of suspected dissidents around the country. This appears to be a counterproductive strategy, as the country's own history has shown that the military solution can never yield a lasting solution to the persistent insurgency. Rather than subside, tensions and violent engagements have in fact been escalating lately, as dissidents only get further inflamed and emboldened by the government's renewed militarization of the countryside. Another **F** rating.

*Healing The Wounds of EDSA.* The current government, itself installed by a peaceful EDSA uprising, is widely perceived to have spurned and directly challenging the lessons of EDSA. Thus, rather than heal the old wounds of EDSA (i.e. arising from the overthrow of the Marcoses), it is instead bringing up new wounds that exacerbate the divisions among the Filipino people. Still another **F**.

*Electricity and Water for All Barangays.* Rural electrification and water supply provision have not been particularly prominent among the achievements of the administration. Private and community initiatives have been more instrumental in providing for greater access to water (but for which Malacañang has been quick to claim credit). For example, Manila Water Company's *Tubig Para sa Barangay* program has been successful in providing water to depressed communities in the Eastern zone of Metro Manila, through a win-win mechanism that also reduces non-revenue water from leakages and pilferage. As progress is more attributable to parties outside of government, a grade of **C** is warranted here.

*Opportunities for Livelihood and 6-10 Million Jobs.* As indicated above, this has been a glaring failure so far. Actual job generation, according to official labor statistics from the NSO and Bureau of Labor Statistics, has been falling well short of the 1-1.2 million jobs targeted every year (see Table 5). Meanwhile, job quality has been deteriorating, indicated by the under-employment rate exceeding 20 percent in recent years (from 16-18 percent before). Furthermore, less than half of the new jobs being created are wage and salary jobs; the bulk have been in the form of self-employment (own-account workers) and unpaid family labor. Again, another **F**.

*Decongest Metro Manila.* There is little evidence so far that Metro Manila is being decongested, other than through piecemeal relocation of informal settlers. More fundamental interventions like the transfer of major facilities outside of Metro Manila have yet to be seen. Metro Manila traffic remains highly congested, and solid waste management systems continue to be unable to cope with the demands of the metropolis. Still another **F**.

*Develop Clark and Subic.* The strategy to focus public investments on Clark and Subic in the medium term appears based on the premise that developing the Clark-Subic-Metro Manila corridor as a center for economic activities will lead to benefits that will permeate the rest of the country. This premise is open to question and seems based on the discredited “trickle-down” theory of development. So far, visible signs of pursuing this objective include the availability of inexpensive flights from Clark to regional destinations like Singapore and Bangkok. A major scale-up in industrial activity in Clark or Subic has yet to materialize, pending installation of needed new facilities for telecommunications and transport infrastructure. Both continue to be hampered by lack of public resources, or interest from private investors in setting up such infrastructure facilities. A lacklustre **C** for the limited achievements here.

Based on the above assessments, the overall rating on the ten-point agenda falls short, unfortunately, of the minimum passing grade of **D** – indicating the need for more focus and more effort on the part of the government.

## **Regional Comparisons**

### *Lagging behind... again*

The Philippines had managed to shed its label as the “sick man” of Asia by the mid-1990s. Lately, however, the country has begun to slip back anew in the pack among its Southeast Asian neighbors. Relative to Indonesia, Malaysia, and Thailand, the Philippines’ growth rate for the period 2004-2005 tended to be on the lower side (see Table 9). Juxtaposed against its growth targets as embodied in the MTPDP, growth rates in 2003 and 2004 were within and beyond target range, respectively. However, targets were missed anew in 2005, and with the prevailing external

pressures (i.e. continuing rise in petroleum prices) and domestic challenges (sluggish real investments and continued political turbulence), the growth target of 6.3-7.3 per cent for 2006 appear too ambitious.

Other economic indicators further reveal the relative fundamental weakness of the Philippine economy compared to its neighbors. These are most obvious in the trends exhibited by per capita income growth rate, investments, inflation and unemployment rate.

The otherwise respectable economic performance of the Philippines in the past five years is undermined by population growth, thereby impacting on growth in per capita income (Table 10). The country's average per capita income growth rate has been below average relative to its neighbors in the periods 2001-2005 (at 2.2 per cent, compared to 2.8 per cent for four countries) and 2004-2005 (at 3.5 per cent, compared to 3.6 per cent for the four countries).

**Table 9. Economic Growth Rates of Southeast Asian Countries (%)**

	2001	2002	2003	2004	2005
Philippines	1.8	4.4	4.5	6.0	4.9
MTPDP targets			4.2-4.6	4.9-5.8	5.3-6.3
Indonesia	3.8	4.3	5.0	4.9	5.6
Malaysia	0.3	4.4	5.4	7.1	5.3
Thailand	2.2	5.3	7.0	6.2	4.5

Source: Asian Development Bank

Note: MTPDP growth target for 2001-2003 was 4.2-4.6 per cent.

**Table 10. Per Capita Income Growth Rates (%)**

	2001	2002	2003	2004	2005
Philippines	-0.6	2.4	2.4	3.9	3.0
Indonesia	2.5	2.9	3.7	3.6	3.3
Malaysia	-1.8	2.2	2.2	4.3	2.5
Thailand	1.3	4.4	6.1	4.4	4.1

Source: Asian Development Bank

The figures in Table 11 reveal a disturbing scenario for the Philippines: there has been a declining trend in domestic investment since 2001. The country averaged 17.2 per cent of GDP and 16.4 per cent of GDP for 2001-2005 and 2004-2005, respectively, compared to the regional average of 21.7 per cent and 22.1 per cent for the same periods. The problem for the Philippines is that domestic investment was already low even from the 1990s. Further reductions in the rate of domestic investment

**Table 11. Domestic Investment As Share of GDP (%)**

	2001	2002	2003	2004	2005
Philippines	19.0	17.7	16.7	17.1	15.7
MTPDP target				20.4	20.3
Indonesia	23.5	20.4	17.3	21.3	21.3
Malaysia	23.9	24.0	21.6	22.6	19.8
Thailand	24.1	23.8	24.9	27.1	31.6

Sources: Asian Development Bank, National Economic Development Authority

will thus compromise the country's long term growth potentials, which is worrying considering that domestic investments have been below target and the gap has been increasing. It is even more worrying that, on average, the trend in the Philippines is declining, while that of other countries in the region is increasing. What the trend suggests is that the country will fall even farther and farther behind its neighboring economies.

On inflation management, Table 12 shows that the Philippines has failed to meet its targets. It is important to note that the inflation targeting policy of the Philippines would be extremely difficult to adhere to when there are external or supply shocks like petroleum and raw materials price increases. Given continuing external pressures, it is doubtful that the country will meet its ambitious 2006 inflation target of 4-5 per cent. The other countries in the region have experienced higher inflation as well, especially as petroleum prices continue to rise. It is interesting to note, however, that while subject to the same petroleum price increases that the Philippines has faced, the inflation uptick in the other countries have not been as dramatic. This suggests that factors internal to the Philippines have also led to acceleration of inflation.

**Table 12. Inflation Rates (%)**

	2001	2002	2003	2004	2005
Philippines	6.1	3.1	3.1	5.5	7.6
MTPDP target				4.0-5.0	4.0-5.0
Indonesia	11.5	11.9	9.8	6.5	10.5
Malaysia	1.4	1.8	1.2	1.4	3.0
Thailand	1.6	0.6	1.8	2.8	4.5

Sources: Asian Development Bank; National Economic Development Authority

Among the economic indicators considered in this analysis, the most worrying trend is that of unemployment rates (Table 13). While it is correct to say that the Philippines exceeded its targets in 2004-2005, it is also quite apparent that the MTPDP employment targets were set too low, and have bordered on insulting the millions of Filipinos without jobs. Even Indonesia, which has about three times the size of the labor force of the Philippines, can claim to have done much better at jobs generation.

**Table 13. Unemployment Rates (%)**

	2001	2002	2003	2004	2005
Philippines	11.1	11.4	11.3	11.8	11.4
MTPDP targets			9.8-10.4	12.1	11.9
Indonesia	8.1	9.1	9.6	9.9	10.3
Malaysia	3.6	3.4	3.6	3.5	3.5
Thailand	3.3	2.4	2.2	2.1	1.4

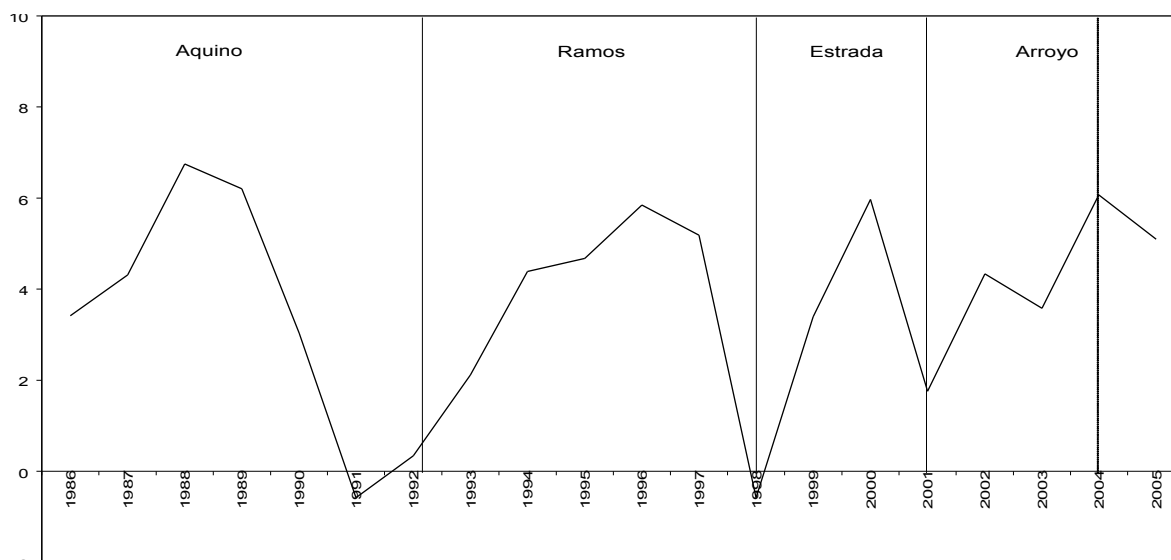
Source: Asian Development Bank; National Economic Development Authority

Note: MTPDP target for 2001-2003 was 9.8-10.4 per cent

### *The enemy is within*

It is worth revisiting the above discussions and put it in the perspective of the historical performance of the country with respect to growth, inflation and unemployment. We compare below the Arroyo government's performance relative to its predecessors.

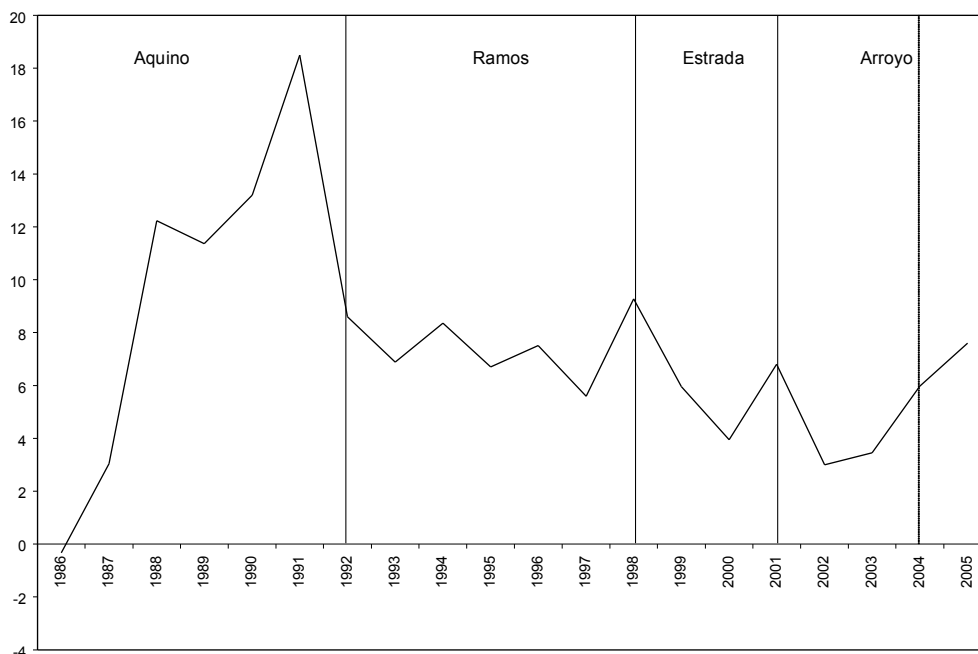
What has come to be a stylized fact about Philippine growth is that it follows a boom-bust cycle. There have been many studies on this observation, but a rudimentary examination of the trend in Figure 1 suggests that the turning-point occurs by the mid-term of a presidency. All the previous governments experienced a trough in the growth rates around the end of the presidency. Perhaps each government loses steam, so to speak, or loses ground in pushing forward reforms. New governments then are energized to perform well at the start of their terms and out-perform the previous governments. Interestingly, only Estrada did not experience negative growth at the end of his presidency. The present Arroyo government has yet to demonstrate its resilience because its best performance is comparable with that of Estrada and Ramos although slightly below Aquino's. The recent downgrading of economic targets for 2006 forewarns that the Philippines' growth prospects are not as optimistic, at least, for the immediate coming years. The fact that recent economic performance has been underpinned by short term capital and remittances inflows and to some extent growth in services sectors put to question the prospects for robust growth in the long term.

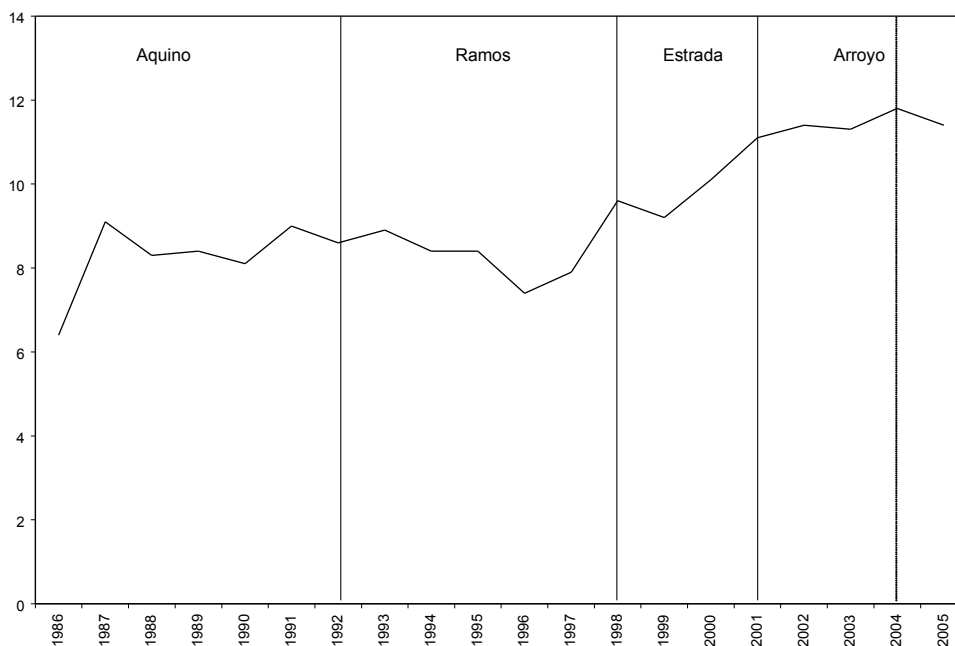


**Figure 1: Growth Rates, 1986-2005**

Overall, one can argue that economic targets have been unimpressive as well. Indeed analysts have pointed out that recent growth can be characterized as narrow, shallow and hollow. It may only be a matter of time that the boom-bust cycle manifests itself once more during the Arroyo government. Indeed, the 2005 performance already represents a downturn from a seeming peak reached in 2004. If recent historical experience is an indication, this could lead one to expect that a political regime change is in the offing.

Finally, juxtaposing the figures on inflation and unemployment reveals an interesting pattern. Relative to its predecessors, the Arroyo government has failed in keeping stable inflation and reducing unemployment. Latest data indicate that inflation was 6.9 per cent in May and June 2006, while unemployment stood at 11.8 per cent in April 2006. Both exceed the targets. Indeed, Figures 2 and 3 above indicate a negative correlation; that is, as inflation is driven down due to price stabilization initiatives (and especially with the inflation targeting policy since 2002), there appears to be an acceleration in unemployment rate. One might be led to perceive an effective, if unwitting, bias in current monetary policy against jobs creation, and hence, a probably unintended anti-poor poor bias.



**Figure 2: Inflation, 1986-2005****Figure 3: Unemployment Rate, 1986-2005**

### Fundamental Weaknesses

The persistent tightness in government finances has had long-term consequences that have led to fundamental weaknesses in the Philippine economy. For decades, the Philippines has lagged behind its Southeast Asian neighbors in key social and economic indicators. This had not always been the case; in the 1960s, the country had been widely considered second only to Japan in level of economic development in the region. In the 1960s and up to 1970, the country was a virtual identical twin to Thailand, with both having exactly the same population levels, average incomes, saving and investment rates, international trade ratios, and more striking similarities. The divergence between the two erstwhile “identical twins” through the next three decades was rather stark, with the Philippines having 18 million more people and managing only about half the average income of Thailand by the turn of the 21<sup>st</sup> century.<sup>7</sup>

In particular, the country stands out as having had the lowest growth in labor productivity (output per worker) and total factor productivity since the 1960s. Whereas Thailand, Malaysia, Singapore, Indonesia, Taiwan and Korea all experienced accelerating growth in labour and total factor productivity since the 1960s, the Philippines was the only country among the group that even slid into negative productivity growth in the 1980s, and remained stagnant up to the early 90s. Average annual labor productivity growth in the seven countries was 4.6 percent by the early 90s, up from 3.2

<sup>7</sup> Cielito F. Habito (2004), “RP and Thailand: estranged twins,” No Free Lunch Column, *Philippine Daily Inquirer*, August 2.

percent in the 1960s. On the other hand, Philippine labor productivity growth was 2.3 percent in the 1960s, slipped into negative annual growth rate of -3.0 in the 1980s, and barely recovered at 0.7 percent in the early 90s. Annual growth rate of total factor productivity averaged a mere 0.2 percent in the 1960s, dipped to -4.6 percent in the 1980s, and was stagnant at 0.0 percent in the early 90s.<sup>8</sup>

Another glaring contrast is in how government capital expenditures in the Philippines account for the lowest share of total capital expenditures among the seven countries named. In 2000-2002, the share averaged less than 9 percent for the Philippines, against 16.2 percent for Thailand, 36 percent for Malaysia, and 43 percent for Indonesia.<sup>9</sup> The result has been inferior infrastructure facilities relative to its neighbouring competitor countries. Social expenditures in the Philippines likewise pale in comparison to what its neighbours have invested in this crucial budget item. Thailand and Malaysia spend about two-fifths of their budgets for the social sector, the Philippines only one-fourth. Clearly, those two countries have been investing much more than the Philippines in two critical areas of productivity and competitiveness: infrastructure and human resources. Unless it is able to close this public investment gap, the Philippines is bound to remain uncompetitive in the international economy, and continue to lag behind indefinitely into the future.

## **Conclusion**

The current economic picture for the Philippines is a mixed, even confused one. On one hand, there has been generally good news in the behaviour of the equity and currency markets, inviting the tempting interpretation that these are signals of improved confidence in the economy, and thus precursors of better times ahead. But an understanding of the underlying weaknesses still plaguing the Philippine economy dictates a more prudent outlook. There is a great deal of uncertainty as to how long the bullish sentiment would last. Seasoned observers of the Philippine economy know well enough to understand that the tides can shift very quickly in this vibrant and highly politicized society.

What is clear is that the persistent fiscal difficulties of the Philippine government call for urgent corrective action. Improvements in tax administration and tax collection efficiency need to be pursued relentlessly, even as the government had enacted new revenue measures estimated to raise about PHP80 billion in additional revenues per year. It is also clear that given the magnitude and proportion of the country's debt service burden, efforts to reduce the debt service burden must be seriously pursued, through various

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<sup>8</sup> Ponciano S. Intal Jr., Gerardo Largoza and Associates (2004), "Society, Economy and Philippine Development: Towards a Social Market Economy Framework for Philippine Development." De La Salle University.

<sup>9</sup> Data cited in Intal, Largoza and Associates (2004).

schemes for negotiated debt reduction that have been employed successfully before.

For the country's leaders, this is not the time for self-serving machinations and political compromises. A country in crisis demands statesmanship, magnanimity and political will – the genuine desire to put aside personal interest in favour of the common good – from its political and business leaders, on whose actions hinge the welfare of over 80 million Filipinos.