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Analysis

Why Has The Philippines Lagged?

Josef Yap and Jenny Balboa*

Compared with other economies in East Asia, economic growth in the Philippines has been disappointing. The Philippines was, notably, not described as a 'high-performing economy' by the World Bank in its 1993 study of the East Asian Miracle, while Thailand, Malaysia and Indonesia were included in this group.

The per capita GDP of the Philippines was almost twice as large as that of Thailand and three times that of Indonesia in 1960. Yet by 2006, Thailand's per capita GDP was more than double that of the Philippines while Indonesia — which has a population more than twice that of the islands — has nearly caught up.

The Philippines also lags in terms of poverty alleviation. The incidence of absolute poverty — based on the one dollar a day threshold applied to recent data — is 13.2 per cent in the Philippines, higher than Indonesia (7.7 percent) and Vietnam (8.40 percent). In stark contrast, Malaysia and Thailand have virtually eliminated absolute poverty. Inequality, based on the spread of household expenditures, is amongst the highest in developing Asia. This is a serious problem for growth as well as social welfare, as recent studies have argued that an inequitable distribution of wealth constrains economic growth and development.

Among the factors that explain weak Philippine economic performance and the persistence of poverty and inequality in the country are:

1) The low priority of basic social services. Effective delivery of basic social services remains the most cost-effective way of combating poverty and inequity. The ideal way to achieve this is to channel 20 per cent of budgetary expenditure and 20 per cent of aid into social services. However, only 8.6 per cent of the Philippine national budget goes to basic social services, whereas a combined 40.6 per cent goes to debt service and defence expenditure.

2) Low investment in infrastructure. Upgrading the Phillipines' infrastructure is necessary to improve economic performance of the country, as it would help attract more foreign investment and reduce production costs. The Philippine budgetary allocation of infrastructure at 2.8 percent of GDP (between 2000 and 2006) is far below the 5 per cent of GDP benchmark set by other Asian countries. Moreover, some resources allotted for infrastructure have become vulnerable to corruption and thus have been inefficiently utilised.

3) Lack of political will to implement a sustained and credible fiscal reform programme. Weak fiscal institutions have led to the creation of policies that increase the national debt burden and create a bias towards deficit spending. Fiscal programs have been marred by politicised spending and corruption. (This has also led to low spending on basic social services and physical infrastructure.) There is a need to establish stronger fiscal institutions that adhere to rules and that do not easily

Paper of the Month

The paper of the month for September 2008 is **Immunising Future Trade Against Protectionists: Preventing the Emergence of More Sensitive Sector** by Andrew Elek.

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Financial Sector Reforms and Economic Integration in Asia prelimnary workshop - Mumbai, 17 November 2008.

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give in to populist demands. The fiscal reforms implemented in 2005 and 2006 have alleviated the situation somewhat, though there is still definite room for improvement.

4) High transaction costs on market-related infrastructure, facilities and services needed to conduct business, in acquiring and exchanging information, and in the enforcement of contracts. This has severely affected the manufacturing sector and prevented domestic industries from fully benefiting from trade liberalisation. It's also affected decisions by foreign investors to consider the Philippines in their production and logistical networks.

5) Lack of a coherent industrial policy. Some analysts argue that the Philippine government has not played an effective strategic role in providing the necessary physical, institutional and social infrastructure for industrialisation. Instead, it has allowed economic managers to follow a program that largely mimicked the Washington consensus. The first attempts to implement a strong and effective industrial policy failed because they did not target high value added exports, instead favouring sectors owned by close political allies of the administration. More recent programs for attracting FDI and setting up industrial and export processing zones achieved some employment generation, but they had weak or absent links to local firms, failing to create technological spillovers to domestic industry. There is a need for the government to reassess industrial policy and create an environment that facilitates a more dynamic interaction between foreign and local firms, and between large and small and medium enterprises.

The government needs to develop a long term strategy to increase productivity by increasing investments in infrastructure, and boosting human and technological capital.

Commitment to regional economic integration might give the impetus for these investments.

It might provide the necessary leverage for policymakers to advocate for the reforms that are necessary. Trade agreements—whether sub-regional, regional, or multilateral in scope —can be the rationale for opening up sectors, for example, air transportation, that would lead to greater efficiency and more widespread benefits through activities like tourism and overseas workers.

Regional cooperation, particularly through new age agreements, like the Japan-Philippine Economic Partnership Agreement, will provide opportunities for upgrading the capability of domestic economic agents and enable them to latch on to global and regional production networks.

The constraints on economic development are not purely economic. There are other 'deep parameters' that affect economic performance. Lack of social cohesion, spotty entrepreneurship, and the inability to establish a credible and selfless political leadership are among the challenges that the Philippines faces today. There is a degree of inconsistency between how religion affects society and capitalist development in the Philippines. Meanwhile, long-held social values, such as ningas cogon (an old Filipino expression, which literally means 'grass flash-fire', referring to cogon dry grass which blazes furiously when set alight, but only for a few minutes before turning to cold ashes), have adversely affected economic growth in less tangible ways.

In the Philippines, as in other countries, policymakers have to be aware of the limitations of economic reforms and contextualise reforms in local society.

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