

**Explaining the Philippine (Non-)Growth Record, 1946-2000:
From Independence to Estrada's Ouster¹**

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Good institutions, it appears, can overcome geographical constraints and lousy initial conditions. Good institutions can be acquired, but doing so often requires experimentation, willingness to depart from orthodoxy, and attention to local conditions....[History constantly] reminds us not to be too deterministic about the source of high-quality institutions. Choices made by political leaders make a big difference (Rodrik 2001).

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Part 1: Introduction and Overview

In the late 1950s and early 1960s, the Philippines was considered only second to Japan and a few others in terms of economic and industrial development in Asia. In 1955, Japan's per capita income was roughly double that of the Philippines and per capita incomes in Malaysia and Taiwan were, respectively, about 25 percent and 10 percent higher than in the Philippines. No 1955 data for Hong Kong and Singapore is available, but five years later in 1960, the per capita figures for both *de facto* city-states were substantially higher than those for the Philippines (Penn World Data 5.6)³ In the subsequent decades, however, the country lost much ground to many countries in the region, notably the Northeast Asian dragons and its key Association of Southeast Asian Nations (ASEAN) partners—Singapore, Malaysia, Thailand, and even Indonesia and earned the reputation of being the region's 'sick man'.

As can be seen in Figures 1-3, which trace the per capita gross domestic product (GDP) of the selected Asian countries (including South Asia) and the ASEAN-4 (excluding Singapore) over the past half-century, the Philippines' per capita GDP was roughly at par with Malaysia's and was higher than Thailand's and Indonesia's in the late 1950s and the early 1960s. From the mid-1960s, however, Malaysia started moving above the Philippine per capita income and by the 1980s, the gap widened even further to register at about \$6,000 (at 1996 prices). If matched with Thailand, Philippine per capita income was higher for about 35 years. As the Philippine economy experienced its worst contraction in the mid-1980s, Thailand's per capita GDP breached the Philippine's level to register a gap of roughly \$4,400 (in 1996 prices) before the onset of the Asian financial crisis in 1997. If we go by the updated Penn World Data set (version 6.0), even Indonesia and unheralded Sri Lanka managed to overtake the Philippines in terms of per capita GDP during the second half of the 1990s.⁴

³ The URL (Universal Resource Locator) for Penn World Tables 5.6/5.7 is <http://www.bized.ac.uk/cgi-bin/stat.htm>.

⁴ All the figures referred to in this paragraph were constructed using data from the updated Penn World Data 6.0 (Summers, Heston and Aten 2001).

Figure 1 : SELECTED ASIAN COUNTRIES: Per Capita GDP (in 1996 prices), 1950-1998

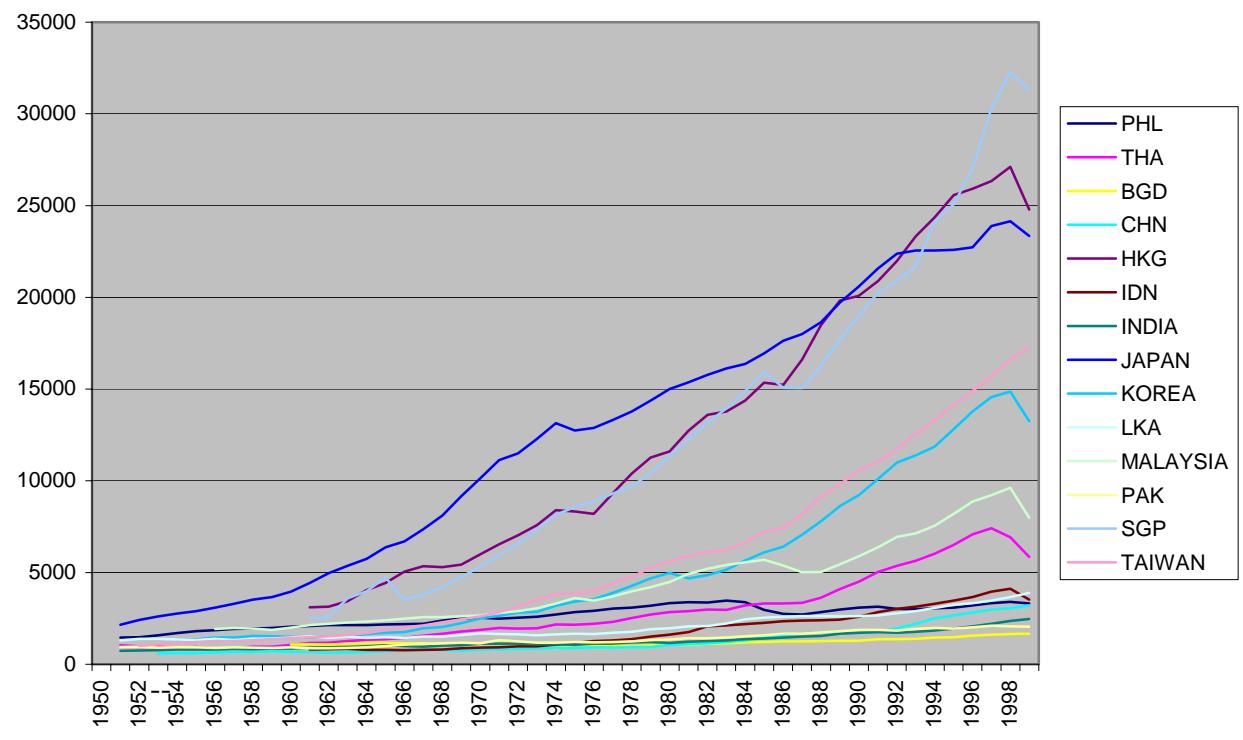


Figure 2 : PHILIPPINES and THAILAND: Per Capita GDP, 1950-1998

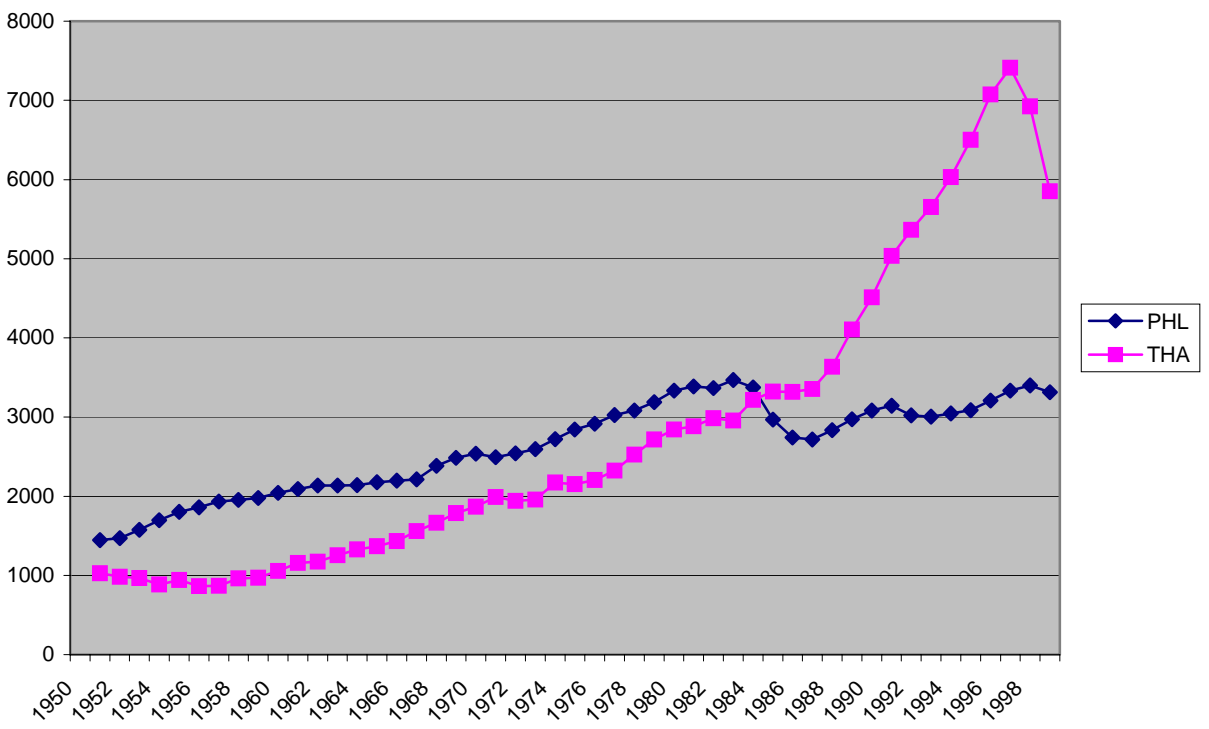
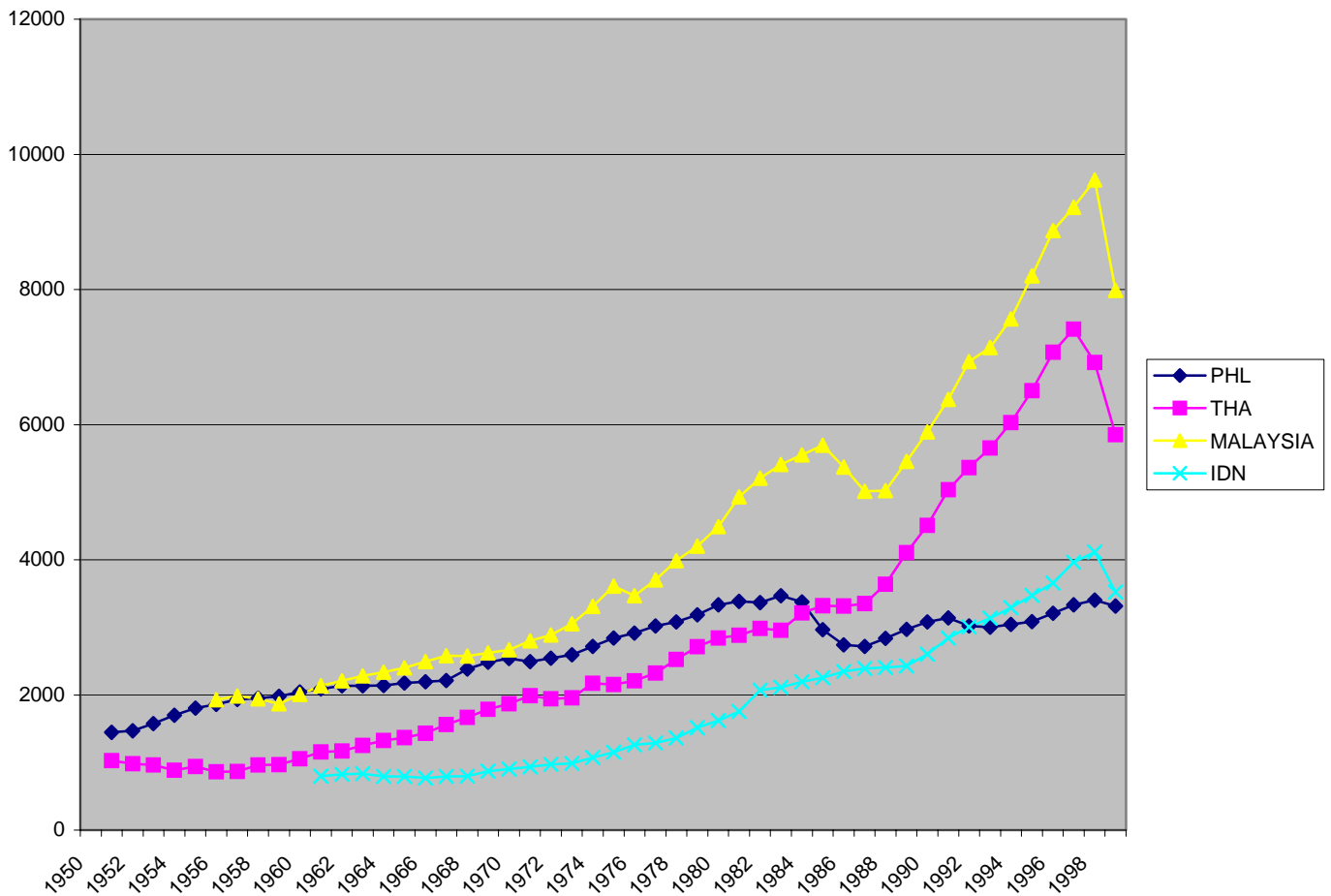


Figure 3 : ASEAN 4: Per Capita GDP, 1950-1998



After the early 1960s, the growth trajectory was not an unmitigated downward slide. What we have is simply a failure to sustain growth over the long haul. Several growth spurts suggested that the country may be poised for long-term growth only for the booms to sputter into busts. So if in the 1950s, we touted as the “next Japan”, we were alternatively dubbed as “the next Asian tiger” by *Euromoney* in the mid-1970s, and “maybe a cub” by *Newsweek*, enthusiastically seconded by Bears Stearns, in 1994 (Fabella 1995). Unfortunately, the would-be “tiger” has yet to grow up and roar.

This country study is organized in three parts plus the appendices. The first part offers an introduction and an overview of the Philippine macroeconomic performance since the new nation was granted independence from the United States in 1946 up to 2000, the eve of the peaceful President Joseph Estrada, admittedly the most popular president of the Republic. The second part forms the bulk of the study and seeks to

examine more closely the reasons behind the country's poor performance over the long-term. The third part concludes and highlights the lessons that could be extracted from the Philippine story. The fourth part includes the appendices and the reference materials.

1.1 Macroeconomic overview

The country's economic record stands out since it is a "notable 'non-miracle' in a region that was" (before the Asian financial crisis of the late 1990s) "teeming with 'miracles'." Among the East Asian countries that did not adopt a command and closed economy (i.e., China, Vietnam, North Korea, and Myanmar), the Philippines is the only country that failed to sustain economic growth in order to achieve the status of an NIC (newly industrializing country) together with its Southeast Asian neighbors. Its slower and erratic stop-go pace of economic growth, poverty alleviation, and social and human development is a stark record in contrast to the rest of the region (Lim 1999: 15). Its economic performance makes it more aligned with Latin America, a region that shares its religion, culture, and colonial history rather than with 'miraculous' East Asia. During the 1980s, for instance, it was the only East Asian economy with the Latin American disease (the so-called Third World debt problem).

What makes the country's record more puzzling is the contrast between respectable advances in education, on one hand, and poor incomes and a weak human development record, on the other. The Philippines is vulnerable to taunts by her ASEAN neighbors: "If you are so smart, why are you poorer than us?" As shown in Table 1, the Philippines in 1999 had better adult literacy rates, combined enrolment ratios, and education indices than Malaysia, Thailand, Singapore, Hong Kong, Chile and Mexico. Yet these latter countries have higher per capita GDPs, GDP indices, and human development indices. The Philippines may have an education index of 0.91 in 1999 but its per capita GDP (PPP US\$) was only \$3,805 and had only 0.749 as its human development index. In contrast, Malaysia may have a lower education index of 0.80, but its per capita GDP, however, at \$8, 209 is more than twice that of the Philippines. At the other side of the Pacific Ocean, Mexico also had a lower education index of 0.84 but its per capita GDP was \$8,297 and human development index stood at 0.790 in 1999.

Of the several countries represented in Table 1.1, only South Korea and Argentina had better education indices, per capita GDPs, and human development levels than the Philippines.

**Table 1.1:
Education, Income, and Human Development (Selected Countries),
1999**

	Adult Literacy Rate (%) age 15 & above	Combined primary secondary and tertiary gross enrolment ratio (%)	GDP per capita (PPP US\$)	Education index	GDP index	Human Development Index
Philippines	95.1	82	3,805	0.91	0.61	0.749
Thailand	95.3	60	6,132	0.84	0.69	0.757
Malaysia	87.0	66	8,209	0.80	0.74	0.774
Singapore	92.1	75	20,767	0.87	0.89	0.876
Hong Kong	93.3	63	22,090	0.83	0.90	0.880
South Korea	97.6	90	15,712	0.95	0.84	0.875
Indonesia	86.3	65	2,857	0.79	0.56	0.677
China	83.5	73	3,617	0.80	0.60	0.718
Vietnam	93.1	67	1,860	0.84	0.49	0.682
Chile	95.6	78	8,652	0.90	0.74	0.825
Mexico	91.1	71	8,297	0.84	0.74	0.790
Argentina	96.7	83	12,277	0.92	0.80	0.842

Source: UNDP (2001), Human Development Report

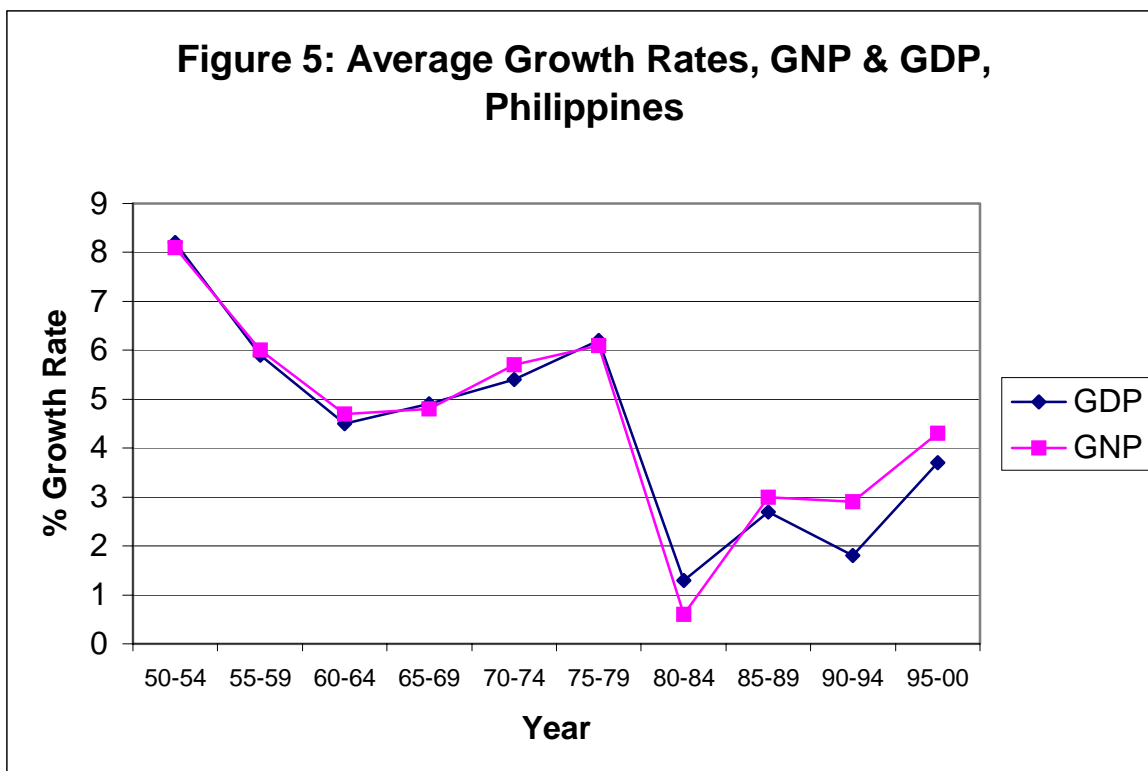
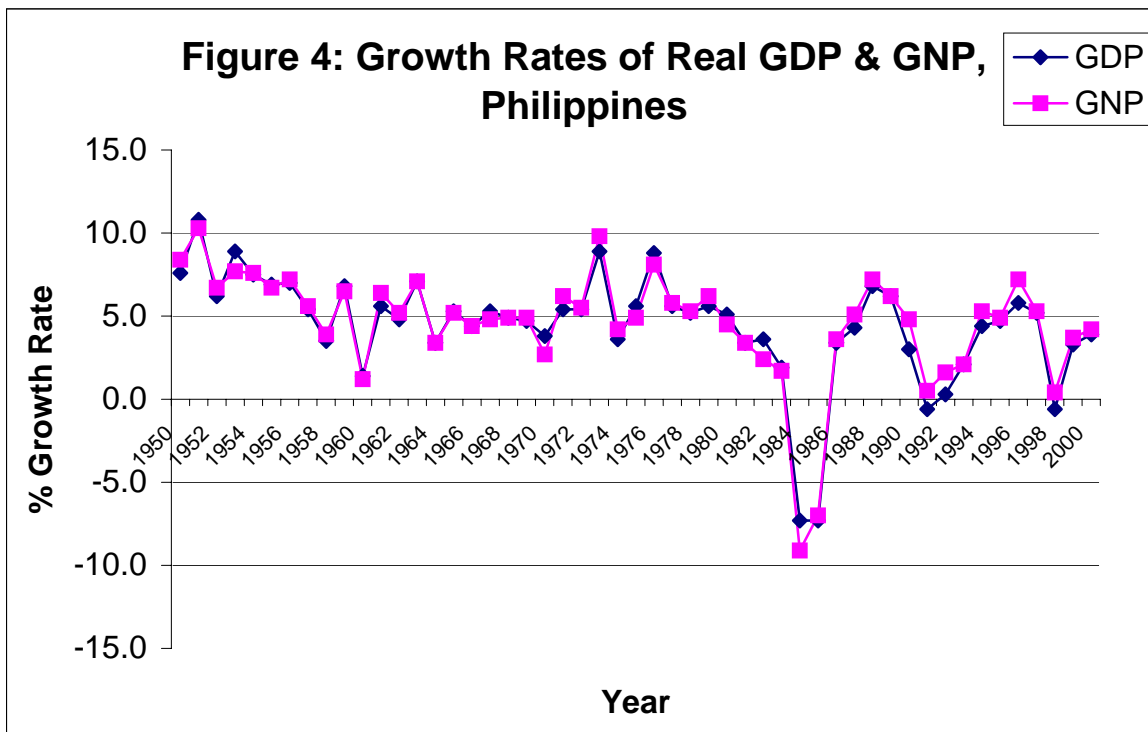
Upon the assumption of office by President Fidel V. Ramos in 1992, the economic growth record improved leading some to believe that the boom-bust days of the country's economy were a thing of the past. Growth and high confidence had been attained and officials started to boast that the Philippines was "back in the world's radar screen" (after languishing in the backwaters during the second half of the 1980s as a coup-prone, crime-ridden banana republic and after basking in the limelight because of the unprecedented peaceful ouster of the Marcos dictatorship in February 1986) and that its economy was now a "tiger cub" or a "baby dragon". Notice that the animal metaphors were all derived from the successful East Asian economies. Then came the Asian financial crisis of the late 1990s, wrecking havoc to the entire region with the El Niño and La Niña phenomena contributing to the devastation. A full-blown economic crisis has brought once again the country to its knees.

The financial crisis clipped the wings of the Ramos administration, then poised to tinker with the Philippine constitution (after the coming out party that was the 1996 APEC summit held in the Philippines) to allow Ramos to run for a new term as Philippine president. The economic turmoil may have convinced many Filipinos to try a

former-actor-turned-populist politician Joseph “Erap” Estrada as the nation’s next chief executive in 1998. During the abbreviated Estrada presidency, the country’s growth began to falter anew. Earlier, Ramos managed to get the economy out of a minor recession during the dying years of President Corazon Aquino’s presidency (February 1986-June 1992). The average annual GNP growth rate during the Ramos term, which included the height of the Asian financial crisis, was 4.4 percent. The Estrada average was a lower 4.16 percent and total factor productivity dropped to -2.37 in 1999, after a year and a half of Estrada’s leadership from a new high of 3.03 reached in 1995. (See appendix TFP tables)

In contrast therefore to almost all of the other country studies in the East Asian region, the task of the writers of the Philippine country paper is to explain the lack of growth or the non-sustainability of economic growth in the country over the past half century. As Figures 4 and 5 would show, the country’s growth followed a boom-bust pattern over a rather flat long-term trend with the average growth rates on a definite downtrend after a very promising start in the late 1940s. The best GDP/GNP growth for the half-century (1950-2000) was registered in 1951 at double-digit figures (10.8 percent/10.3 percent). The growth figures during the immediate post-war reconstruction years were even better or even spectacular. However, the 1946-1949 period should be considered an aberrant period since growth was achieved from an extremely low economic base in a country deemed to have suffered the worst destruction next only to Poland during the last world war. The best performance for the succeeding decades moved in the single-digit 6-9 % range. We must therefore write the story why and how, as Hutchcroft (1998) puts it, the Philippines got trapped in the “development bog” or why the country is now dubbed a “democratic dud” by Pritchett (2001) that suffers in comparison to Vietnam’s “socialist star”.⁵

⁵ In his comparative analysis of their economic performance in the late 1980s and the 1990s, Pritchett (2001) is struck by the paradox that the country (i.e., the Philippines) whose policies and institutions best fit today’s conventional wisdom (i.e., democratic polity, market reforms, etc.) is doing poorly, while the one with divergent institutions (i.e., Vietnam) does very well.



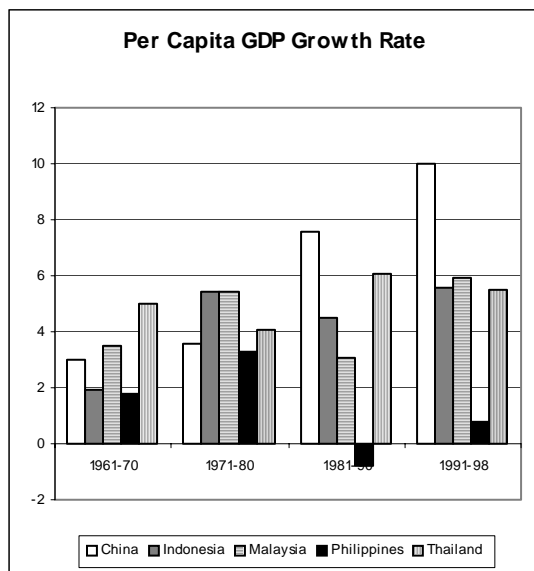
As discussed in the next section, the Philippines compared to other East Asian countries has fared poorly in poverty alleviation and reduction. Thus, the country lags behind the region in both economic and human development. Poverty alleviation in the Philippines depends largely on the country's economic growth performance. Lack of sustained growth is behind a rather lackluster (compared to regional neighbors) human development record (Ahuja *et al.* 1997; Lim 1999).

1.2 Growth and human development over the long-term⁶

It is widely accepted that economic growth is necessary for development (Collas-Monsod 1998; Collas-Monsod and Monsod 1999; Fujisaki, 1999). A large body of evidence supports the view that countries that achieved the most rapid progress in alleviating absolute poverty were the ones that managed to sustain rapid growth of average income (Balisacan 1999a; 1999b; Fujisaki 1999).

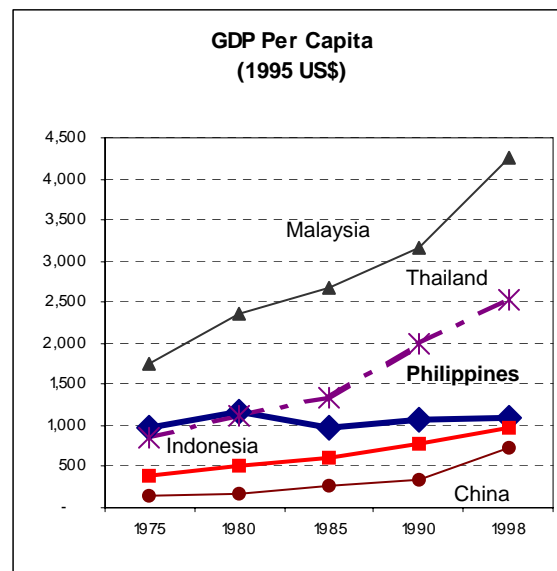
Similar logic explains why poverty is more widespread and more persistent in the Philippines than in neighboring ASEAN countries. Gerson (1998) reports that poverty incidence in the Philippines declined at an average annual rate of 0.7 in the last 25 years⁷, compared to 0.9 in Korea, 1.4 in Thailand, 1.6 in Malaysia and 2 in Indonesia. It is interesting to note that in the same period, real GDP in the Philippines grew only by about half of the growth rate of its neighbors (see Figures 6 and 7), barely exceeding population growth. This supports the view that the country's poor progress in poverty reduction may be traced to its poor growth performance (Balisacan 1999a; Gerson 1998).

Figure 6



Source: World Bank (2000).

Figure 7



Source: UNDP (2000).

⁶ This section was written by Ms. Hazel Malapit of the UP School of Economics.

⁷ Researchers have raised concerns regarding the accuracy and comparability of pre-1985 poverty indicators due to methodological inconsistencies (Boyce, 1993; Collas-Monsod, 1998).

1.2.1 Absolute poverty⁸

Nevertheless, World Bank (2000) observes that the country achieved more than what its growth record warranted – a direct result of the pro-poor policies pursued since the return of democracy in 1986. Over the 12-year period, the number of people living below the poverty line⁹ was reduced from 41 percent in 1985 to 25 percent in 1997. Poverty depth and severity have likewise improved significantly. (Table 1.2)

Table 1.2:
Recent Evolution of Poverty, 1985-1997

	Incidence	Depth	Severity
1985	40.9	13.2	5.8
1988	34.4	10.1	4.2
1991	34.3	10.6	4.5
1994	32.1	8.7	3.4
1997	25.0	6.4	2.3

Source: Table 1.1, World Bank (2000:7)

World Bank (2000) estimates a rising elasticity of poverty to growth for the Philippines. Between 1985 to 1997, poverty incidence declined by about 1.57 percentage points for every point increase in the growth rate, compared to a decline of 0.26 in the period 1960-1985. These estimates confirm that other factors may have contributed to make growth more pro-poor.

⁸ The most common poverty measure used is poverty “incidence,” or the *head-count index*, which simply counts the proportionate number of the population whose income/consumption fall below a defined poverty line. Another familiar measure is poverty “depth”, or the poverty-gap index, defined as the average income shortfall of the poor as a proportion of the poverty line. This index measures the minimum amount needed to eradicate poverty given perfect information on income shortfalls. However, this measure is insensitive to a redistribution of income within the poor group. To measure the distribution of living standards among the poor, the “severity” index is used, defined as the mean of squared proportionate poverty gaps. Poverty measured using this index falls when a transfer of income takes place from a poor household to a poorer one. (Balisacan, 1999a; 1999b)

⁹ Poverty indices reported here are based on the “fixed level of living” (FLOL) approach, which controls for living standards across regions/areas and years. These indices necessarily show lower levels of poverty incidence, depth and severity compared to the official measures produced by the NSO because the official approach systematically underestimates the impact of growth on absolute poverty. For an extensive discussion of the methodology, see Balisacan (1999a).

Table 1.3:
Evolution of Poverty by Sector of Employment, 1985-1997

(% of population)	1985	1988	1991	1994	1997	1985-97 change
Agriculture	57.7	51.2	51.9	49.9	42.3	-17.38
Industry	32	23.8	25	22.4	16.8	-29.41
Services	21.8	17.6	16.8	15.1	10.6	-39.77
Others	21.6	19.5	16.8	17.2	12.1	-37.95
Total	40.9	34.4	34.3	32.1	25.0	-27.33
<i>Rural population only:</i>						
Agriculture	60	53.3	55.2	52.5	44.8	-15.95
Non-agriculture	38.7	31.8	35.7	32.2	23.6	-25.79
Total (Rural)	53.1	45.7	48.6	45.4	36.9	-19.26

Source: Table 1.20, World Bank (2000:22).

The bulk of the recent progress in poverty reduction was felt by those employed in services and other sectors, while agriculture workers, especially those in the rural areas, benefited the least (Table 1.3).

A recent study by Balisacan (1999a) uses simple counterfactual experiments to demonstrate the impact of recent growth in reducing poverty in the Philippines. His estimates show what would have been the change in poverty measures if, in a given period: (i) all groups had shared equally in the growth that occurred; and (ii) no growth occurred. The first experiment reflects the growth component of a poverty change, which shows the change in the poverty measure if the pie (per capita income) grew and the increase in the pie is shared equally. The second experiment reflects the redistribution component, which shows what the poverty measures would have been if the pie remained the same. Put differently, if some groups became poorer or richer even while sharing the same pie, then there must have been changes in the way the pie was shared.

The results of these experiments show that the 9.3 percentage point reduction in poverty incidence between 1985 and 1994 was almost entirely contributed by growth in average incomes (Table 1.4).

Contrary to popular views that the recent episodes of growth have not benefited the poor, Balisacan's findings show that, as in East Asia, poverty in the Philippines has been quite responsive to economic growth. Thus, the relatively high level of poverty in the Philippines is primarily due to the shortness of growth periods, and the slowness of this growth (Balisacan 1999a; 1999b).

Table 1.4:
Decomposition of Poverty Change

	Total Poverty		
	Change	Growth	Redistribution
Incidence			
1985-1988	-6.46	-6.15	-0.31
1988-1991	0.43	-3.12	3.55
1991-1994	-3.27	-1.07	-2.20
1985-1994	-9.30	-10.34	1.04
Depth			
1985-1988	-3.13	-2.62	-0.51
1988-1991	0.54	-1.28	1.82
1991-1994	-1.18	-0.43	-0.75
1985-1994	-3.77	-4.33	0.56
Severity			
1985-1988	-1.69	-1.29	-0.40
1988-1991	0.37	0.61	0.98
1991-1994	-0.56	-0.21	-0.35
1985-1994	-1.88	-0.89	0.23

Source: Table 3, *Balisacan (1999b:103)*.

Note that the finding that economic growth in recent years has benefited the poor is a stark contrast to earlier findings for the 1960s and 1970s when the ‘trickle down’ effects of growth on poverty were comparatively small (Balisacan 1999b; World Bank 2000; Boyce 1993).

1.2.2 *Income inequality*

Relative poverty trends, as measured by income distribution tell a slightly different story. Gini ratios¹⁰ between 1985 and 1997 show slightly increasing income inequality, as opposed to the achievement in poverty alleviation. Over the longer term, between 1957 and 2000, the Gini coefficient barely changed, ranging from a low of 0.445 in 1988, to a high of 0.513 in 1961. (Table 1.5)

Looking at the ratio of incomes for the top and bottom quintiles, there has been a significant deterioration of the distribution of income over the entire period. In 2000, the top quintile earns about 12.5 times the bottom quintile, about two-thirds more than the multiple in 1957.

¹⁰ The Gini ratio ranges from 0 and 1. A value of 0 represents perfectly equal income distribution.

Table 1.5:
Income Distribution in Selected Years, 1957-2000

	1957	1961	1965	1971	1985	1988	1991	1994	1997	2000
Gini coefficient	0.461	0.497	0.513	0.494	0.447	0.445	0.468	0.451	0.487	0.482
Percent of income, top 20 percent	48.6	56.5	56	54	52.1	51.8	53.9	51.9	55.5	54.8
Percent of income, bottom 20 percent	6.5	4.2	3.5	3.6	5.2	5.2	4.7	4.9	4.4	4.4
Ratio of incomes, top 20/bottom 20	7.5	13.5	16.0	15.0	10.0	10.0	11.5	10.6	12.6	12.5

Sources: Gerson (1998:2); 2000 FIES (www.census.gov.ph).

However, Gerson (1998) notes that while the country's progress in poverty reduction has been slow by Asian standards, its failure in improving income distribution is not unique in Asia. The same countries applauded for their dramatic achievements in poverty reduction have not realized a large decline in their Gini ratios in recent decades. Instead, it appears that these countries have reduced their poverty rates by increasing incomes for all income groups. Again, this suggests that slow growth, rather than inequality, may be the primary cause of persistence of poverty in the Philippines.

Table 1.6:
Gini Coefficients in Selected Asian Countries

	Years	First Year	Last Year
Philippines	1957-2000	0.461	0.482
Indonesia	1964-99	0.333	0.317
Korea, Rep.	1953-93	0.340	0.316
Malaysia	1970-97	0.500	0.492
Thailand	1962-98	0.413	0.414

Sources: Gerson (1998:2); 2000 FIES (www.census.gov.ph); UNDP (2001).

1.2.3 Population and demographic trends

Unabated population growth has been touted as among the most important hurdles to progress in poverty reduction (World Bank, 2000). Although population growth rates have been on a downtrend over the last few decades, the Philippines still has a high fertility rate by Asian standards (Table 1.7). The relatively high rate of demographic expansion makes the task of increasing per capita incomes more difficult. Moreover, the increasing population magnifies the challenge of providing food, health care and education.

Table 1.7:
Demographic Trends, Selected Countries

	Total population (millions)			Annual population growth rate (%)		Total fertility rate (per woman)*	
	1975	1999	2015	1975-99	1999-2015	1970-75	1995-2000
Philippines	42.0	74.2	95.9	2.4	1.6	6.0	3.6
Indonesia	134.6	209.3	250.1	1.8	1.1	5.2	2.6
Malaysia	12.3	21.8	27.9	2.4	1.5	5.2	3.3
Thailand	41.1	62.0	72.5	1.7	1.0	5.0	2.1
Singapore	2.3	3.9	4.8	2.3	1.2	2.6	1.6
East Asia & Pacific				1.5	0.8	5.0	2.1

Source: UNDP (2001).

*Estimates for the period specified.

1.2.4 Trends in the Human Development Index (HDI) and income

The Human Development Index (HDI), developed by the UNDP, is a broader indicator of development, which considers poverty in critical dimensions other than income. It is a composite of three outcomes: health, proxied by life expectancy; knowledge, proxied by functional literacy; and standard of living, as measured by real per capita income.¹¹

An examination of the cross-country trends in HDI and per capita income reveals that the Philippines has performed better than the other countries in terms of translating income into human development (Collas-Monsod and Monsod, 1999).

Table 1.8 shows that between 1975 and 1998, Philippine real per capita GDP increased by only 12 percent, while real GDP in other countries grew by at least 143 percent. At the same time, improvement in human development was also the slowest, growing by only 15 percent over the period versus at least 22 percent for the next slowest country.

¹¹ The methodology used to derive the HDI and other related indices (i.e. HPI, GDI, and GEM) are discussed in the Human Development Report (UNDP, 2001).

Table 1.8:
Trends in Human Development and Per Capita Income,
Philippines and Selected Countries (1960-1999)

	Philippines	Indonesia	Malaysia	Singapore	Thailand	China
HDI						
1975	0.648	0.465	0.620	0.725	0.600	0.518
1980	0.682	0.526	0.663	0.756	0.643	0.548
1985	0.685	0.578	0.696	0.785	0.673	0.584
1990	0.713	0.619	0.725	0.823	0.708	0.619
1998	0.744	0.670	0.772	0.881	0.745	0.706
% change 1975-1998	14.8	44.1	24.5	21.5	24.2	36.3
GDP per capita (1995 US\$)						
1975	974	385	1,750	8,722	863	138
1980	1,166	504	2,348	11,709	1,121	168
1985	967	603	2,664	14,532	1,335	261
1990	1,064	778	3,164	19,967	2,006	349
1998	1,092	972	4,251	31,139	2,539	727
% change 1975-1998	12.1	152.5	142.9	257.0	194.2	426.8
HDI Change/GDP per capita change	1.2	0.3	0.2	0.1	0.1	0.1

Source: UNDP (2000).

However, relative change in HDI with respect to the relative change in per capita income was highest in Philippines—1.2 compared to 0.3 for the next highest country. These figures imply that Philippines got more human development gain for every point change in income – a higher income elasticity of human development. This finding is consistent with the observation that poverty reduction in the Philippines has improved more than its growth record warranted (World Bank, 2000).

While trends in HDI gives an indication of how the Philippines fared in terms of the three aspects of poverty, an analysis of other indicators of health, education and standard of living is necessary to explain the country's human development performance. Table 1.9 presents a snapshot of other indicators of capabilities and opportunities for the six countries in the mid-90s.

1.2.5 Trends in Capabilities: Education and Health

While education and health outcomes are ends in themselves, they are also means to attaining higher standards of living. Thus, improvements in education and health increase the productivity of the economy by creating a more productive workforce—a positive externality. The emphasis on human capital investments has been said to be the key to the “East Asian miracle,” allowing these economies to continuously increase output per capita (Lim, 1998; Collas-Monsod and Monsod, 1999).

Table 1.9:
Other Indicators of Capabilities and Opportunities
Philippines and Selected Countries

Indicators	Year	Philippines	Indonesia	Malaysia	Singapore	Thailand	China
Education							
Primary school completion rate (%)	1993	70	77	96	100	87	85
Pupil-Teacher ratio:							
Primary	1992	34	23	30	26	17	22
Secondary	1992	33	14	19	22	18	15
Health							
Access to health services	1990-95	71	93	na	na	90	88
No of persons per physician	1995	9,689	7,028	1,865	665	4,260	633
Daily per capita protein supply (g)	1994	52	60	64	na	53	73
Daily per capita calorie supply	1994	2,424	2,616	2,785	2,929	2,387	2,834
Employment							
Unemployment rate	1986-90	8.1	2.6	6.9	3.2	2.6	2.6
	1991-94	8.7	2.4	3.5	1.9	1.9	2.5
Employment share (%)							
Manufacturing	1995	10	11	25	24	12	18
Agriculture	1995	44	51	19	-	57	53

Source: Table 5, Collas-Monsod and Monsod (1999:65).

Since the 1970s, most East Asian countries showed improvements in the social indicators, although improvements for the Philippines were still smaller (Lim 1999). In the 80s and 90s, one could say that the Philippine educational system succeeded in its most basic mission: functional literacy rate has risen from 73% in 1989 to 84% in 1994. Moreover, enrollment in primary education has been near universal, enrollment in secondary education has reached the level of “mass education,” and tertiary level enrollment is comparable to that of developed countries. However, while literacy rates and enrollment rates for the Philippines have always been high, other indicators of quality such as completion rates and pupil-teacher ratios lag behind its neighbors.

Comparative data on education presented in Table 1.9 show alarming results. About 30 percent of children drop out of primary school – at least double the dropout rates for comparator countries with the exception of Indonesia. Studies have shown that educational attainment is negatively correlated with poverty, implying that these primary school dropouts are prime candidates for poverty (Collas-Monsod and Monsod 1999; World Bank 2000). Similarly, the Philippines registered the highest pupil-teacher ratios in the group, implying a lower quality of education. These findings have serious implications regarding the future quality of the Philippine labor force.

The health indicators presented in Table 1.9 unanimously show lower levels of health care access and quality for the Philippines relative to the comparator countries. Whether or not these figures represent an improvement over time is difficult to determine

because Philippine health surveys have been sporadic and are not always comparable due to differences in methodologies and definitions (Boyce 1993).

However, data on life expectancies and infant mortality show slow but steady improvements over the long term. UNDP (2002) reports that life expectancy at birth improved by 18 percent over the last three decades, from 58.1 years in 1970-75, to 68.6 years in 1995-2000 (Table 1.10). Data on infant mortality show a similar trend, from 60 deaths per 1,000 births in 1970 to 30 per 1,000 births in 2000 (Table 1.11).

Table 1.10:
Life expectancy at birth (years)

	1970-75	1995-2000	change
Philippines	58.1	68.6	18%
Indonesia	49.2	65.1	32%
Malaysia	63	71.9	14%
Thailand	59.5	69.6	17%
Singapore	69.5	77.1	11%

Source: UNDP (2002).

Table 1.11:
Infant Mortality Rate (per 1,000 live births)

	1970	1988	1989	1991	1992	1994	1998	2000
Philippines	60	44	44	42	44	36	32	30
Indonesia	104	84	73	68	58	53	40	35
Malaysia	46	24	23	15	13	12	9	8
Thailand	74	38	27	28	37	29	30	25
Singapore	22	9	8	7	6	5	4	4

Sources: Table 25, Yap (1998:89); UNDP (2000; 2002).

Economists have noted that the lackluster performance of the Philippines in education and health is an indication that the Philippines have not given human capital development the same importance as other East Asian countries (Collas-Monsod and Monsod 1999; Lim 1998; Gerson 1998). This can partly explain why the Philippines did not enjoy the same quality of growth as its neighbors.

Public spending on education over the last fifteen years, both as a share of GNP and as a share of total government spending, have lagged behind the comparator countries (Tables 1.12 and 1.13). Malaysia and Thailand, in particular, devoted a substantial amount of resources to education especially in the late 80s. In terms of health, however, Philippine public spending as a share of GDP is at par with its neighbors.

Table 1.12:
Public Expenditure Shares, Selected Countries

	Education (% of GNP)			Health (% of GDP)	
	1985-87	1990	1995-97	1990	1998
Philippines	2.1	2.9	3.4	1.5	1.7
Indonesia	0.9	1.0	1.4	0.6	0.7
Malaysia	6.9	5.5	4.9	1.5	1.4
Thailand	3.4	3.6	4.8	1.0	1.7
Singapore	3.9	3.0	3.0	1.0	1.2
Southeast Asia & Pacific	na	na	3.3	1.0	1.2

Source: UNDP (2000; 2001).

Table 1.13:
Public education expenditure
(% of total govt expenditure)

	1985-87	1995-97
Philippines	11.2	15.7
Indonesia	4.3	7.9
Malaysia	18.8	15.4
Thailand	17.9	20.1
Singapore	11.5	23.3

Source: UNDP (2002).

Gerson (1998) noted that, for many years, public investment in human capital in the Philippines was both low and inefficiently allocated, thus it had a limited effect on poverty and inequality. Moreover, the composition of spending is biased towards secondary and university level education, and tertiary-level health care.

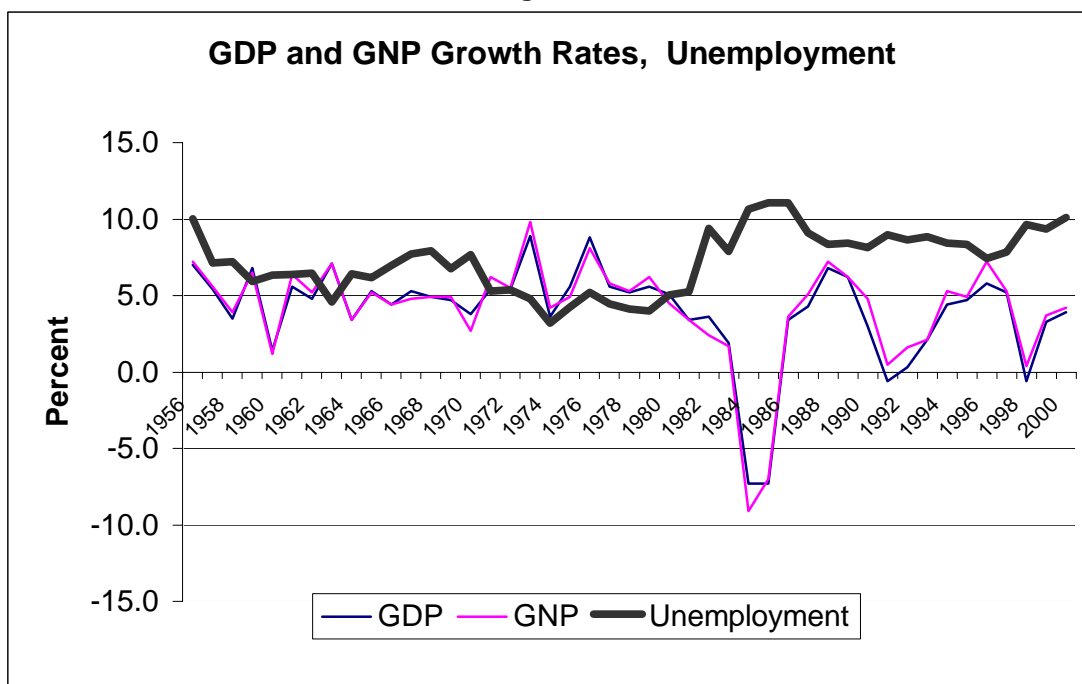
Overall, it appears that the country has not been able to match the human capital investments made by other countries over the last few decades. This puts a cap on the ability of the labor force to take advantage of opportunities and move to high-productivity sectors.

1.2.6 Trends in Opportunities: Employment

The failure of growth to “trickle down” to the poor in the Philippines emerges most clearly from an examination of trends in employment (Boyce 1993). Unemployment rates, although not perfectly comparable among countries, give an indication of the extent to which opportunities have expanded or stagnated for the poor, whose most abundant asset is their labor.

Between 1986 and 1994, unemployment rates in the Philippines are not only higher than in other countries, they have also been rising, while those in other countries are falling (Table 1.14). Over the longer term, Philippine unemployment rates have generally remained between 5 to 10 percent (Figure 8), bottoming out in the mid-70s and hitting a high in the mid-80s. Interestingly, unemployment rates have not always declined during boom times, especially during the 60s when growth was said to have come from expansion in capital-intensive rather than labor-intensive industries. In the 90s, unemployment rates have been steady near the 10 percent mark, seemingly oblivious to the boom and bust cycle.

Figure 8:



Source: National Statistical Coordination Board

More important than the quantity of jobs generated by growth is its quality. Jobs in the formal sector (wage employment) are perceived to be of better quality compared to those in the informal sector (e.g. own-account workers) in terms of remuneration and job security. The share of manufacturing employment in total employment is used as a proxy for the size of the formal labor market since informal sector workers are mostly employed in the agriculture and service sectors (Collas-Monsod and Monsod 1999). Looking at the figures in Table 1.14, it appears that employment opportunities for the poor are most limited and are of lesser quality in the Philippines compared to the other countries.

In the last decade, unemployment has ranged from 7.4 percent in 1996 to 10.1 percent in 2000. While unemployment rates are already high by any standard, taking into account both unemployment and underemployment gives an even more vivid picture of

the unused labor resources in the Philippines (Table 1.14). About a third of the country's labor resource has yet to be unleashed.

Table 1.14:
Economic Growth, Unemployment, Underemployment and Flexible Work, 1991-2000 (in percent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP Growth Rate	-0.6	0.3	2.1	4.4	4.7	5.8	5.2	-0.6	3.3	3.9
GNP Growth Rate	0.5	1.6	2.1	5.3	4.9	7.2	5.3	0.4	3.7	4.2
Unemployed	9.0	8.6	8.9	8.4	8.4	7.4	7.9	9.6	9.6	10.1
Underemployed	22.5	20.5	21.7	21.4	19.8	19.4	20.8	23.7	21.9	19.9
Total Labor Underutilization	31.5	29.1	30.6	29.8	28.2	26.8	28.7	33.3	31.5	30.0
Part-time, casual, contractual, piece rate & task rate workers	17.5	20.6	20.1	18.5	22.9	22.2	na	na	na	na

Sources: NSCB, DOLE Yearbook, various years; 1991-1996, ILO (2001:7); 1997-2000, Labor Force Survey, various years (www.census.gov.ph).

1.3 Summation

It is quite clear from the above discussion that despite a favorable initial start, the Philippine economy went into an erratic boom-bust gyration since it was granted independence in 1946 up to the end of the 20th century. This gyration apparently mirrors the Republic's rather turbulent and checkered socio-political history of corruption, dirty elections, dictatorship, communist and secessionist insurgencies, massive brain and brawn drains to North America and the Middle East, failed coups, rising criminality, and two, not just one, unprecedented People Power 'revolutions'.¹²

Every boom period was aborted and the growth spurts were rather short. While on the long haul, growth rates were still positive, they were decelerating across the decades. The worst contraction was experienced during the last years of the Marcos dictatorship after the Philippine was touted internationally as the next "dragon economy". While growth rates and incomes recovered in the late 1980s and 1990s, the ground lost has yet to be recovered. For this reason, human development in the country lagged behind the record of its neighbors. However, and this is an important point, this rather dismal summation must be qualified to note that the Philippines got more "human development bang" for its "income buck" and that its poverty reduction has improved

¹² The failed urban poor explosion, properly called People Power or EDSA III, fortunately happened in May 2001 and is not included in our study period. Nonetheless, the pro-Estrada insurrection was obviously a response to EDSA II that toppled President Estrada from power. To this rather long list of man-made 'calamities', one should add the numerous killer-typhoons, earthquakes, and volcanic eruptions (including one that happens only once every 600 years, i.e., 1991, that has caused periodic lahar flows in the Central Luzon plains that threaten to engulf major cities in the region) that obviously had adverse effects on productivity and the country's physical capital stock.

more than its growth record warranted. For a country hungry for good news, this fact may give more than a small consolation.

Part 2: Understanding Philippine Economic Growth

This version date: 17 September 2002

2.1 Introduction

Nobel laureate Simon Kuznets characterizes economic growth as secular swings over a long time span. Unfortunately, the Philippine economic data series are not lengthy enough to identify these long secular variations. However, this does not mean that the study of Philippine economic growth is not interesting. Over the past fifty years, the Philippines had been experiencing a growth pattern characterized by booms and busts. Growth economists would dismiss this phenomenon as nothing unusual by arguing that economic growth is not linear but rather a cyclical pattern over a positively sloped trend. What makes the study of Philippine economic growth interesting is the explanation why growth had been fluctuating over a rather flat long-term trend.¹

In this part, a subsequent section reviews some of the existing Philippine literature on the measurement of economic growth, economic policy regimes, the development of markets, and social issues related to economic growth². The next section proposes a simple framework for explaining Philippine economic growth and development. Section 3 gives a general overview of the Philippine economy. A more detailed analysis of the causes of the cyclical fluctuations follows in the fourth section. The last section supplements the discussion in Section 4. It reviews briefly the relationship between fiscal and monetary investment behavior and identifies shifts in sectoral employment. It also estimates total factor productivity (TFP) of the Philippines. The TFP estimates are compared with estimates done by other authors as well as the TFP estimates of other ASEAN economies. The impact of economic liberalization on TFP growth is likewise examined. No summation is included in this part of the paper; the said summation is presented in the third part of this paper.

2.2 A Framework for Explaining Economic Growth

The study of Philippine economic growth can be approached from two perspectives. The first approach is to quantitatively decompose Philippine growth. This decomposition can either be factor decomposition, which measures the contributions to growth according to factors of production, *i.e.*, labor and capital, and computes total factor productivity, or a sectoral decomposition, which decomposes aggregate output into the contributions of demand-side and supply-side sectors.

¹ The long-term trend is an absolute level and it is flat for the Philippines. While Philippine economic growth rates are positive, they are decelerating over the decades. If growth rates were negative, meaning if the economy was consistently contracting across time, the long-term trend will be downward sloping. This clarification emerged in the dialogue between the authors, one a political scientist and the other an economist and practitioner.

² The review of the existing literature on growth is provided in Appendix 1.

Factor decomposition is done by estimating a production function:

$$(1) \quad Y_t = A_t f(K_t, L_t),$$

where Y is aggregate output, K is capital stock, L is labor and A is total factor productivity. Usually a Cobb-Douglas specification with constant returns to scale is used for the production function:

$$(2) \quad Y_t = A_t K_t^\beta L_t^{1-\beta},$$

where β is the factor share of capital. Total factor productivity growth is estimated us the identity:

$$(3) \quad \hat{a}_t = \hat{y}_t - \beta \hat{k}_t - (1 - \beta) \hat{l}_t,$$

where the lowercase variables with a "hat" in equation (3) correspond to the growth rate of the uppercase variables in the previous equation. In the actual estimation, capital service and quality-adjusted labor are used.

Sectoral decomposition is done by computing for the weighted growth rates of demand and supply components. Suppose X_i is a component of X and $X = \sum_{i=1}^n X_i$. The weighted growth rates can be computed as:

$$(4) \quad \tilde{x}_i = \frac{X_i}{X} \frac{dX_i / dt}{X_i},$$

where \tilde{x} represents the weighted growth rate of X_i such that $(dX / dt) / X = \sum_{i=1}^n \tilde{x}_i$. By using weighted growth rates, the growth rate of demand and supply components of aggregate output are appropriately scaled by their share in the latter.

The second approach is to identify the economic policy regimes and environment over the period of study. Political economy issues can likewise be included here. It is also important to understand the development of resource allocation mechanisms within the economy. A key ingredient of economic growth is the efficiency in resource mobilization and allocation. Economic literature more than often finds that mobilization and allocation of resources by a central planner is hardly Pareto optimal. The market, absent of distortions, will always be better. Hence, it is important to understand the evolution of markets, and to what extent did the different policy regimes affect them. We can then go back to the growth estimates and match them with the economic policy regimes and milestones in the evolution of markets. Thus, we can arrive at explanations for the quantified growth parameters.

2.3 An Overview of the Philippine Economy, 1946 to 2000

Economic growth in the Philippines has drawn much attention as the economy has progressed at a very slow pace over the past five decades despite a very promising start. Although ravaged by war, the prospects for the Philippines were bright in the early post-war period. However, the succeeding decades reveal an economy that is unable to sustain growth and perennially plagued by a boom-bust cycle. This section investigates the factors that have contributed to the under-performance of the Philippine economy over the long haul.

2.3.1 *Initial economic conditions in post-war Philippines*³

Similar to its pre-war condition, the Philippines, after the Second World War, was essentially agriculture- and service-based, with both sectors accounting for nearly 80 percent of the economy. Post-war reconstruction increased the shares of both investment and construction in the gross domestic product (GDP). Growth rates registered in 1947 for both aggregate demand and supply components were tremendously high due to the low production base that emerged from wartime. However, real output in most agricultural, forestry, fishing, mining and manufacturing activities were below their pre-war levels. Goldstein (1962) showed that, on a per capita basis, recovery was only achieved in 17 of 52 farm activities, 2 of 7 mining and quarrying activities, and in 11 of 26 manufacturing activities. Post-war farm production between 1948 and 1949 was 68 percent of the average levels from 1937 to 1939.

Weak export production and high dependence on imports was notable in the immediate post-war period. A trade deficit of \$271 million was registered in 1946. Financing of this deficit mainly came from US government expenditures that led to an inflow of \$119 million. The remainder was funded by drawing upon and depleting international reserves. Due to the low state of productive capacity, the investment rate in 1946 was lower than the saving rate. The early pre-war period was in a deflationary setting with prices contracting by 6.32 percent between 1946 and 1949.

³ The discussion on the evolution of the Philippine economy from the Spanish colonial period up to the Second World War is provided in Appendix 2.

Table 2.1
Initial Conditions

	Initial Conditions	
Real Sector	<u>Share to GDP (% , 1946)</u>	<u>Growth Rate(% , 1947)</u>
Private Consumption	68.89	45.41
Government Consumption	4.95	117.39
Gross Investments	23.52	76.47
Fixed Investments	18.81	86.53
Exports	7.15	468.05
Imports	15.48	456.23
Agriculture	40.37	31.14
Industry	20.87	74.66
Manufacturing	7.13	101.93
Construction	11.30	72.59
Services	38.76	29.25
GDP		39.49
External Sector		
Trade Balance (\$M)	-271.00	
Other Payments, net (\$M)	-29.00	
US Government Expenditures, net (\$M)	119.00	
Errors and Omission (\$M)	-26.00	
Net Change in Int'l Reserves (\$M)	-207.00	
Exchange Rate (P/\$)	2.00	
Monetary Sector		
Inflation (% , 1947-49 average)	-6.32	
Money Growth (% , 1949)	-6.82	
Saving and Investment		
Saving Rate (%)	26.16	
Investment Rate (%)	23.52	

Source of basic data: National Accounts of the Philippines, International Financial Statistics

2.3.2 Structural Shifts in the Philippine Economy

Between 1946 and 1949, agriculture and services (mainly trade and financial services) comprised more than 70 percent of the economy. During the 1950s when policies geared towards industrialization were initiated, the share of the manufacturing sub-sector to GDP jumped by almost 10 percent, making it account for more than a fifth of total output. With services maintaining its share in production, a shift in the structure

of production is observed from agriculture to industry. As industrialization policies continued in the 1960s, the shifts from agriculture to industry continued. By the 1970s, the transition toward a greater industrial share in the aggregate production was completed with its share in GDP averaging 37 percent over the decade. After industry's share reached its peak in 1983 at 41 percent of GDP, a shift from industry towards services is observed. By the mid-eighties, the share of industry fell to 35 percent, mainly due to the contraction in the construction industry. During the same period, the service sector reached 40 percent of GDP. While industry was able to maintain its share in production at 35 percent in the 1990s, the share of agriculture in GDP continued to shrink causing the share of services in GDP to average 44 percent during the same decade.

Table 2.2
Sectoral Share to GDP by Decade (%)

	1947-49	1950-59	1960-69	1970-79	1980-89	1990-00
Agriculture	36.81	32.46	29.69	25.92	23.49	21.43
Industry	26.70	29.96	32.14	37.43	37.63	34.97
Mfg.	11.93	21.31	25.13	27.96	25.92	25.05
Services	36.49	37.58	38.17	36.65	38.88	43.60

Source of basic data: National Accounts of the Philippines

There are some stylized facts that need to be highlighted. First, the services sector has always played a major role in the Philippine economy. Since independence, the services have accounted for at least 36 percent of GDP. While shifts in agriculture and industry have occurred, the service sector had either maintained or increased its share in total production. Second, the shift from agriculture toward industry was a conscious policy thrust during the early years of the Republic. In contrast, the shift toward more service sector production in later years was the result of a sharp crisis that hit the country in 1983 to 1985. While broadening the industrial sector remains a policy thrust, it is observed that services continue to be the lynchpin of the economy in recent decades.

Similar attributions can be made with respect to weighted growth rates. While agriculture accounted for a larger part of economy in the early post-war years until the 1950s, its contribution to growth has been the lowest among the three major sectors. Until the 1970s, industry has been providing the growth impetus. The service sector, on the other hand, has been a stable contributor to growth over the past half century. In fact, it has been the principal source of growth during the last two decades.

Table 2.3
Weighted Growth Rates (%)

	1947-49	1950-59	1960-69	1970-79	1980-89	1990-00
Private Consumption	17.57	4.91	3.58	3.13	2.03	2.84
Government Consumption	2.91	0.33	0.40	0.60	0.09	0.24
Gross Investments	5.62	1.11	1.09	2.20	-0.23	0.60
Fixed Investments	5.21	0.91	0.96	1.74	0.11	0.69
Exports	12.45	0.75	0.77	1.43	1.73	2.70
Imports	28.15	-2.30	1.58	1.32	1.61	2.93
Statistical Discrepancy	10.50	-2.33	0.43	-0.25	0.00	-0.56
Agriculture	5.70	1.91	1.25	0.96	0.38	0.34
Industry	8.43	2.41	1.63	2.93	0.26	0.90
Mining	0.20	0.13	0.06	0.09	0.05	-0.01
Manufacturing	5.54	2.31	1.32	1.81	0.31	0.65
Construction	2.62	-0.07	0.20	0.85	-0.22	0.10
Utilities	0.08	0.05	0.04	0.18	0.12	0.16
Services	6.75	2.74	1.81	1.90	1.37	1.64
GDP	20.88	7.07	4.69	5.79	2.01	2.88

Source of basic data: National Accounts of the Philippines

2.3.3 Cycles in Philippine economic history

An examination of the cyclic movements of the Philippine economy since 1946 may be instructive. The Hodrick-Prescott (HP) filter is applied to extract the long-term trend from actual values of GDP.⁴ Figure 2.1 shows the difference between the actual and trend GDP from 1946 to 2000. Before moving to the analysis of the economic cycles, it is worth noting that the average long-term growth of GDP has been falling through the decades, as shown in Figure 2.2. This indicates that the performance of the economy has been weakening through the decades.

⁴ In their study of business cycles in post-war United States, Hodrick and Prescott (1997) used this filter to obtain a smooth estimate of the long-term trend component of a time series. The HP filter is a linear filter aimed at removing low frequency variation from series. In its implementation, a smoothing parameter is chosen to balance the trade-off between lack of smoothness and poor fit of the trend. In this study, a smoothing parameter of 100 was used in obtaining the long-term trend of GDP.

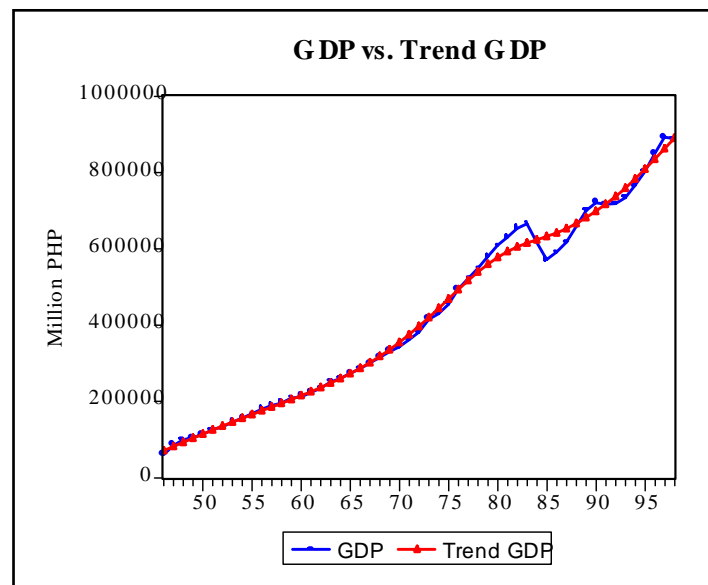


Figure 2.1

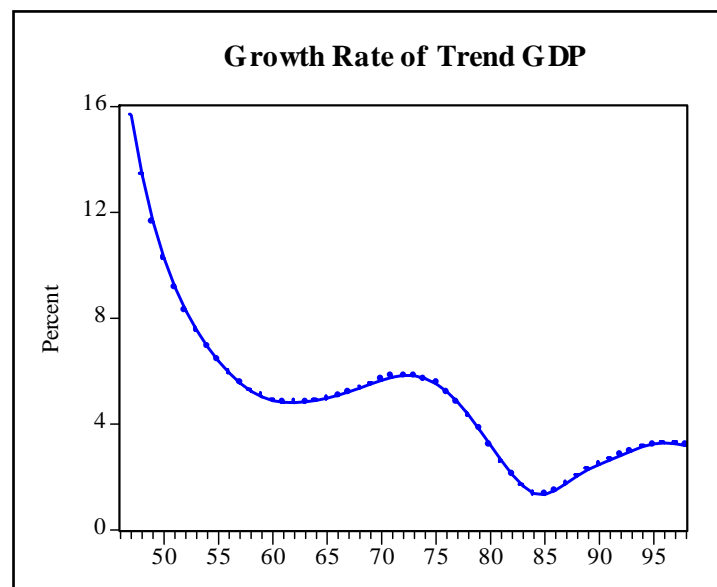


Figure 2.2

Economic cycles can be identified through the deviation of actual GDP from its trend value (Haywood 1973). Following Haywood's characterization of the deviation cycle, starting at the peak, the first phase would be a slowdown followed by a contraction. After the bottom of the cycle, the economy starts its recovery phase by increasing at an accelerating rate before decelerating and reaching its next peak. A stronger than normal expansion is a boom period while a stronger slowdown is a recession. Figure 2.3 shows the percentage deviations of actual GDP from trend GDP. It is clearly seen that the Philippines follows a rather quite cyclical pattern of growth. Between 1946 and 2000, six cycles can be identified. The first cycle starts with the

strong growth in the post-war reconstruction period followed by a slowdown in 1949 and a period of erratic growth in the next three years. The next cycle starts in 1953 as the economy shifts into import substituting industrialization. The economy again stalls by 1957 and a period of erratic growth similarly follows until 1961. A damped cycle occurs between 1962 and 1972 when the government experimented with a flexible exchange rate regime. Modest growth was being achieved until slowdown was triggered towards the end of the 1960s. The next cycle starts in 1973 and ends in 1985. A period of rapid expansion occurs between 1973 and 1980 despite the oil crises. A slowdown commences in 1981 culminating in a deep economic crisis between 1983 and 1985. The economy recovers in 1986 only to fall into a mild recession between 1990 and 1992. Another recovery commences in 1993 only to falter to the adverse effects of the 1997 Asian financial crisis, adverse weather conditions, and governance problems in the late 1990s.

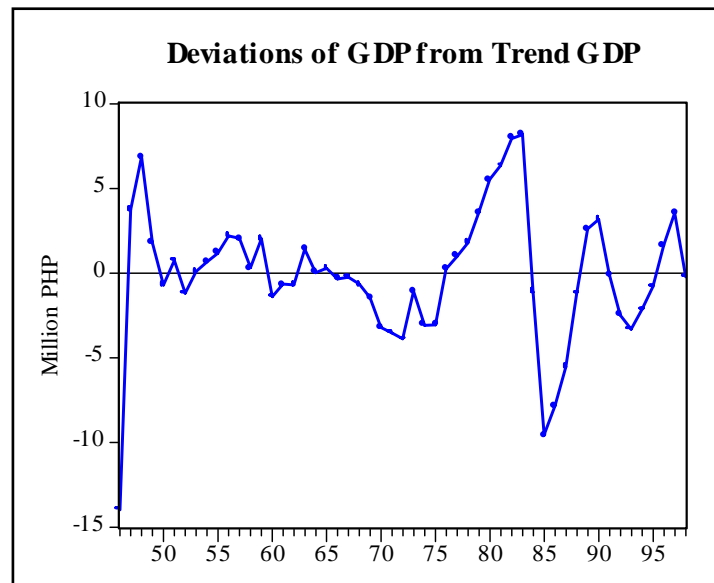


Figure 2.3

Two stylized facts of the Philippine economy are recognized, and may be quite problematic from a growth perspective. First, the pattern of growth in the Philippines has remained cyclical over the past half century. Furthermore, most of the cycles have been quite short. The occurrence of these cycles implies that growth is not being sustained and major policy changes will have to be adopted to break these cycles. Significant interruptions in economic growth precipitated by a balance of payments (BOP) crisis occurred in 1949, 1958-60, 1970, 1974, 1983-85, 1990-92, and in 1997-98. While a number of the BOP crises can be traced to adverse external shocks such as war in the Middle East and the consequent increases in crude oil prices, and the Asian financial crisis, political phenomena such as extremely expensive and/or fraudulent electoral elections (in 1949, 1957, and 1969), political turmoil generated by an over-staying dictator, festering Communist and secessionist insurgencies and the assassination of a key

opposition leader (in 1983), and policy short-sightedness and errors—almost always figures among the precipitants of economic slowdowns.

The typical pattern of a boom-bust cycle runs like so: “a few years of moderate economic growth are followed by shortages of foreign exchange, making it necessary to cut back on government spending and contract money supply, thus halting the growth episode. A period of partial adjustment follows, and the growth cycle resumes once the foreign exchange constraint is eased, with the government typically feeling freer to resort to deficit spending. As a result, the growth episodes have closely followed a periodization according to major balance of payments crises. Although different factors may immediately precipitate these crises, they are ultimately traceable to the economy’s failure to earn enough foreign exchange to pay for the imports (both productive inputs and final goods) associated with rising output and incomes” (De Dios 1998: 50).

Second, average long-term growth has been declining through the decades. This suggests instead of achieving a higher growth path, the Philippines has been doing the opposite. Its growth trajectory has been falling, thus mitigating any prospects for high growth. In the following section 2.5, the causes of the muted and cyclical growth will be explained. But first a short note on growth and the Philippine political economy.

2.3.4 *Growth and the Philippine political economy*

Most of the more perceptive Philippine watchers agree that the nature and character of the country’s political economy will account for much of the reasons why the Philippines has failed to develop. A good number of economists have pointed to the inappropriateness of economic policies adopted over the decades as the main culprit. The greater task remains: why were these erroneous and inappropriate policies adopted in the first place, especially since they were clearly inefficient?

Various interpretations of Philippine political economy (McCoy 1994; Hutchcroft 1998; Sidel 1995), share a common emphasis on the characteristics determining the likelihood of the “capture” of the state and its instrumentalities by vested interests based on political “clans”—the so-called ‘weak state-strong society’ thesis (Migdal 1988). Notwithstanding a certain amount of dissatisfaction and subsequent amendments, most views have developed from an earlier tradition in Philippine political literature that came to be known as the ‘factional model’ of Philippine politics (e.g., Lande 1965). In this reading, the economic elite is seen as being divided into various factions formed out of historical alliances based on kinship and patronage. Factions are thought to be based on the political and economic power of local, meaning sub-national, elites, referring originally to agricultural land ownership. The resulting patron-client relationships cut across lines of social class; allied local interests and influences were then successively consolidated upwards and ultimately found their expression in political factions contending periodically for direct control of government.

The only possible significant exception to this characterization is the episode of authoritarianism under Marcos, from 1972 to 1986, when the power of local interests was

weakened with the suppression of Congress and regular elections, which had served as the traditional channels for their expression.

The post-dictatorship period, beginning with the restoration of democratic institutions in 1986, is broadly regarded as a return to the previous era, although recent changes in economic structure, demography, culture, and the occurrence of economic crises as well as the growth of new social movements and so-called ‘civil society’ have suggested that clan-based patron-client relations may be beginning to weaken. In particular, the previous understanding that the indispensable basis for such politics was the system of large traditional land-holdings has become increasingly under question (Sidel 1995; Rivera 1995; Mendoza 1997). Most would nonetheless concede that, although weakened, clan-based patron-client relations that have long influenced the country’s political economic landscape are still present.

The intensity of political contests in the Philippines stems from the fact that the government disposes a significant amount of resources and exercises discretion over a wide sphere. The implicit goal of elite struggles is to control the state’s machinery and resources and to skew their deployment to favor specific interests. Powerful incentives then work to persuade incumbents to retain power indefinitely in order to protect such interests. Conversely, turnovers—whether electoral contests or more fundamental challenges to legitimacy, such as attempted coups—may be viewed as chances to attain or to retain this power.

The economic costs occasioned by such regimes can be seen to be large a priori. First are the obvious losses from competitive rent seeking, as factions seek to build their capacities to compete for dominance. The larger the prices are (which could turn on the scope of the government’s influence over resource allocation) and the more evenly-matched factions are, the greater is the likely dissipation of resources in terms of lobbying, maintaining retinues of followers, and so on. These losses from classical rent seeking result from the diversion of resources towards unproductive or purely dissipative uses, where these could have been invested or allocated more efficiently.

Further losses apart from those occasioned by rent seeking may arise as investment is discouraged by political uncertainty. In this respect, two potential effects of democratic, decentralized regimes in raising investment uncertainty may be distinguished.

- One effect owes to the greater challenge to authority even in periods between regime turnovers—in short, internal uncertainty to investors brought on by the diffusion of power (through the system of checks and balances) even without a regime change. For instance, a government contract approved by the executive can be challenged at the legislature or at the Supreme Court. The Supreme Court’s decision in the mid-90s to nullify the sale of the historic Manila Hotel to a group of Malaysian investors (in favor of a group of Filipino-Chinese businessmen) on the grounds of “protecting the national patrimony” is a major case in point.

- A second source of uncertainty is regime turnovers. This uncertainty results from possibly large changes in policies, ranging from reversals of broad policy initiatives to alteration of contracts. The threat of victory by hostile factions may be viewed as leading to unsettling changes in policies that further raise the cost and the risk of investing. Potential political challengers may threaten to reverse the results of transactions accomplished under the incumbent administration once they come to power. The possible shift in policy consequent to turnover represents additional uncertainty and a discouragement to investment.

Uncertainty about policy is not experienced only with overstaying dictators but also with democratic polities. Investments may have dipped during the last years of the Marcos dictatorship. But they likewise tend not to be forthcoming during the penultimate years of an incumbent president as well as the initial years of a new presidential regime. Investors tend to hold back during these periods and investments resume only when the policy directions are clear.

Noting the paradox between the “democratic dud” (the Philippines) and the “socialist star” (Vietnam), Pritchett (2001) suggests that countries that are in the process of escaping from ‘low-level poverty traps’ (e.g. Vietnam) may be fundamentally different compared to middle-income countries (e.g. the Philippines). Apparently, the policies required to initiate a transition from a low-income equilibrium to a state of rapid growth may be qualitatively different from those required to re-ignite growth for an MIC. At low income levels, it may be relatively easier, with reasonable institutions and policies, to achieve high growth in a low-income country (LIC). However, the institutional requirements for re-starting growth in an MIC can be significantly more demanding. Pritchett observes that per-capita GDP in the Philippines remains lower than its 1982 level (as can be seen in Figures 1, 2 and 3 in Part 1), even though institutional quality (with the re-democratization started in February 1986) has increased significantly. He speculates that the trouble may be that uncertainty about the rebuilt institutions (understood in Douglass North’s sense as ‘rules of the game’) has increased. During the Marcos dictatorship, there was lesser policy uncertainty even if the probability of policy change is higher compared to democracies given that a single leader determines key policy directions.⁵ With the restoration of democracy, political actors who were previously inert during the lingering dictatorship will now have a say in policy. The sudden change (even if for the better) increases investor uncertainty. Thus the

⁵ With a single decision-maker (or veto player) in a dictatorship, the probability of policy swings is great but the danger of policy rigidity is low. In contrast, the presence of many veto players in a democracy increases the danger of policy rigidity. The good scenario will look like this: if the dictatorship adopts a set of pro-growth policies, then social welfare is enhanced, *ceteris paribus*. If the dictator initially adopted anti-growth policies, there is a greater probability of policy change because it takes only one person to decide. The bad scenario looks thus: if a democratic polity adopts anti-growth policies, there is a greater possibility of policy ossification because of the multiplicity of political players and therefore, social welfare is adversely affected. Your best bet therefore for democratic polities is for them to adopt a good set of policies. Once these policies are in place, they may prove difficult to scuttle. Unfortunately, policies that prove to be efficacious in a particular place and time may not be useful even in the same place but with a different time frame. The proper balance between policy consistency and policy flexibility is apparently the key to sustained growth in any jurisdiction.

uncertainty that accompanies comprehensive but poorly managed institutional change (consider the greater instability during the Aquino presidency compared to the first half of the Marcos dictatorship) is a key roadblock to sustained economic growth (Rodrik 2001).

Another view explaining policy inconsistency within and across regimes is supplied by Rivera (1995) who argued that the non-completion of elite differentiation, or what he calls “elite inter-penetration” is the key. Landlord interests also went into real estate, manufacturing, banking and finance, and foreign trade such that no clear policy consensus may be reach vis-à-vis agrarian reform, dismantling of monopolies, the foreign trade regime, exchange rate policy, and many more. These factors may help explain why export interests have been weaker and entrepreneurship less defined in the Philippines than say, Thailand.

However, the problem for such closed readings of the Philippine political economy is explaining how the rapid pace of economic (though not yet social) reforms in the 1990s can have occurred without the outbreak of large social conflicts or realignments. There are two options: one casts doubts on the permanence of the changes that have taken place (this view was strengthened by the backsliding during the Estrada presidency) since the countervailing (against vested interests) social coalition to support these same changes is either absent or weak. The other admits the possibility that vested interests are fluid and can be redefined by changing external circumstances as well as simply by learning.

2.4 Explaining the Cyclical Growth Pattern

The persistence of a cyclical growth pattern for the Philippine economy can be attributed to many factors ranging from political and policy instability to external shocks and internal man-made disasters. What follows are analyses of the six cycles that the economy experienced over the past 55 years. The identified cycles are the following:

1. 1946-1952, the post-war reconstruction period;
2. 1953-1961, the import substitution period;
3. 1962-1972, the period of initial experiments of flexible exchange arrangements;
4. 1973 – 1985, the period of sharp swings;
5. 1986 – 1992, the period of institution rebuilding; and
6. 1993 – 2000, the period of economic integration.

2.4.1 *The 1946-1952 Cycle: the post-war reconstruction period*

The 1946-1952 period was essentially the highest growth period during the last 55 years. The average growth for this period reached 14.54 percent. The high growth can readily be attributed to the low production base that resulted from the Second World War. The period can be further divided to two sub-periods: (1) 1946-1948 and (2) 1949-1952.

The 1946-1948 sub-period can be considered as the post-war reconstruction years. GDP growth averaged 28 percent during this sub-period. Again, this was due to the almost non-existent economy immediately after the war. Agriculture and services expanded rapidly during this period. Industry likewise expanded largely due to an understandable surge in construction and manufacturing. In terms of aggregate demand, growth was essentially driven by consumption expenditures. Export growth likewise surged during this period, primarily because of the Philippine Trade Act of 1946, also known as the Bell Trade Act, which provided a ready market for Philippine primary commodities in the US market. Post-war reconstruction likewise required substantial investments. During the sub-period, the average weighted growth of investment reached 12 percent.

Table 2.4
Weighted Growth Rates (%), 1947-52

	1947-48	1949-52
Private Consumption	20.70	6.72
Government Consumption	3.86	0.62
Gross Investments	12.31	-2.28
Fixed Investments	10.46	-1.67
Exports	23.18	-0.56
Imports	34.76	-3.52
Statistical Discrepancy	2.88	-0.30
Agriculture	7.41	2.30
Industry	12.82	1.69
Mining	0.22	0.23
Manufacturing	6.63	2.68
Construction	5.88	-1.27
Utilities	0.08	0.05
Services	7.94	3.74
GDP	28.17	7.72

Source of basic data: National Accounts of the Philippines

However, high growth masked the economy's weakness. Although exports grew substantially, they were limited to a few products. Desiccated coconut, copra, abaca and cordage exports accounted for nearly 80 percent of total exports. In addition, growth in exports was limited by the maintenance of the P2 to \$1 pre-war parity. The maintenance of a cheap dollar, together with the dollar bonanza arising from US government expenditures fostered massive importation during the period. Consequently, the balance of trade worsened during the period. The trade deficit during this sub-period averaged at around 8.9 percent of GDP. Although US government expenditures were substantial, these were not enough to cover the trade deficit. The Philippine government had to draw from its international reserves to pay for the shortfall. By 1948, international reserves had fallen to \$402 million from \$647 million at the end of 1945. Anticipating balance of payment problems, Republic Act No. 330 was legislated in July 15, 1948 authorizing the President to impose a system of import control to take effect in 1949. An economic slowdown was becoming imminent.

Table 2.5
Balance of Payments (\$M), 1945-49

	1945	1946	1947	1948	1949
Exports	1	64	265	318	260
Imports	29	335	588	674	673
Balance of Trade	-28	-271	-323	-356	-413
Other Payments, net		-29	21	-24	-55
US Government Expenditures	284	119	335	339	324
Errors and Omissions		-26	-16	4	-16
Net Change in International Reserves	256	-207	17	-37	-160

Source: Bell Mission Report

Table 2.6
External Sector Indicators, 1947-52

	1947-48	1949-52
Trade Balance/GDP (%)	-8.90	-3.58
GIR less Gold (\$M)	402.75	250.00
GIR less Gold in Months of Import	8.33	6.94

Source of basic data: National Accounts of the Philippines, International Financial Statistics

The 1949-1952 sub-period was characterized as an era of import controls. A system of import controls was imposed in January 1, 1949 but had almost no impact. More controls, such as the imposition of quota limitations, were resorted to. However, massive importation persisted. By 1949, the trade deficit as a ratio of GDP was at a high of 10.6 percent and international reserves dwindled to \$233 million putting the economy on the verge of a balance of payments (BOP) crisis. That year, GDP growth fell to 6.32 percent from 16.8 percent in 1948 and 39.5 percent in 1947. Instead of an upward adjustment of the exchange rate, government responded with the institutionalization of import and exchange controls. Republic Act No. 426, also known as the Import Control Law, was passed in 1950 that ended presidential authority to impose import controls and set limitations on imports. An Import Control Board was created instead to classify imports in order to reduce the level of importation by 1953, when the law was scheduled to lapse. Under the Import Control Law, the surrender of export receipts to the central bank became necessary. The severity of the import controls together with the continued US government expenditures and remittance of war reparations resulted in the build up of the international reserves to safer levels.

The slowdown in 1949 was followed by erratic growth from 1950 to 1952, mainly due to volatile performance of agriculture and construction. Manufacturing was consistently growing but at a declining rate. The initial high growth rates in the supply components might be due to the low production base as the country emerged from the devastation of war. From the demand-side, on the average, it was only consumption that

was growing strongly. Capital formation and exports registered negative weighted growth rates, although the severe import controls also reduced the leakage to growth arising from imports. Due to import controls, the trade deficit to GDP ratio fell to an average of 0.88 percent between 1950 and 1951. Hence, the government was able to maintain international reserves at \$250 million, equivalent to more than six months of imports.

The factors that led to the first boom-bust cycle in post-war Philippines are quite apparent. First, high growth cannot be sustained if solely and largely anchored on high consumption growth. While this dominating effect of consumption is true for many countries (and is not the reason for non-sustainability), the weakness of capital formation and exports mitigates capacity building and introduces resource constraints that may cause growth to slacken in the future. Thus, broadening the sources of growth from the demand-side, particularly investments and exports, is necessary. Finally, the sustainability of Philippine economic growth depends on the ability to ease foreign exchange constraints. A structure of production that exhibits high dependence on imported inputs and whose output does not generate foreign exchange receipts will always be subject to cyclical growth patterns as foreign exchange constraints become crippling. In the next five boom-bust cycles, similar observations will be repeated implying a chronic and deep structural problem in the Philippine economy.

2.4.2 The 1953-1961 Cycle: the import-substitution period

The next cycle occurs between 1953 and 1961. From 1953 to 1957, there was a rapid expansion of the economy, with GDP growing by 7.17 percent. Realizing that a strong industrial base is necessary for growth, the intensification of the import substitution as an inherent part of economic policy was pursued during this particular sub-period. As the Import Control Law lapsed in 1953, the central bank took over import controls. Import controls were relaxed but were made to favor selected industries. This was to complement the import substitution program, which has its roots as far back as 1946 with the enactment of Republic Act No. 35 (which provided tax incentives to new and necessary industries). This amounted to a subsidy to manufactures. Republic Act No. 901, enacted in June 1953, expanded the range of tax exemptions from internal revenue taxes to all taxes. It also extended the applicability of the full exemptions until 1958. The said tax exemptions are to be gradually reduced until 1963. Between 1949 and 1959, the number of product lines exempt from taxes reached 1,021, with the years 1955 to 1957 accounting for more than a half of this total. With the exchange and import controls and tax incentives, the import-substitution policy took shape and led to the expansion of the manufacturing sector. Foreign exchange inflows due to Japanese war reparations and sales proceeds from US Public Law 480 were used to subsidize industrialization. The central bank likewise set up a permissive credit policy to support import substitution.

The import substitution years saw rapid growth in the Philippines, making it one of the top economic performers in Asia. From 1953 to 1956, GDP growth averaged nearly 8 percent. A slight dip was registered only in 1957 when GDP growth dropped to

5.41 percent as foreign exchange constraints manifested anew through a BOP crisis. Capital accumulation likewise improved with the weighted growth rate of investments almost reaching almost 2 percent, a reversal of the negative weighted growth rates from 1949 to 1952. The weighted growth rate of industrial value added to GDP increased by 1 percent compared to the 1949-1952 sub-period. The weighted growth rate of manufacturing, although below the average during the aberrant immediate post-war period, was at 2.4 percent, higher than the average weighted growth in the subsequent forty-odd years after 1961.

Table 2.7
Weighted Growth Rates (%), 1953-61

	1953-57	1958-61
Private Consumption	5.50	3.13
Government Consumption	0.28	0.36
Gross Investments	1.98	0.82
Fixed Investments	1.76	0.52
Exports	0.15	0.47
Imports	2.39	-0.75
Statistical Discrepancy	1.65	-1.22
Agriculture	1.80	1.27
Industry	2.69	1.28
Mining	0.08	0.01
Manufacturing	2.36	1.38
Construction	0.19	-0.14
Utilities	0.06	0.03
Services	2.67	1.76
GDP	7.17	4.31

Source of basic data: National Accounts of the Philippines

Table 2.8
External Sector Indicators, 1953-61

	1953-57	1958-61
Trade Balance/GDP (%)	-2.16	-1.16
GIR less Gold (\$M)	155.90	76.26
GIR less Gold in Months of Import	3.78	1.53

Source of basic data: National Accounts of the Philippines, International Financial Statistics

With the push for import substitution, the weighted growth rate of exports dropped to a mere 0.15 percent. This validated the notion that the import substitution program adopted was geared toward the production of domestic consumer goods and was

biased against exports. Leakage due to imports, on the other hand, increased to 2.4 percent due to rise in the importation of essential producer goods. The trade balance as a ratio to GDP worsened from -1.9 percent in 1952 to -3.2 percent in 1955.

By 1957, there were indications that rapid economic growth could not be sustained. With relaxed import controls, the import substitution programs fostered the rapid importation of essential producer and consumer imports. At the same time, the policy was biased against exporters. The trade deficit had swelled to 3.4 percent of GDP. This made the economy vulnerable to a BOP crisis. Also, the import substitution strategy in itself led to a diversified manufacturing sector but there were no apparent efficiency gains. The system of controls provided too much economic rent and profit to manufactures that there was a proliferation of product lines with relatively small value added. These factors made the high growth process unsustainable. By 1957, the economy experienced its second BOP crisis in less than a decade. International reserves had fallen to \$65 million in that year. Once more, foreign exchange regulations were tightened. Also, a highly protective tariff code, which lowered customs duties on essential consumer, raw material and producer goods and raising those for non-essentials, was enacted in the same year.

Consequently, the 1958-1961 sub-period witnessed the re-imposition of import controls. These policies eased the foreign exchange constraint. By 1959, the economy recovered and grew by 6.8 percent and the worsening of the trade deficit was diminished. However, the same controls led to an uncertainty in business, which persisted until the end of the 1950s. Black market exchange rates were twice the official rate. In April 1960, the central bank launched its first experiment on foreign exchange decontrol by adopting a multiple exchange rate system. The exchange decontrol was hardly genuine as foreign exchange was still not allocated via the market. Recovery was short-lived as the economic growth fell to 1.4 percent in 1960.

On the average, growth during the 1958-1961 sub-period dropped to 4.3 percent. The same drop was reflected in all components of aggregate demand. The weight growth rate of imports fell to -9.8 percent. There too was an across-the-board reduction weighted growth rates of contribution to growth by agriculture, industry and services.

Apparently, the main reasons for the failure to sustain the 1953-1957 growth were again binding foreign exchange constraints. Instead of unimpeded importations as in the first cycle, the depletion of the foreign exchange reserves was caused by a mix of policies, i.e., the import substitution policy, the easing of import controls and the maintenance of an overvalued currency, which were biased against exports.

2.4.3 The 1962-72 Cycle: the period of initial experiments with flexible exchange rate regimes

The third cycle is characterized by more serious experiments on exchange rate and industrial policies by the government. Unlike the previous cycle, the 1962-1972 cycle had damped oscillations with no observable and significant boom and bust. Instead the

first part of the cycle, 1963-1969, is more of stable rather than high growth. The first three years of the period show volatile growth, moving from 4.77 percent in 1962, up to 7.06 percent in 1963 and down to 3.45 percent in 1964. In the next five years, growth stabilizes at the 4.7-5.3 percent range. The floating of the peso and favorable terms of trade averted the BOP crisis that could have ensued in the following year.

When a new government led by President Diosdado Macapagal entered office in 1962, a more authentic step toward foreign exchange decontrol was made. In January 22, 1962, the system of allocating foreign exchange was terminated and replaced by a system of fluctuating rates. The exchange rate was allowed to float and the allocation of foreign exchange was done principally through the market. In November 6, 1965, the exchange rate was however re-pegged at P3.90 to \$1. Exports grew at a rapid pace during this period, partly brought about by increased global demand for primary goods. During the early part of the period, this addressed the widening trade deficit. However, even with foreign exchange decontrol, exporters were still discriminated against with a multiple exchange rate system. Prior to 1965, they had to surrender 20 percent of their proceeds to the central bank at P3.52/\$ with the rest of the proceeds bought at a higher market rate. Likewise, due to its import substituting character, the devaluation had a negative effect on manufacturing sector growth. Clearly, there was an inconsistency in exchange rate and industrial policies. In November 6, 1965, the exchange rate was re-pegged at P3.90 to \$1, ending the country's first experiment with a flexible exchange rate regime. Between 1962 and 1966, the trade deficit as a percentage of GDP improved.

Industrial policy, however, remained biased against exports and favored import substitution. In 1961, recognizing the deficiencies of the tax exemption system to "new and necessary industries" crafted in the previous decade, Republic Act No. 3127, or the Basic Industries Act was passed into law. However, the new law was too broad such that the many of the "new and necessary industries" already in existence were also covered. Two years later, amendments were introduced to correct the broadness but it only ended up replacing 12 industries with 10 new ones. Republic Act No. 5186, otherwise known as the Investment Incentives Act, was enacted in 1967. This legislation had a divestment clause, which strengthened the local market orientation of foreign investments. Import substituting policy was reinforced. In addition, the expansionary monetary policy in 1966 encouraged more imports. By 1967, the trade deficit began to bloat again. Instead of devaluing the currency, import controls were reintroduced. The government likewise opted to finance the deficit through foreign borrowings and drawings from international reserves. Also, import-substituting industrialization encouraged more short-term borrowing. The surge in infrastructure spending during the early years of President Ferdinand Marcos led to deficit spending likewise financed by foreign debt. By 1966 and 1967, short-term liabilities was around 60 percent of foreign debt. From 1960 to 1969, external liabilities rose six-fold from \$71 million to \$434 million. Compounding the problem were weak exports and decline in US government expenditures. The import substituting industrial policies' bias against exports led to worsening of the trade deficit as a ratio to GDP to range between 3 and 4 percent from 1967 to 1969. Again, another BOP crisis was emerging in 1969 with international reserves falling to \$76 million.

As partial compliance to the conditionalities of the International Monetary Fund (IMF) for a stand-by loan to help the country cope with the BOP crisis, the peso was floated in February 21, 1970. This was accompanied by tighter fiscal and monetary policies designed to curtail inflationary pressures. Inflation, however, persisted. Devaluation together with high inflation fueled civil unrest and opposition to the government. This made the 1970-1972 sub-period a tumultuous era politically, leading to the declaration of martial law in 1972.

The foundations for an export-led industrialization strategy were laid out during the 1970-1972 sub-period. The first major economic legislation to support exports was passed in the 1970 with the enactment of the Republic Act No. 5145, otherwise known as the Export Incentives Law. This was followed by the passage into law of the Foreign Trade Zone Law. Together with the de facto devaluation of the peso, which allowed greater profitability for exporters, these legislative measures boosted exports by providing counteracting incentives to lessen the bias against exports that had been built over the previous decades. Noticeably, during this period, the weighted growth rate of exports to GDP growth jumped to 2 percent compared to the less than 0.5 percent in the previous two decades.

Table 2.9
Weighted Growth Rates (%), 1962-72

	1962-69	1970-72
Private Consumption	3.66	2.34
Government Consumption	0.37	0.73
Gross Investments	1.26	0.34
Fixed Investments	1.16	0.11
Exports	0.74	2.00
Imports	1.62	-0.29
Statistical Discrepancy	0.57	-0.82
Agriculture	1.33	0.92
Industry	1.84	2.26
Mining	0.08	0.10
Manufacturing	1.45	1.84
Construction	0.26	0.21
Utilities	0.05	0.11
Services	1.82	1.70
GDP	4.99	4.88

Source of basic data: National Accounts of the Philippines

The shifts in industrial and exchange rate policies were reflected in the weighted growth rates. In the 1962-1969 sub-period, capital formation regained steam with an average weighted growth rate of 1.3 percent, more than a fourth of average GDP growth.

Investments were particularly strong in 1963 and 1964, the immediate years after the currency float, and 1967, the enactment year of the Investment Incentives Act. Exports likewise increased its contribution to growth particularly during the period of the currency float. This, however, slackened and even turned negative, when the currency was re-pegged in 1965. In the 1970-1972 sub-period, the floating of the peso and enactment of export promotion laws, together with favorable terms of trade, pushed exports as the principal contributor to growth. The currency adjustment also drastically cut the growth leakage from imports. Consequently, net exports had positive and high contributions to growth. The policy changes may have also led to the turnaround in industrial sector. Throughout the whole cycle, there were significant improvements in the performance of industry and manufacturing.

Table 2.10
External Sector Indicators, 1962-72

	1962-69	1970-72
Trade Balance/GDP (%)	-2.07	-1.42
GIR less Gold (\$M)	101.87	327.93
GIR less Gold in Months of Import	1.42	3.25

Source of basic data: National Accounts of the Philippines, International Financial Statistics

The story for the 1962-1972 cycle remained the same as the previous two cycles. The sustainability of Philippine growth depended on its ability to ease the foreign exchange constraint. The country was able to prevent a potentially deep crisis in 1970 by allowing the currency to float. Also, the events during this period highlight the shift in the mindset of the policymakers—the turn to foreign debt to ease any binding foreign exchange constraint.

2.4.4 *The 1973-1985 Cycle: the turbulent martial law years*

This period is the most turbulent one in Philippine political and economic history. The declaration of martial law in September 1972 represents a radical break from formal democratic processes of the Third Philippine Republic (1946-1972), which includes the first two electoral terms of President Marcos, and ushers in a 14-year reign of Marcos as dictator. From an initial strong expansion, the economy falls into a deep economic crisis. There are three sub-periods during the dictatorship: (1) 1973-1980, (2) 1981-1982, and (3) 1983-1985.

1973 was a very favorable year for the Philippines in terms of international trade. Global economic conditions were very conducive to growth. The strong world economy boosted Philippine exports, allowing the country to register its first trade surplus since independence. GDP grew 8.9 percent during that year. This ushered a sense of stability and strength for the martial law government enabling it to enjoy a modicum of political support domestically and internationally. Except for the drastic adjustment in 1974 due to the first oil crisis, high growth was maintained till the end of the decade.

The 1973-1980 sub-period is considered a boom era for the Philippine economy. GDP growth averaged 6.05 percent over eight years, despite the two oil crises. It started off very strong in 1973 when GDP grew 8.92 percent due to a very favorable global environment. During the sub-period, consumption remained the top growth driver. However, growth was more broad-based as investments and exports expanded. The contribution of capital formation increased to 2.49 percent unlike the previous period where it barely exceeded 1 percent. The investment rate for the period averaged more than 22 percent, the highest since the post-war reconstruction period. A major factor contributing to the surge in investments was the utilization of foreign debt to finance these expenditures. From the supply-side, the contribution of industry rose to 3.06 percent, although manufacturing only had a contribution of 1.71 percent. Construction was strong during the sub-period, particularly in 1975 and 1976, as the regime went into an international convention center and five-star hotel construction binge in preparation for the holding of the 1976 annual joint meetings of the World Bank and the IMF in Manila.

Table 2.11
Weighted Growth Rates (%), 1973-85

	1973-80	1981-82	1983-85
Private Consumption	3.40	1.98	-0.08
Government Consumption	0.52	0.17	-0.45
Gross Investments	2.49	1.48	-5.02
Fixed Investments	2.37	2.18	-4.34
Exports	1.99	-0.23	-0.80
Imports	2.40	0.23	-2.95
Statistical Discrepancy	0.05	0.35	-0.86
Agriculture	0.98	0.52	-0.47
Industry	3.06	1.45	-3.37
Mining	0.09	0.00	0.15
Manufacturing	1.71	0.49	-1.57
Construction	1.05	0.56	-1.86
Utilities	0.21	0.40	-0.09
Services	2.01	1.55	-0.41
GDP	6.05	3.52	-4.25

Source of basic data: National Accounts of the Philippines

Table 2.12
External Sector Indicators, 1973-85

	1973-80	1981-82	1983-85
Trade Balance/GDP (%)	-4.47	-6.83	-3.72
GIR less Gold (\$M)	1712.66	1476.85	654.64
GIR less Gold in Months of Import	5.09	2.26	1.29

Source of basic data: National Accounts of the Philippines, International Financial Statistics

The establishment of state enterprises that became the primary conduits for resource mobilization characterized the period. These state enterprises undertook massive public spending necessary to achieve the high growth objective. With the glut in international debt markets, cheap external financing was used to fund these expenditures. Consequently, the foreign debt stock surged during this period, from \$2.2 billion in 1973 to \$11.3 billion in 1980. The accumulation of foreign debt allowed the government to relax foreign exchange constraints. However, the cost of foreign borrowing started to rise in the late seventies. The second oil crisis even made foreign financing more expensive and difficult. These developments laid the seeds for the economic crisis experienced in succeeding periods.

Programs to boost agriculture were also initiated. Foremost was the implementation of land reform. This, however, proved to be an unsuccessful program. The green revolution was also undertaken to increase agricultural productivity.

Industrial policy headed toward the direction of reducing the bias against an export-led industrialization strategy. However, a major weakness was its own bias towards capital-intensive activities. To deepen industrial structure and create intermediate goods industries, a program of major industrial projects was initiated in 1979. Among those contemplated were activities in aluminum smelting, pulp and paper milling, petrochemical manufacturing, integrated steel milling, copper smelting, diesel engine manufacturing, coal conversion of the cement industry, phosphatic fertilizer manufacturing, heavy engineering, and coco-chemical manufacturing. However, these projects were highly capital intensive and had long gestation periods. At the same time, the implementation plan was ill-timed. By the early eighties, external financing had become difficult and the country was unable to generate internal funds to finance these projects. Government was simply forced to either delay, if not cancel, them.

The thrust toward export expansion continued. During the period, there was a shift to a more balanced mix of traditional and non-traditional exports. However, the growth in exports remained modest. The weighted growth rate of exports remained at the 2 percent level. This can be attributed to the worsening of the terms of trade in the mid-seventies. Also, while there was a flexible exchange rate regime, the central bank opted for a managed or “dirty” float that kept the exchange rate below market equilibrium, thus providing a disincentive to export. Likewise, there was the inability to dismantle the vestiges of import-substituting industrialization policy. Exports remained an enclave activity (confined the export processing zones) and highly import-intensive. As export

and industrial investments were spurred, the importation of capital and other intermediate goods increased. Consequently, the growth in exports was offset by the huge increase in imports. The contribution of net exports to growth was estimated to be -1.4 percent during the period.

As the 'national security-developmental' state led the drive towards growth, political and economic power became highly concentrated on the Marcoses, their relatives, friends, and political allies. State enterprises that were supposed to lead development were built around the Marcoses and company. Even private businesses were controlled by known Marcos associates. Monopolies, especially in the coconut and sugar industries, were created favoring interests close to the Marcoses. As this rent seeking activities heightened, more inefficiencies were introduced.

The high growth period had come to an end in 1980. The cheap foreign credit used to finance the previous period's growth was no longer available. Making the situation worse, the widening trade and current account deficits preclude the generation of foreign exchange to service external debts. Likewise, refinancing cost has become expensive. The unsustainability of the external debt was a ticking time bomb, waiting to explode any time. Within the succeeding five years, the economy falls into a deep economic crisis that sets back economic development by about seven years in terms of GDP levels and perhaps more, in terms of per capita income.

The 1981-1982 sub-period had all indications of a slowdown. Growth was cut by almost a half compared to the boom period. Investments still played a major part in the growth process, with a average weighted growth rate of 1.5 percent for the period. Weighted export growth, however, contracted to -0.23 percent. Public investments continue to be funded by foreign debt but at higher and variable rates. Agriculture, industry and services had lower contributions to growth during the sub-period. Moreover, weighted manufacturing growth fell to 0.49 percent. To spur the economy, government engaged in an even greater deficit spending, still financed by external borrowings.

Recognizing the inefficient industrial structure and its drag on the economy, the government initiated tariff and industrial reforms in the early eighties. A five-year tariff reform and import liberalization program was launched. New investment laws were enacted. Presidential Decree No. 1789 or the Investments Incentives Act was enacted in 1981 and amended by *Batas Pambansa Blng. 391* in 1983. These laws radically changed the system of investment incentives and promotion by correcting the anti-export bias of previous investment laws. Financial liberalization (started in 1980), through the deregulation of interest rates, was likewise pursued to improve financial intermediation. However, the global recession made the international economic environment not conducive to growth. Furthermore, the Mexican debt crisis made international lenders more cautious and restrictive especially with regard to lending to highly indebted countries, including the Philippines. In the domestic front, the financial market was rocked by a scandal that left a number of financial institutions distressed and the financial liberalization program in a quandary. The government had to engage in rescue programs

for the distressed institutions to avert a financial crisis, thus, making the balance sheets of the central bank and two key government financial institutions weaker in the process. One must note, however, that most of the distressed companies that received government financial support belonged to conglomerates controlled by known Marcos cronies. Private losses were thus socialized and to the extent that the crony companies got into trouble because of capital flight and mismanagement, the adverse impact to economic growth and public welfare is amplified further (Boyce 1993).

The slowdown culminated in the deep economic crisis that started in 1983 and continued in 1985. Over the period, the economy contracted by an average of 4.3 percent and a cumulative 12.8 percent for the worse economic setback since the last world war. In October 1983, the foreign debt overhang was so burdensome that a debt moratorium was declared. International reserves had fallen to \$235 million during that month triggering a peso devaluation. Investor confidence was shattered resulting in massive capital flight, further aggravating the BOP crisis. Inflation surged to an all time high of 63 percent as contractionary fiscal and monetary policies were adopted to stabilize the external accounts. Compounding the problems was the political crisis that ensued with the assassination of a key leader in the Marcos opposition, Benigno Aquino, Jr., in August 1983.

As a consequence, the tariff reform and import liberalization program were suspended. Foreign exchange rationing and import controls were again introduced. Although interest rate deregulation was not reversed, the rules governing financial institutions were significantly tightened.

The 1973-1985 cycle was the longest and deepest boom-bust cycle in Philippine history. The cause of the crisis was the inability to generate foreign exchange receipts necessary for external payments, thus resulting in the depletion of international reserves. The cheap foreign borrowing and refinancing allowed an extended period of rapid expansion. However, when market conditions turned unfavorable, the economy became hostage to a debt overhang, which led to a deep economic crisis. Thus, the crisis in the Philippine easily unfolded as international credit markets became tighter during the first half of the 1980s.

2.4.5 The 1986-1992 Cycle: the turbulent years of re-democratization and institution rebuilding

The 1986-1992 cycle was a short but significant cycle in Philippine economic history. During this period, the government embarked on a program on structural reforms that aimed at rebuilding and strengthening economic and political institutions. With a change of political regime and leadership in 1986, reforms suspended due to the economic crisis were restarted. These reforms covered a vast range of areas such as agrarian reform, tax reform, agricultural liberalization, demonopolization, government corporate reform and privatization, public investment reforms, financial sector reforms, investment and industrial policy changes, trade reform, environmental policy and human resource development. The guiding principles for economic policies and reforms were

market orientation, deregulation and liberalization. The motivation behind market orientation and deregulation is that by removing the distortions (especially those introduced or nurtured by long-standing government policies), which impinge on the market process, the allocation and mobilization of resources are made efficient. Economic liberalization, on the other hand, is rooted on the notion that the infusion of competition, both internal and external, will make economic agents perform at their efficiency frontiers. Reforms that strengthen institutions are also necessary in order to foster an economic structure that could meet the challenges brought about by a freer and globalized market.

Coming out of the deep economic crisis in 1986, the Philippines was left with a highly restricted financial sector. Bank entry and branching had very stringent rules that carried on until the late eighties. The first generation reforms to strengthen the financial sector were done between 1986 and 1987 with the rehabilitation of the government financial institutions like the Philippine National Bank and the Development Bank of the Philippines. There too was a reduction in the market share of government financial institutions relative to the entire banking system. 1989 signaled further liberalization of the banking system. Reserve requirements were unified and there was a gradual liberalization of bank branching requirements. In 1990, the moratorium on the establishment of new domestic banks was lifted.

Foreign exchange controls started to be lifted in 1991 when exporters were allowed to retain up to 40 percent of their foreign currency receipts. By 1992, most exchange controls were lifted, thus making the Philippine capital account virtually open. The Philippine Dealing System was introduced in 1992 to replace the Bankers Association of the Philippines (BAP) trading floor paving the way for a more genuine system of dollar trading.

Tax reforms were likewise initiated in 1986. These measures aimed at restructuring the tax system and generate additional revenue. The tax reform package included personal income tax reform, corporate income tax reform, real property tax reform, conversion of excise taxes to *ad valorem* taxes, and indirect tax reforms. Also included were a series of tax amnesty programs and removal of export duties. In 1988, the Value Added Tax (VAT) system was introduced replacing the cascading sales tax system.

Privatization of state enterprises was pursued to improve the government's fiscal position, and reduce the involvement of the government in what would otherwise be the domain of the private sector. By doing so, inefficiency in the economy is reduced. On the expenditure side, the Build-Operate-Transfer (BOT) Law was enacted in 1990 to supplement the scarcity of funding for public investments. The BOT Law enshrined private-public sector partnership in building infrastructure. It provides the legal and administrative framework as well as the appropriate incentives for BOT projects.

In 1986, the administration of President Corazon Aquino revived the import liberalization program. Under Phases 1 and 2 of the program, a total of 1, 229 and 533

items were liberalized and tariffed, respectively. Tariff reform was also initiated. A major step to rationalize the tariff schedule was done via Executive Order No. 413 in 1990, which was later amended by Executive Order No. 470.

Philippine investment policy also underwent a series of reforms. In 1987, the Omnibus Investment Code was enacted to provide the new regulatory framework and incentives for foreign investments. The law was an attempt to replicate the Japanese model of industrialization. However, the code was considered inferior to the investment law (*Batas Pambansa Blng. 391*) it replaced in terms of export promotion. To some extent, it again reinforced protectionist strategies for industrialization. In 1991, the Foreign Investments Act changed the areas for foreign investment from a positive list to a negative list. Except for the areas that are contained in the list, all other areas were deemed open for foreign investment. Wage setting was also depoliticized by the creation of the tripartite wage boards in 1989, thereby creating a more conducive environment for investment.

The demonopolization of certain industries was also pursued with the removal of agricultural marketing boards. The trading monopolies in coconut and sugar were dismantled while barriers to entry in the transportation industry were reduced, if not eliminated. Inter-island shipping was deregulated, ports were demonopolized, and the one-airline policy was repealed.

The reforms, aided by government pump-priming, provided an impetus to growth. Between 1986 and 1989, the economy grew at an average of 5.17 percent.

Table 2.13
Weighted Growth Rates (%), 1986-92

	1986-89	1990-92
Private Consumption	3.41	2.67
Government Consumption	0.40	0.09
Gross Investments	2.72	0.26
Fixed Investments	1.96	0.36
Exports	3.15	1.28
Imports	4.87	2.11
Statistical Discrepancy	0.36	-1.27
Agriculture	0.80	0.17
Industry	1.96	-0.07
Mining	-0.02	0.00
Manufacturing	1.43	0.04
Construction	0.43	-0.16
Utilities	0.12	0.04
Services	2.42	0.84
GDP	5.17	0.93

Source of basic data: National Accounts of the Philippines

Table 2.14
External Sector Indicators, 1986-92

	1986-89	1990-92
Trade Balance/GDP (%)	-3.30	-8.47
GIR less Gold (\$M)	1279.20	2857.85
GIR less Gold in Months of Import	2.23	2.60

Source of basic data: National Accounts of the Philippines, International Financial Statistics

From 1986 to 1989, consumer spending was strong with a weighted growth rate of 3.41 percent. Capital formation was likewise strong with a weighted growth rate of 2.72 percent. The principal contributor to growth was exports with a weighted growth rate of 3.15 percent. However, there was substantial leakage with weighted import growth jumping to 4.87 percent. From the supply-side, growth was across-the-board. The service sector was the principal source of growth, contributing 2.42 percent. Industry and manufacturing had a major rebound. The same was also true with agriculture.

Growth, however, was not sustained. The leakage due to the widening trade deficit led to another foreign exchange crisis in the early 1990s. One of the major reasons cited was the trade reforms were not complemented by the appropriate exchange rate policies. An upward adjustment of the exchange rate would have accorded the natural protection to liberalized products. Government had chosen to defend the currency, thus favoring imports anew. The issue of consistency of trade and exchange rate policies was again raised by some quarters when tariff reduction measures were introduced in 1990 and 1991. By 1990, international reserves had fallen to less than a billion dollars, and, only then was the currency allowed to adjust to more realistic levels. Compounding this was political instability. For the first time in its post-war history, the Philippine was rocked by coup attempts from disgruntled military forces. The most serious was the December 1989 episode. After 1989, GDP growth rates plummeted to culminate in the 1991-1992 recession. Power shortages in the early nineties complicated matters even more.

The binding foreign exchange constraint led to a mild recession in the early 1990s. Average growth fell to 0.93 percent, mainly due to the substantial fall in investment and exports. Net exports continued to have a negative effect but at a lower scale. From the supply-side, the weighted growth of industry contracted by 0.07 percent while that of manufacturing increased by a forgettable 0.04 percent. Except for the imposition of an import levy, which countered the liberalization thrusts, the reform program did not suffer major reversals.

The main lesson from the 1986-1992 cycles is that reforms are needed to spur economic growth but they will have to be consistent with each other to make growth sustainable.

2.4.6 The 1993-2000 Cycle: the period of economic integration and People Power II

The reform program continued in the 1993-2000 cycle. The continuity of reforms was one factor that contributed to the boom from 1993 to 1997. While there may be a difference in the political thrusts and agenda of the Aquino and Ramos administrations, the economic agenda for both have been rather continuous. Continuity does not mean that the succeeding administration adopts the plans of the previous one. It means that there is agreement on the direction of the economic reforms. In the case of the two named administrations, they were in agreement that the central theme of the reform process revolves around deregulation and economic liberalization. Hence their policy actions were geared towards these ends. Continuity ensures that previous reforms form the foundation upon which new reforms are to be built. Continuity also provides the much-needed stability in the reform process. This renders an implicit guarantee that no surprises will occur over the medium-term horizon. Finally, continuity calls for the non-reversal of previous reforms. Any sharp reversal of reforms may impart the wrong signals and may shatter the credibility of the reform process.

The immediate task of the Ramos government was to improve the energy situation. By 1993, the power supply was returned to normalcy. The trade-off, however, was high cost of energy.

Financial reforms were brought a step further. By 1993, the opening of new branches was made very easy. The General Banking Act was amended in 1994 to allow the entry of more foreign banks. By 1995, 10 foreign banks had established full service branches in the country. Other foreign banks entered by establishing banking subsidiaries. In 1993, the Central Bank of the Philippines, suffering from losses that were accumulating since the crisis years, was financially rehabilitated and reorganized as the *Bangko Sentral ng Pilipinas*. Most recently, the General Banking Law of 2000 was enacted raising banking regulation to international standards. Intermediation cost was reduced by the series of cuts in reserve requirements. At the same time, a certain percentage of required reserves of banks were allowed to earn market rates.

Tariff reforms continued with further tariff reductions mandated under Executive Order Nos. 264 and 288. Under these laws, a uniform tariff of 5 percent will be imposed on non-agricultural and non-sensitive agricultural items by 2004. The nineties also saw the accession of the Philippines to the ASEAN Free Trade Agreement (AFTA) and World Trade Organization (WTO), and membership in Asia Pacific Economic Cooperation (APEC).

Infrastructure development was given an impetus with the amendment of the Build-Operate-and-Transfer to included new schemes.

Industrial restructuring was pursued during the boom years. The telecommunications sector was deregulated. In 1993, franchises were given to other companies to set up telecommunication systems. More international gateways were established. Consequently, there has been increased universal access to basic telecommunications services. In 1996, the entry of foreign investments was further liberalized with the deletion of List C of the negative list under Republic Act No. 8179. To introduce efficiency in the oil sector, the petroleum industry had a series of deregulation starting 1996. Liberalized importation of crude oil and petroleum products was allowed. The lease or ownership and operation of oil refineries were liberalized. Lastly, the setting of petroleum prices was liberalized.

Measures to support the growth of export were likewise enacted. The Export Development Act was legislated into law in 1994. The creation of the Export Development Council provided the institutional support for the development of the export industry. Under the law, the incentives, in addition to Board of Investment (BOI) incentives, were also included in the law.⁶ The creation of the Philippine Economic Zone Authority also provided impetus to export production.

⁶A ticklish issue has been that the actual grant of incentives to exporters has not yet materialized.

More fiscal reforms were undertaken. The coverage of the VAT was expanded in 1994; however, its implementation was delayed until 1996. Finally, the Comprehensive Tax Reform Program (CTRP) was passed in 1997. The CTRP provides relief to taxpayers by increasing personal tax exemptions and lowering the tax rates. Progressivity was also attained by exempting the taxpayers living below the poverty line. It also rationalized the allowable level of deductions and broadened the tax base by taxing undeclared revenues.

Another major achievement was the institutionalization of governance mechanisms. Consensus building mechanisms were utilized to support government programs. The Legislative-Executive Development and Advisory Council was created to increase cooperation and build synergy between the executive and legislative branches of government.

The period of reform made the economy boom between 1993 and 1997, growing by an average of 4.44 percent. Growth was export-driven. The average weighted growth rate of exports for the period was 5.69 percent. Import growth, though, was causing higher leakages, at 7.12 percent. Hence, net exports had a negative contribution. Investments were likewise strong, contributing 2.03 percent to growth. Fiscal surpluses were registered during this period. Services and industry were driving growth from the supply-side contributing 2.03 and 1.87 percent, respectively.

Table 2.15
Weighted Growth Rates (%), 1993-00

	1993-97	1998-00
Private Consumption	3.14	2.50
Government Consumption	0.43	0.09
Gross Investments	2.06	-1.50
Fixed Investments	2.03	-1.23
Exports	5.69	-0.89
Imports	7.12	-3.22
Stat. Discr.	0.25	-1.20
Agriculture	0.55	0.17
Industry	1.87	0.27
Mining	-0.03	0.01
Manufacturing	1.12	0.49
Construction	0.53	-0.35
Utilities	0.25	0.11
Services	2.03	1.79
GDP	4.44	2.23

Source of basic data: National Accounts of the Philippines

Table 2.16
External Sector Indicators, 1998-99

	1993-97	1998-99
Trade Balance/GDP (%)	-12.73	3.71
GIR less Gold (\$M)	6872.31	11227.63
GIR less Gold in Months of Import	3.13	4.45

Source of basic data: National Accounts of the Philippines, International Financial Statistics

Growth was halted by the advent of the Asian financial crisis. Unlike previous cycles, the international reserve position was quite healthy and the foreign exchange constraint appeared far from being binding. However, globalization resulted in an integration of markets, and the Philippines had earlier opened its capital account fully. The crisis in Thailand triggered a currency crisis in the Philippines and the rest of the region. These contagion effects made the speculative attacks on the currency so huge that government was forced to make sharp adjustments in the exchange rate. Otherwise, international reserves would be depleted rapidly, no matter how healthy the international reserve position was. Likewise, the initial response of government to hike overnight rates to defend the peso significantly increased borrowing costs. Companies that opted to have dollar exposures due the very stable currency before the crisis were hit hard by the currency adjustment. Between 1998 and 2000, GDP growth fell to 2.23 percent. From the demand-side, growth was driven only by consumption. Capital formation and exports had negative contributions. From the supply-side, only services proved to be resilient, having an average weighted growth of 1.79 percent. Making matters worse, governance problems were experienced during the Estrada presidency, resulting in a loss of confidence in government. In January 2001, as is now well known, Estrada was ousted from the presidency by another People Power ‘revolution’.

2.5 Growth, macroeconomic policies and variables, and TFP estimates⁷

This section reviews the relationship between fiscal and monetary policies and growth and identifies shifts in sectoral employment across time. It also estimates total factor productivity (TFP) of the Philippines. The TFP estimates are compared with estimates done by other authors as well as the TFP estimates of other ASEAN economies. The impact of economic liberalization on TFP growth is likewise examined.

2.5.1 Macroeconomic policies, variables and economic growth

With respect to the relationship between fiscal and monetary policies and growth, it could be seen in Figures 2.4 and 2.5 (which plot the growth in real fiscal expenditures against GDP growth and the fiscal balance-to-GDP ratios) and in Tables 2.2.17 and 2.18 that growth in monetary aggregates was more contemporaneous with GDP growth than fiscal variables.

⁷ A fuller discussion of this section is offered in Appendix 3, Macroeconomic policies, variables and growth; and Appendix 4, Estimating Total factor productivity in the Philippines.

In the 1960s, it appears that the growth of real government spending co-moves with GDP growth with neither lead nor lag. This, however, changed in the 1970s when real fiscal expenditure leads GDP by about one period. The correlation coefficient between GDP growth and real fiscal expenditures lagged one period is 0.47. This suggests that the government in the 1970s engaged in pump priming to help prop the economy. It should be noted that it was during this time that state enterprises were mushrooming all over the country. Attempts to pump prime the economy continued in early 1980s in attempts to avert the economic slowdown. Pump priming had to be stopped when the economy went into a crisis since resources were no longer available for such activities. The fiscal deficit had ballooned to nearly five percent of GDP. Also, the IMF had caused the initiation of an austerity program to restore fiscal discipline. Pump priming was resumed as the economy emerged from the crisis in the late 1980s. However, the program was not continued for an extended period. By the 1990s, pump priming was no longer resorted to boost the economy

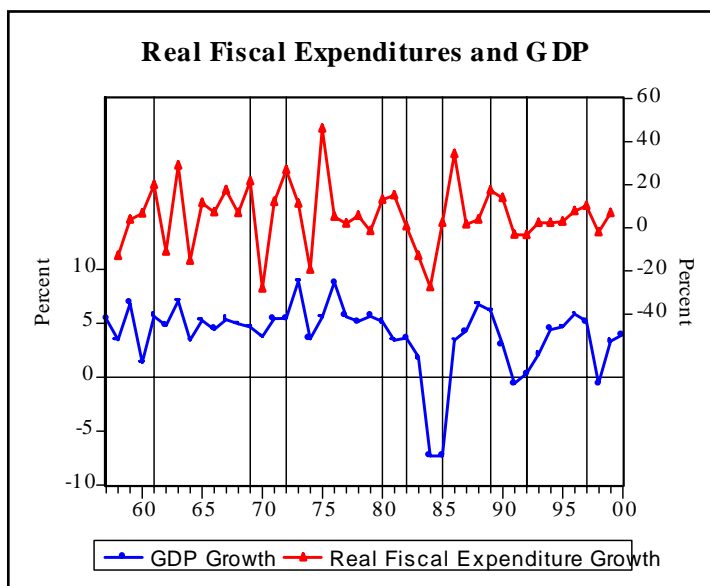


Figure 2.4

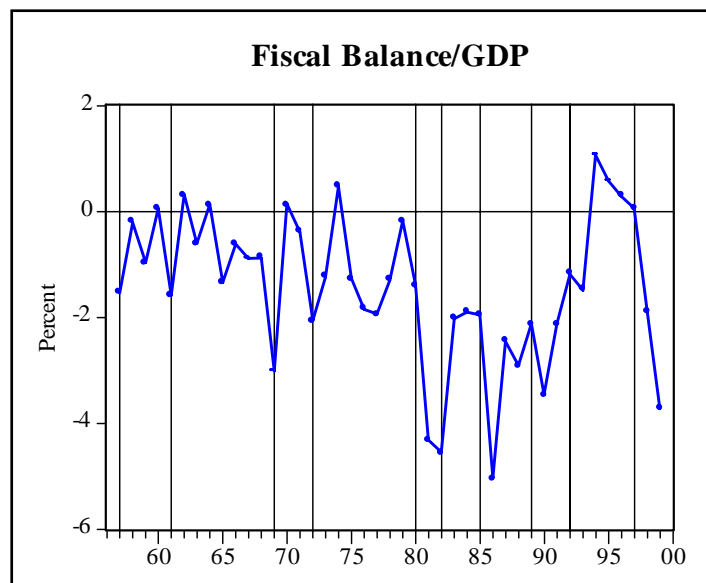


Figure 2.5

Table 2.17
Real Fiscal Expenditure Growth vs. GDP Growth, 1957-99

	Correlation Coefficient
Real Fiscal Expenditure Growth _t , GDP Growth _t	0.47
Real Fiscal Expenditure Growth _{t-1} , GDP Growth _t	0.33
Real Fiscal Expenditure Growth _{t-2} , GDP Growth _t	0.16

Unlike fiscal variables, growth in monetary aggregates was more contemporaneous with GDP growth. This can be observed in Figure 2.6. Also, correlation coefficients show positive correlation between contemporaneous variables. This suggests that monetary authorities, while concerned about economic growth, had other target variables such as price and exchange rate stability in mind. The more relevant financial variable appears to be real credit to the private sector. While there is still some contemporaneousness, real credit growth at times leads GDP growth.

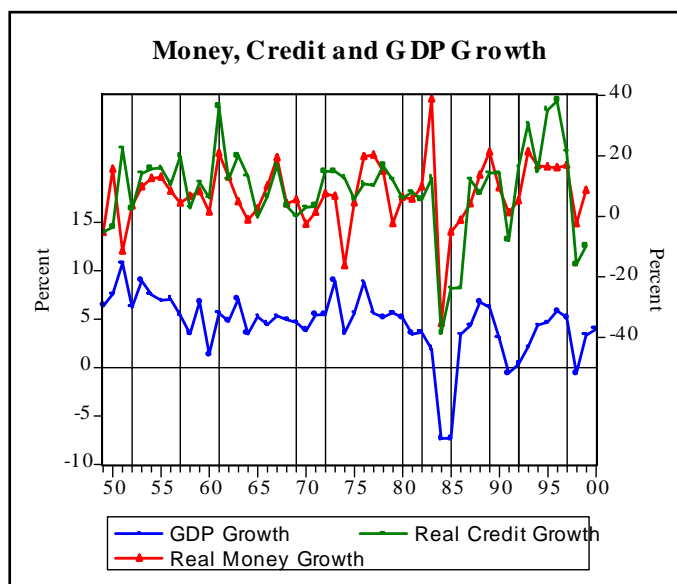


Figure 2.6

Table 2.18
Real Money and Private Credit Growth vs. GDP Growth, 1949-99

	Correlation Coefficient
Real Money Growth _t , GDP Growth _t	0.39
Real Money Growth _{t-1} , GDP Growth _t	0.06
Real Private Credit Growth _t , GDP Growth _t	0.58
Real Private Credit Growth _{t-1} , GDP Growth _t	0.22

A cursory investigation of the saving and investment behavior from 1946 to 2000 would yield the following stylized facts. First, prior to 1980, the investment-saving gap tends to turn positive during economic booms. This is true during the post-war reconstruction years, the import substitution period, the exchange de-control and Marcos industrialization periods. This indicates that during boom periods, foreign savings played a major role in financing capital accumulation.

Second, it is also observable that prior to 1980, except for the 1949-1952 period when the saving rate in the prior period was exceptionally high, the saving rate does not drop, and, in fact increases during times of busts. This suggests that during those times, people tend to hold on to their incomes when the economy weakens.

Third, saving and investment behavior changed immensely after 1980. During the crisis of 1983-1985, the saving rate fell but investment had a sharper fall. And, since then, the saving rate had been trending downward. Investments did recover in the crisis. Although its rate of recovery was quite steep, the crisis had caused the investment rate to cut by half between 1983 and 1985 (from 28.7 percent to 14.4 percent). It would take four years before a positive investment saving gap was attained. Since 1989, the investment-saving gap has been widening, indicating increasing dependence on foreign capital. By 1997, the gap has widened to nearly 11 percent of GDP. The Asian financial crisis caused the narrowing gap as both saving and investment rates, on the average, fell.

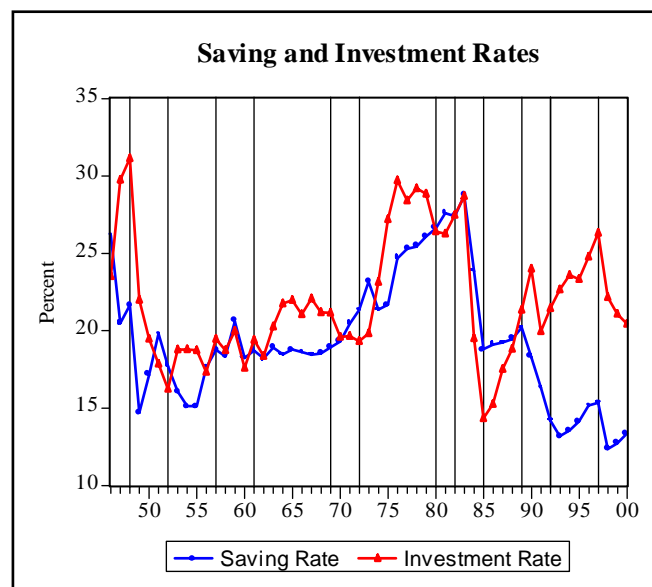
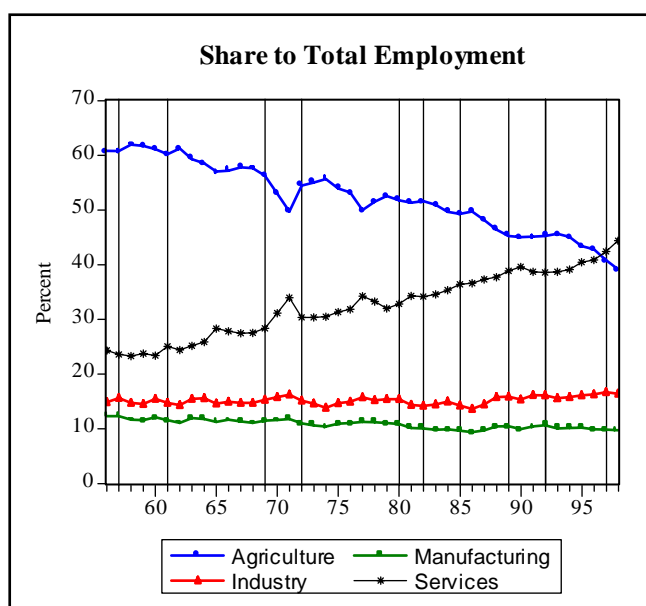


Figure 2.7

Finally, with the saving rate having a downward trend, gross domestic saving are currently at their lowest level in the post-war period. Such occurrence suggests that capital accumulation will always be tied up with the availability of foreign savings. It also means that a growth pattern that is hinged on high capital accumulation, as will be shown in later sections of this paper, will not be sustainable in the Philippine case.

Shifts in sectoral employment in the Philippines are quite straightforward and do not fluctuate with the business cycle. This is mainly driven by the change in industrial structure, primarily the movement from agriculture toward service. In 1956, agricultural employment accounted for more than 60 percent of the employment, and this gradually fell to 39 percent in 1998. Services, on the other hand, increased from 24 percent in 1956 to 44 percent in 1998. Since the transition from agriculture to services bypassed the industrial sector, the employment by industry and manufacturing stagnated for more than 40 years.

Figure 2.8



Between 1956 and 1999, apparently the unemployment rate shifted around five times. In 1956, the economy had a double-digit unemployment rate, which was unusual since 1956 was still considered a year of rapid growth that resulted from the import substitution program. The unemployment was brought in succeeding and from 1959 until 1965 had stabilized around six percent level. Subsequently, unemployment again rose to the seven to eight percent region from 1967 to 1970. The rapid expansion in the 1970s brought about the reduction of the unemployment rate to an average of around 4.3 percent. The 1983-85 crisis resulted in a severe economic dislocation causing the unemployment rate to breach 10 percent. In the years following the crisis until 1999, unemployment rate was in the 8 to 9 percent range.



Figure 2.9

2.5.2 Estimating Total Factor Productivity⁸

Annual economy-wide data were used to estimate total factor productivity. Assuming a constant returns to scale Cobb-Douglas production function given by

$$(1) \quad Y_t = A_t K_t^{*\beta} L_t^{*1-\beta},$$

where Y is gross domestic product, K^* is capital service, L^* is total employment adjusted for the quality of labor, A is total factor productivity and β is the factor share of capital. K^* is equal to real capital stock (K) adjusted for capacity utilization (CU). L^* is total employment (L) multiplied by an index for quality of labor (H). Taking the log difference and adding a stochastic error term yields the regression equation:

$$(2) \quad \Delta y_t = \Delta a_t + \beta \Delta k_t^* + (1 - \beta) \Delta l_t^* + u_t,$$

where the lowercase letter denotes the logarithm of the variable and u is the stochastic error term. The estimator of the factor share, $\hat{\beta}$, is then used to estimate total factor productivity growth using the identity:

$$(3) \quad \Delta a_t = \Delta y_t - \hat{\beta} \Delta k_t^* - (1 - \hat{\beta}) \Delta l_t^*.$$

⁸ A complete discussion of the methodology and data sources for this TFP estimation exercise is provided in Appendix 4.

Stationarity tests were conducted on Y , K^* and L^* and all variables were found to have unit roots. Given this, the estimation of the production function in log difference form is justified. To deal with the endogeneity problem of the explanatory variables, instrumental variable (IV) estimation was adopted. The choice of instruments followed Yamagata (2000).⁹ The regression results are given below in Table 2.19.

Table 2.19
IV Regression Results

	Coefficient	t-statistic
Δa	-0.011	-1.854
Δk^*	0.492**	2.570
R^2	0.353	
Adjusted R^2	0.337	
DW	1.907	
LM(1)	0.080	
LM(2)	5.381	
F-statistic	1.861*	
Sample	1957-99	

** significant at 5%; *significant at 1%

As shown in Table 2.20, the estimated β of 0.492 appears to be consistent with the recent econometric work of Senhadji (2000) where he estimated the factor share of capital to be 0.47. The estimate also approximated the estimate of Yamagata (2000), although the latter's data were limited to the manufacturing sector.

Table 2.20
Comparison of Estimated of the Factor Share of Capital

	Estimate
Mendoza and Tan (2002; economy-wide)	0.492
Senhadji (2000; economy-wide)	0.470
Yamagata (2000; manufacturing only)	0.492

Annual estimates of total factor productivity growth are shown in Figure 2.10. It can be seen that TFP growth had, on the average, performed better prior 1974, after which TFP growth has been largely negative. Over the entire period, average TFP growth was -1.19 percent, thereby having a negative contribution to growth of -30 percent. The principal source of growth was capital input that grew by 3.13 percent, accounting for 80 percent of growth. Labor input, on the other hand, grew by 1.98

⁹ The following instruments were used: the first difference of the federal funds rate, the log difference of average petroleum prices, the log difference of US per capita GDP and import index and the log difference in Japanese per capita GDP and import index.

percent, accounting for 51 percent of GDP growth. Table 2.21 shows the behavior of factor productivity across the economic cycles, while Table 2.22 computes for the contribution of factor inputs and TFP to growth.

Figure 2.10

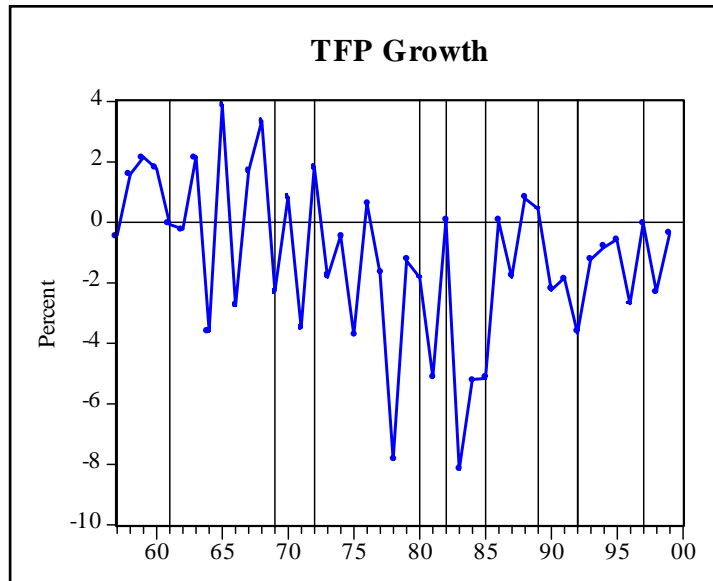


Table 2.21
Average Growth Rates of Factor Inputs and Productivity

	Capital	Labor	TFP	GDP Growth
1957-61	1.79	1.73	1.00	4.53
1962-69	2.77	1.93	0.28	4.99
1970-72	2.60	2.55	-0.27	4.88
1973-80	6.01	2.29	-2.24	6.05
1981-82	5.15	0.89	-2.52	3.52
1983-85	-0.56	2.48	-6.18	-4.25
1986-89	3.05	2.25	-0.13	5.17
1990-92	1.75	1.76	-2.58	0.93
1993-97	3.69	1.82	-1.07	4.44
1998-99	1.50	1.21	-1.34	1.37
1957-99	3.13	1.98	-1.19	3.91

Table 2.22
Contribution to Growth

	Capital	Labor	TFP	GDP Growth
1957-61	39.56	38.29	22.15	100.00
1962-69	55.58	38.70	5.71	100.00
1970-72	53.31	52.18	-5.49	100.00
1973-80	99.30	37.78	-37.08	100.00
1981-82	146.13	25.38	-71.51	100.00
1983-85	-13.17	58.40	-145.23	100.00
1986-89	58.90	43.59	-2.48	100.00
1990-92	187.52	189.23	-276.76	100.00
1993-97	83.07	40.95	-24.02	100.00
1998-99	110.02	88.38	-98.40	100.00
1957-99	79.92	50.56	-30.48	100.00

Compared to subsequent periods, the growth performance from 1957 to 1972 was rather more stable averaging at around 4.83 percent. However, the effect on TFP on output growth was declining. While TFP growth averaged at 1 percent during the 1957-61 span, it declined to 0.28 percent from 1962 to 1969, and turned negative (-0.27 percent) during the 1970-72 span. 1973 to 1979 was a high growth period for the Philippines with GDP growth averaging over 6 percent. However, it is noticeable that growth is not due to TFP growth but rather was attributable to high capital accumulation. TFP growth was -2.24 percent while capital was accounting for 99 percent of GDP growth. This huge deluge of capital was made possible by the aggressive borrowing strategy of the Marcos government.

Capital accumulation continued to drive growth in from 1980 to 1982 but labor's contribution sharply contracted in the 1981-82 span.. It fell to 25 percent when the unemployment rate nearly doubled. Adding to this, TFP growth further deteriorated to -2.52 percent in the same period. With the access to capital restricted in the next sub-period (1983-85), capital growth sharply reversed to -0.56 percent. TFP registered a negative growth of -6.18 percent. By this time, the economy was in a crisis. The only positive source of growth was labor.

The reform program was restarted in 1986 as a new government took over. Average TFP growth from 1986 to 1989, though still negative, improved to -0.13 percent. After several years of negative or near zero TFP growth rates, positive TFP growth were achieved in 1986, 1988 and 1989. A factor contributing to this improvement was the structural reforms introduced during this period. It must be noted, however, capital accumulation played a major role in attaining the GDP growth rates for the 1986-89 period accounting nearly 60 percent of the total.

As the economy entered into a mild recession in 1990 and as the power crisis loomed, TFP shrank by an average of -2.58 percent between 1990 and 1992. Similar reductions in the growth of capital and labor were also observed.

Despite market reforms continued by the Ramos government, TFP growth, while improving, remained negative from 1993 to 1997. From -1.24 percent in 1993, TFP growth steadily improved to -0.56 in 1995. The sharp drop in the unemployment rate in 1997 increased the contribution of labor to GDP growth, thereby undermining TFP. By 1997, TFP growth was close to zero. Similar to previous sub-periods, growth was driven by capital accumulation, accounting for 83 percent of GDP growth. The impact of the Asian financial crisis was felt starting 1998. From 1998 to 1999, the growth rates of factor inputs and productivity were adversely affected. TFP growth again worsened to -1.34 percent.

The review of the sources of growth by factor input reveals that Philippine economic growth has been driven primarily by capital accumulation. This situation may be no different from Singapore where capital accumulation is said to underlie the rapid economic growth. The major difference between the Philippines and Singapore is that former has been unable to sustain the high rate of capital accumulation. Internally, the saving rate is quite low. On the other hand, not enough foreign savings have been attracted since the country is rather late in opening its capital accounts and has a comparatively unstable political situation and a poor anti-crime record even after the fall of the dictatorship in the mid-1980s. For instance, the Philippines failed to cash in on the outward migration of Japanese capital into Southeast Asia as a result of the Plaza Accord of 1985. Investors had to discount deeply the uncertainties of regime succession in 1985 (as Marcos hang on to power in the face of massive political unrest) and the various coup attempts that must suppressed by the Aquino government from late 1986 up to 1989.

It is worthwhile to compare the present estimates with previous works. The decadal averages can be compared to the results of Cororaton and Cuenca (2001), Hahn and Kim (2000), Collins and Bosworth (1996), and Hooley (1985). The decadal patterns of average TFP growth are similar, although the magnitudes differ. Hooley (1985) utilized manufacturing data, in contrast to this paper that used economy-wide data. Aside from the differences in the data used, a possible reason for difference in magnitude is that each study has different values for factor shares. Cororaton and Cuenca (2001) used factor shares derived from the National Accounts of the Philippines where the factor share of capital ranges from 0.705 to 0.755. Hahn and Kim (2000) and Collins and Bosworth (1996) both assumed 0.35 as the share of capital.

Table 2.23
Comparison of TFP Growth Results

	Mendoza & Tan (2002)	Cororaton & Cuenca (2001)	Hahn & Kim (2000)	Collins & Bosworth (1996)	Hooley (1985; mfg. only)
1957-69	0.56		0.50 (1960-69)	0.70 (1960-73)	0.56 (1956-70)
1970-79	-1.69		-0.59	-1.30 (1973-84)	-1.23 (1971-80)
1980-89	-2.59	0.27 (1981-89)	-2.00	-0.90 (1984-94)	
1990-99	-1.58	-0.98 (1990-98)			

What picture emerges if we compare TFP estimates for the Philippines with those of its ASEAN neighbors? Hahn and Kim (2000) find that Philippine productivity was better than Singapore and Indonesia in the 1960s. Since then, Singapore has continuously improved its TFP growth in the next decades. Indonesia, on the other hand, showed substantial improvement in TFP growth in the 1970s. Malaysia and Thailand, like the Philippines, exhibited declining TFP growth rates over the three decades. The top three economies, namely, Malaysia, Thailand and the Philippines, exhibited declining TFP growth rates over the three decades. However, the deterioration of Philippines TFP growth was substantially sharper. And, considering that the Philippine TFP growth was lower than the other two countries, negative growth rates were registered in the 1970 and 1980s.

Table 2.24
Sources of Growth: TFP

	1960s	1970s	1980s
Philippines	0.50	-0.59	-2.00
Indonesia	-0.73	1.84	0.07
Malaysia	0.80	0.54	-0.41
Singapore	-0.14	1.29	1.50
Thailand	1.91	0.93	0.38

Source: Hahn and Kim (2000).

Growth of the five economies was primarily driven by physical capital. There is, however, a large disparity between Philippine physical capital growth and the other ASEAN economies. In the Philippines, growth of physical capital per worker did not reach five percent across the three decades. In contrast, the other countries were growing at least twice as fast. This only shows that while the Philippines is no different from other Southeast Asian economies in terms of importance of physical capital in propelling

growth, the rate at which capital is accumulated varies widely across countries. Having a low saving rate, capital accumulation in the Philippines is much lower than its neighbors.

Table 2.25
Sources of Growth: Physical Capital per Worker

	1960s	1970s	1980s
Philippines	3.99	4.73	2.03
Indonesia	1.28	8.56	7.36
Malaysia	6.70	6.81	5.35
Singapore	12.75	10.15	7.19
Thailand	9.47	6.36	5.27

Source: Hahn and Kim (2000).

Meanwhile, what is the impact of the series of economic liberalization measures adopted since the early 1980s on TFP growth? As discussed above, the Philippines embarked on economic liberalization as early as 1980 with financial liberalization. In 1981, import liberalization and tariff reforms were introduced. However, the economic crisis of 1983 caused the reversal of reforms. It was only in 1986 when the reforms were re-introduced, and was continued until and completed in the mid-1990s. The last set of reforms focused on capital account liberalization. This was started in late 1991 and took full effect in the following year.

We find that the economic liberalization in trade and finance has had positive effects on TFP growth. However, the benefits of capital account liberalization have yet to manifest themselves.

As a measure of financial deepening, the ratio of M2 to GDP is used. Trade liberalization is measured by the total trade (i.e., export plus imports) as a ratio to GDP. Finally, the gross foreign investment flow (i.e., inward foreign investments plus outward foreign investments) as percent of GDP is used as an indicator of capital account liberalization. Movements of these indicators are shown in Figure 2.11.

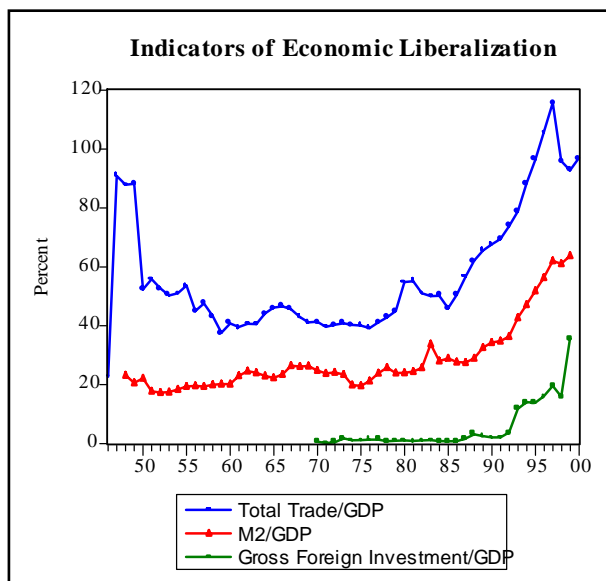


Figure 2.11

An OLS regression is estimated to determine the effect of the liberalization measures on total factor productivity. Interaction dummy variables (i.e., D81 for financial liberalization, D86 for trade liberalization and D92 for capital account liberalization) are introduced to ascertain whether the reforms led to a positive change in the coefficient. A positive and statistically significant coefficient indicates that the reforms had positive effects on TFP growth. A time trend is also included to capture the long-term behavior of TFP growth. The results are shown in Table 2.26. Adjustment for auto-correlation was made because the Lagrange multiplier tests indicated the presence of second-order auto-correlated errors.

Table 2.26
OLS Regression Results
Dependent Variable: Total Factor Productivity Growth

	Coefficient	t-statistic
Constant	14.473*	4.795
Gross Foreign Investment Flow/GDP	0.759**	2.309
M2/GDP	-0.280*	-3.034
Total Trade/GDP	0.041	1.045
D92*Gross Foreign Investment/GDP	-0.456	-1.480
D81*M2/GDP	0.067**	2.082
D86*Total Trade/GDP	0.081*	6.692
Time	-0.422*	-5.110
AR(1)	-0.831*	-4.152
AR(2)	-0.521**	-2.583
R ²	0.727	
Adjusted R ²	0.590	
DW	2.097	
LM(1)	0.892	
LM(2)	3.294	
F-statistic	5.319*	
Sample	1972-99	

** significant at 5%; *significant at 1%

The positive and statistically significant coefficient of the D81*M2/GDP indicate that financial liberalization did help improve TFP growth. However, the negative sign for M2/GDP shows that financial deepening has not totally eradicated the inefficiencies of and distortions in the financial sector such as the continued existence of selective credit facilities and high intermediation costs. Possible causes include the high statutory and liquidity reserve requirements that at some instances reached 25 percent even with liberalization. Bank spreads have also remained high in years, either due to the high risk premia or intermediation cost.

Our results also suggest that trade liberalization contributed to TFP growth. There may be several reasons for this. One is that foreign competition caused domestic producers to improve efficiency. Also, the opening of the goods markets may have exposed Philippine export manufacturers to global best practices. Access to imported capital goods may have helped close the technology gap between domestic and foreign manufacturers.

However, we have yet to feel the benefits of capital account liberalization with respect to productivity gains. There might be several reasons for this. First, while the regulations have virtually opened the capital account, the degree of financial integration has not reached the threshold that is needed to impact on TFP growth. Tan and Paderanga (1998), which concluded that the degree of financial integration while increasing is still

low, support this. Second, a large portion of the capital flows attracted by the capital account opening is portfolio capital (“hot money”) that has no direct beneficial effect on TFP growth. Foreign direct investments would have more impact on TFP growth. Finally, the Asian financial crisis might in a way have made investors more cautious and risk averse. Hence capital inflows tend to be limited in spite of a liberal foreign exchange regime.

Part 3: Conclusion: What can the Philippine Growth Story Tell Us?

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Good institutions, it appears, can overcome geographical constraints and lousy initial conditions. Good institutions can be acquired, but doing so often requires experimentation, willingness to depart from orthodoxy, and attention to local conditions....[History constantly] reminds us not to be too deterministic about the source of high-quality institutions. Choices made by political leaders make a big difference.

--Dani Rodrik (2001)

For the Philippines, Rodrik's epigraph at the beginning of this paper should be properly paraphrased in this manner: "*Bad institutions, it appears, can overcome natural resource bounties, geographical advantages, and extremely favorable initial conditions. Our history supplies us with the stark reasons behind low-quality institutions. The choices made by our leaders obviously made a big difference.*"

The World Bank (Vinod Thomas: 2000)¹ noted that the Philippines are an example of a promise that turned into a dud. The 1950s was designated as the "development decade" following the spate of triumphalist developmental think pieces emanating from the West, exemplified by that poor parody of Marxist historiography that is W.W. Rostow's *Stages of Growth*. At the time, the resource-rich Philippines were seen as the most likely economic success story. The business model looked something like this: parlay your export foreign exchange revenues into an industrialization fund that will finance the purchase of producer goods and technology from the West; set up industries that will cater to your home market so the forex will not be used to finance imported consumer goods; set up protective tariff walls to nurture infant industries, etc.—and *voila*, you will have transformed an agricultural economy into an industrial one in no time.

¹ In their preface, Thomas and company wrote: "Sometimes expectations based on experience have been borne out, sometimes not. Early discussions predicted the success of such natural resource-rich countries as Myanmar, the Philippines, and some in Africa and the failure of such natural resource-poor economies as the Republic of Korea or Singapore (Thomas *et al.*: 2000, xviii).

The promise of sustained growth and industrial growth for the Philippines was raised anew during the last half century: in the 1970s under the auspices of the Marcosian national security-developmental state; in the late 1980s under the auspices of the People Power state under President Corazon Aquino, and in the mid-1990s under the fighting banner “Philippines 2000” of President Fidel V. Ramos. As if the Asian financial crisis of the late 1990s was not enough, the Fates have decided to unleash the Estrada presidency on the archipelago. Hopes sprung anew in January 2001 as the hard-nosed, no-nonsense, and business-like administration of President Gloria Macapagal-Arroyo was ushered into office by a less-universally welcomed repeat of People Power 1986.

Nowadays, a most certain gloom has gripped the country as it struggles with the largest public deficit ever, puts up with an un-elected president hell-bent on winning the 2004 presidential elections, and ponders on a possible repeat of an Erap come 2004 with the electoral victory of Erap’s friend and movie box-office rival, the “King”—Fernando Poe, Jr., or FPJ, for short.²

In Appendix 5 of this paper, we argue that building a strong democratic republic in the Philippines was a *sine qua non* for sustained and high-quality economic growth. A shorter version of that argument is made below. In the rest of this Part 3, we highlight the lessons that we should learn from the Philippine growth experience since its establishment in July 1946 to Estrada’s ouster in January 2001 so one may have an inkling of what the future has in store for the country if the past keeps repeating itself.

The Philippine growth story is rather a sad but familiar one akin to the front-runner who lost steam and finished last in the race: a promising start followed by short bursts of growth followed by busts to produce an over-all inability to sustain growth and alleviate poverty. With this general story, the authors want to highlight the following arguments that illustrate the interplay of socially-irrational yet privately-beneficial policies and outcomes:

1. The question of foreign exchange constraints and recurring balance-of-payments crises. The lack of sustainable growth is really due to persistent foreign exchange constraints. This is exemplified by the fact that foreign savings (represented by the gap between saving and investment rates) tend to be higher during boom periods. When foreign savings weaken, the economy usually enters into a bust period. The same pattern can be seen by a study of international reserve levels. The questions remain: why do these constraints continuously frustrate growth? Why and how did other neighboring economies managed to overcome these same constraints? The answer seems apparently clear: while other countries prudentially used foreign exchange earnings to

² Political pundits observed that FPJ is an even more formidable presidential candidate than Erap, who has garnered the highest number of votes for president in Philippine history. Like Erap, FPJ’s electoral appeal rests largely on his cinematic exploits and drawing power at the box-office. Erap himself acknowledges FPJ’s edge by confessing that if both their movies were shown simultaneously, FPJ’s will consistently beat his’ at the box office. They had contrasting movie *personas*; while Erap was anti-hero, FPJ was pure hero and appealed not only to the men but to the women and children as well.

finance foreign exchange-generating ventures, the Philippines practically squandered the same in unproductive (e.g., conspicuous consumption, monument building) and/or anti-social activities (e.g., electioneering, vote-buying, private army-building, capital flight). The country's elites has irresponsibly violated the fundamental tenet of finance that even ordinary housewives understand: *save while the sun shines for the rainy day*.

2. Policies geared toward sustainability of growth rather than just high growth. The policies adopted were short-sighted, aimed primarily at stoking growth for a few years (in time for the next elections, perhaps?) rather than sustaining growth in the long-term. Prior to 1969, no chief executive has ever won his bid for re-election despite throwing everything (baby, bath water, bath tub, and all) into the electoral fray. For this reason, a concern for the medium-term has been lacking. But what compounds the problem is a stronger concern to protect and promote private interests even at the expense of social welfare, an affliction common to all regimes even to the present. When the dictatorship was established in 1972 by Ferdinand E. Marcos (who was prevented from assuming a third term at the presidential palace), the problem with short-term time horizons was apparently solved. But that proved to be insufficient and even made the situation worse. If the authoritarian leader, his relatives, and his cronies have placed greater value on their personal aggrandizement, then a longer but uncertain "term of office" will mean greater social costs. In contrast, the *Yushin* regime of Gen. Park Chung Hee established a few months after Marcos' "New Society" started the process that will culminate in South Korea's membership in the rich men's club—the Organization of Economic Cooperation and Development (OECD)—as early as 1995. The economic policies adopted by both democratic and authoritarian regimes were singularly inconsistent with the sustainability of economic growth.

- In the late 1940s, the elites went into an orgy of importing consumer products to satisfy a demand suppressed during the Japanese occupation of the country. The economy faced its first post-independence balance-of-payments crisis and the new Republic almost collapsed as the country leaders did a Nero—'fiddling' as Moscow-supported Huk insurgents³ were practically knocking at the gates of the capital city and even unmindful that soldiers and public school teachers were without pay and therefore were vulnerable to Huk propaganda. The Americans' concern for the newly acquired military bases (Clark Air Base and Subic Bay Naval Base; the largest outside continental USA) provided the wherewithal to save the day for their indolent and extravagant Filipino allies.

³ The "Huks" (short for *Hukbo*, the Tagalog term for army) were first organized by the local communist party (*Partido Komunista ng Pilipinas* or *PKP*) as the *Hukbo ng Bayan Laban sa Hapon* (People's Army against the Japanese) or *Hukbalahap* after the Japanese Imperial Army invaded the archipelago in 1942. After the war and upon the return of the American soldiers in 1946, it was reconstituted as the *Hukbong Magpapalaya sa Bayan* (National Liberation Army) or *HMB*.

- In the 1950s, for instance, the import controls targeted against finished products and the import substitution industrialization (ISI) program caused rapid economic growth (one of the highest in Asia at the time) and a change in the country's industrial structure (manifested in the growth of industry's and manufacturing's share-of-GDP ratios)⁴. However, the bias against exports prevented the accumulation of international reserves to support the program. Consequently, the foreign exchange constraint re-emerged. The industrialization effort was *ad hoc* or haphazard as "rent-seeking entrepreneurs flooded the halls of the central bank in search of dollar allocations that enabled them to reap windfall profits in producing for a protected market" (de Dios and Hutchcroft: forthcoming). The unassailable economic logic: Given the overvaluation of the peso (fixed at P2 to \$1), imports were relatively cheap. On the other hand, if the domestic market for industrial products were protected against external producers, a local monopolist-industrialist stands to capture enormous rents. However, since foreign exchange (to purchase capital and intermediate goods) was necessary to produce consumer products, these same monopolists had to rely on non-economic means (including bribery) to obtain their share of rationed foreign exchange. Furthermore, the failure to broaden and deepen the internal market for industrial consumer goods served to present objectives limits to inward-looking industrialization.
- After 1962 and up through most of the Marcos era, entrepreneurs responded to (import and foreign exchange) decontrol and the peso devaluation (to about P3.25-3.90 per dollar) by over-exploiting the country's natural resource base (timber and copper ore). In the process, the country's natural capital base was run down at non-sustainable rates and proportions leading to severe environmental degradation. In a survey of the country's forestry sector, Boyce (1993: 240-1) wrote: "*Philippine forestry in the Marcos era provides a case study in the political economy of environmental degradation. A natural inheritance has been squandered, as future income opportunities are sacrificed for short-term gains. At the same time, the social costs of soil erosion, floods, droughts, and lost (sic) of biological diversity have been imposed on current and future generations. In a setting of marked political and economic inequalities, one can expect state policies with respect to the natural environment to favor the interests of the rich and powerful over those of the poor and powerless. If environmental degradation benefits the former at the expense of the latter, it will continue until such time as it is blocked by the mobilization of countervailing power.*" A parallel story could be related for the country's mining sector and is told by McAndrew (1983) and Briones (1987). Alongside decontrol and peso devaluation, the protectionist walls that fostered inefficiency in domestic

⁴ Manufacturing's share increased from 10% of GDP in 1948 to 17.9% in 1960.

manufacturing were retained. Thus, instead of boosting higher value-added manufactured exports, lower value-added and more-vulnerable-to-the-vagaries-of-the-world-market (i.e., demand-elastic) raw material exports were promoted.

- During the seventies, the dictatorship's easy access to foreign capital and US military aid encouraged an aggressive borrowing program to finance growth anchored on inefficient public enterprises and so-called strategic industries, and wasteful capital flight and empire building, only to end in a massive debt overhang in the 1980s. In this case, the foreign exchange constraint manifested itself in a very big way. Throughout the dictatorship, favored parties were given preferential access to state-provided funds in a supposed-replication of South Korean export-oriented industrialization that had as its core state financial support for the export-oriented *chaebols*. The logic was to provide adequate muscle for strategic industries that could eventually compete effectively in the world manufactured-exports markets. These strategic industries were likewise protected within the domestic market so their learning curves would be shorter and less steep. The South Koreans managed to succeed as the stronger national security-developmental state under Park Chung Hee was able to impose discipline on South Korean big business with the warning: export or lose state support! In this case, the arbiter for continued state support was an impartial world export market, an arena where even the most powerful *national* dictator is relatively powerless. In contrast, the authoritarian state under dictator Marcos was weaker and was unable to prevent crony firms from siphoning state funds to egg nests abroad or to concentrate production in an easier (because protected) internal market. The inefficiencies of the import-substituting industrialization period were carried over to a supposedly export-oriented regime engaged in a "half-hearted flirtation" with export-promotion policies (Montes: 1987, 2). Thus, no objective test existed to assess whether crony firms deserved continued state support such that public resources became the private resources of inefficient and criminally-wasteful crony firms. When the cronies left the proverbial sinking ship even before 1986, their failed firms (shored up by Marcos with public loans and equities) became the state's charges during the Aquino administration. Social welfare was thus harmed twice: at first, public assets became privatized during the dictatorship; then private losses and liabilities were socialized by post-Marcos democracies—in a perverse Philippine version of socialism!⁵
- In the mid-1980s up to the 1990s, trade and foreign exchange liberalization was accompanied by an unofficial peg of the exchange

⁵ These points are amplified in Mendoza's (1992) assessment of the Corazon Aquino economic program and Mendoza (1995) *Kasarinlan* article on South Korean finance, rent-seeking, and economic development. (Full bibliographic citation will be given later)

rate, thereby negating the positive effects of the liberalization efforts. The peso remained over-valued and exports remained generally uncompetitive. The result was the curious phenomenon of 'reverse mercantilism' where liberal foreign trade regimes brought a flood of imports into the country while exports, while growing also, grew at a slower pace relative to imports. While the liberal importation of consumer and producer goods managed to tame inflation, the failure of exports to outpace imports carries the seeds of future BOP crises.

3. Growth in the Philippines is largely capital-driven even as capital growth has been restrained. While this is not unique to the Philippines, the relative slower pace of capital formation in the country is a major factor behind lower economic growth rates compared to its East Asian neighbors. The spasmodic character of the country's economic growth record is one factor behind its poorer investment record. The propensity to use capital resources unproductively is another. Of course, the uncertainties behind electoral and unconventional regime changes (and attempts at regime change such as the coup attempts of the late 1980s) have similarly led to an investment boom and bust cycle.⁶ The inordinate power and influence that Philippine presidents enjoy over the economy and economic outcomes is a principal factor behind investment fluctuations. Every new occupant of the presidential palace (including the incumbent president, Gloria Macapagal Arroyo, 2001-) since Manuel L. Quezon of (the American-sponsored toddler-state that is) the pre-war Philippine Commonwealth brings with him a new set of cronies that will gain first stab at stealing from the public treasury. Thus, a pattern has been observed where investors hold back during the year before and after the presidential elections. They do so in response to the uncertainty of the election's outcome as well as uncertainty about the policies to be adopted by the incoming chief executive including the security of property rights and contracts entered into with the previous administration. The Marcos dictatorship (1972-86), even as it got rid of elections, failed to remedy investor uncertainty. Investors became wary towards the beginning of the 1980s as it was becoming clear that Marcos was veering to make wife Imelda Marcos and his armed force and intelligence chief, Gen. Fabian Ver, to be his successors and regents that will prepare his son, Ferdinand Jr., and daughter Imelda (a.k.a. Imee), for eventual dynastic succession. Businessmen were worried about the power struggle that would ensue when Imelda and Ver assume power and move against putative rivals, defense minister Juan Ponce Enrile and Armed Forces of the Philippines (AFP) vice chief of staff Fidel V. Ramos, two people who will figure in the failed-military-coup-turned-People-Power-Revolution on 1986 that toppled Marcos from power. Even before the Marcos dictatorship went into a deep crisis after the 1983 assassination of oppositionist leader, former Senator Benigno Aquino, Jr., his cronies abandoned him and engaged in massive capital flight in 1981-82 (Boyce 1993) after a financial scandal revealed the internal weakness of many

⁶ See de Dios (2000), which discusses the political cycle hypothesis (PCH) to explain Philippine economic boom-bust cycles.

crony conglomerates. In another illustration of the moral hazard problem, Marcos was forced to use public funds to shore up the crony firms instead of courting political problems if these same firms were allowed to go bankrupt.⁷ The restoration of presidential elections after 1986 also restored pre-martial law patterns. The preference of President Estrada for businessmen and other shady characters of Chinese-descent will largely explain why the same coterie of business groups (that was largely based on the old Spanish families such as the Ayalas) that helped topple Marcos would again figure prominently in the anti-Estrada effort of the late 2000-early 2001 period and are again complaining of the new cronies of the First Gentleman, Miguel “Mike” Arroyo.

4. One clear weakness of capital formation in the Philippines that impacts adversely on economic growth is the obvious shortfall in public infrastructure⁸, which any comparison with neighboring countries will make obvious. In this issue area, one has also to factor in the almost-incalculable destruction wrought by typhoons and tropical depressions, of which an average of 25 buffet the archipelago annually, several earthquakes, including one in 1990 that registered 7.3 on the Richter scale, followed by a once-every-six-centuries-explosion of Mt. Pinatubo in 1991, among many other volcanic eruptions in various parts of the country—all of which transpired during the historical period under consideration. We must also calculate the damage to physical infrastructure caused by the many internal armed conflicts across the decades. And finally, we need to consider the additional transactions costs attendant to infrastructure construction due to natural and man-made calamities. In the same manner that inclement weather can delay or prevent construction, so too can armed conflict. The glaring shortage of high quality roads and bridges, the inaccessibility of rural areas, and the high costs of inter-island transport are all important constraints to limiting the scope of internal markets as well as access to foreign ones.⁹ This in turn is related to the government’s perennial inability to raise taxes and other internal revenues. All post-Marcos administrations have struggled with a fiscal dilemma: on the one hand, they recognize that long-term

⁷ The non-crony capitalists, who eventually joined the anti-Marcos opposition after the Aquino assassination in 1983, were first to complain about the preferential treatment of the undeserving businessmen. Jaime Ongpin of Benguet Corporation, who soon became the finance minister of President Corazon Aquino, made a play on the acronym of the crony-owned Construction and Development Corporation of the Philippines (CDCP) to explain Marcos’ policy response to the financial scandal. According to Ongpin, the real meaning of CDCP was Capitalism Daw, Cronyism Pala! (roughly translated as Capitalism in words, Cronyism in deeds).

⁸ A fuller discussion of the arguments raised in this section is found in the *Philippine Human Development Report 2002* (or PHDR 2002).

⁹ One of the authors was involved in the demographic and economic assessment of the so-called 19 poorest provinces of the country undertaken by the Philippine Council for Countryside Development in 1995. Agricultural productivity was quite respectable in these so-called poor provinces but the failure to bring their products to the relevant markets (due to lack of farm-to-market roads, post-production facilities, and the prohibitive cost of inter-island transport) leads to the failure to transform produce into income (in the poor farmer’s version of the realization crisis of capitalists ala Karl Marx). For example, bumper corn harvests in Northern Mindanao fail to find markets with the feed integrators and millers of Cebu (in central Philippines) who prefer to use corn imported from Vietnam and Thailand.

growth and poverty-alleviating employment requires the provision of critical infrastructure and therefore greater government spending. On the other hand, with a poor tax collection record and an annual budget that is saddled (almost 90%) with employee payrolls and operating expenses, there is little room to expand public capital spending without risking a growing budget shortfall. With the latter, meanwhile, comes the disapproving ire of multilateral financial institutions like the International Monetary Fund and private commercial banks, who then threaten to raise the premia on additional loans. Recent Philippine administrations have taken the modest option of limiting spending rather than incur the IMF's ire over yawning public deficits. While this may make our macroeconomic indicators look healthy to foreign institutional investors and fund managers, the continued expenditure of only 2-3 percent of GNP every year on public infrastructure will continue to hamper growth. While everybody knows the obvious solution—drastic improvement of tax collection by cleaning up the internal revenue agencies and running after wealthy and powerful tax evaders (who would rather contribute to political campaigns for a bigger and faster bang for the buck)—nobody has tried this difficult and dangerous course of action. The recent resignation of the internal revenue chief, which was graciously accepted by President GMA, serves as the latest warning. But the more relevant warning is: unless the government's coffers are healthy enough to engage in public capital formation in a more massive scale, there can be no strong basis for sustained growth and employment.

5. A major long-term obstacle to sustainable and high-quality growth in the Philippines has been the unresolved issue of rapid population growth. In here, the failure of the Philippine state to face up to the strong influence and interference of the Roman Catholic Church is at the issue's core. The final results of the 2000 census indicate that instead of the occurrence of a much-awaited slowdown in population growth, it actually accelerated slightly over the past two decades, from 2.35 percent annually in the 1980s to 2.36 percent in the 1995-2000 period.¹⁰ The effects of a large population on employment and economic growth are quite evident. It immediately means a higher dependency ratio and heavier burdens for working people who must feed more on meager incomes.¹¹ Nonetheless, the dependency ratio is actually an underestimate of its adverse impact on overall productivity since not all people of working age actually find employment. For one, women of working age, especially from the poor sectors of society, have difficulty finding employment because of the large number of their children. In addition, a high dependency ratio may also help explain the country's low saving and investment record. Furthermore, a rapidly

¹⁰ Records show that a Filipina of child-bearing age has 3.7 children on the average, of which one birth is unplanned. This is high compared to a world average of 2.9 children per woman. At this rate, today's total population of 80-odd million may be expected to double in 29 years. The Philippine record contrasts markedly with that of similarly densely populated countries (e.g., Indonesia, China, India, Thailand, and Vietnam) which managed to reduce population growth to below 2 percent more than a decade ago (*PHDR 2002*, p. 12).

¹¹ In year 2000, the dependency ratio was 0.67, or 67 dependents (people too young or too old to work) for every 100 people of working age. This figure is computed from the medium scenario projections of the 2000 census. (See <http://www.census.gov.ph/data/sectordata/popproj03.txt>).

growing population eventually creates a large industrial army of the unemployed (*ala* Marx) that exerts further downward pressure on real wages and incomes. A large population also strains government resources for both physical infrastructure and human development (i.e., health, education, etc.) to the limit. Quality education and training are not likely to be attained when public budgets are engulfed with the ever-increasing annual streams of schoolchildren. Physical infrastructure will prove to be inadequate in the face of burgeoning urban settlements, especially those of the urban poor. Quite apart from poor tax collection, the existence of a very young population—many of whom are unemployed or mired in low-paying and insecure informal sector jobs—implies a narrow tax base from which to finance public infrastructure and social services. Finally, a larger population does greater harm to the natural environment that in turn causes a worsening in the quality of life in both urban and rural settings, especially among the poor. Poor people, especially in the rural areas, because of their greater reliance on natural resources for their livelihood, will suffer disproportionately from environmental degradation (Thomas *et al*: 2000). In sum, the result of runaway population growth is a weak foundation for growth in terms of human, physical and natural capital. While this truth is known to all, population growth in the Philippines has yet to be curbed.

6. One cannot ignore, as a major reason for non-sustainability and low level of Philippine economic growth, the historical instability of the political process itself. Objectively speaking, formal political processes in the Philippines have been periodically challenged and subverted, for good and bad reasons. Since 1946, the Republic has run the gamut of the Marcosian dictatorship, fraudulent, violent, and costly elections (1949, 1969 and 1986 especially), armed rebellions (of the Huks during the 1950s, the re-established communist party since the late 60s to the present, the various Muslim secessionist movements since the 1970s to the present) and failed coups (of the rightist military rebels during the second half of the 1980s), and the three People Power uprisings (February 1986, January 2001, and April-May 2001), two of which have resulted in regime changes. In recent decades since Marcos' ouster, the challenge posed by organized crime both to political stability as well as the integrity of the democratic electoral process has to be fully recognized. The impunity with which criminal syndicates can operate undermines government's credibility and people's trust. The extent to which criminally-sourced funds helped influence electoral outcomes at all levels will likewise diminish faith in governmental authority and legitimacy. Of course, all of these phenomena are bound to be a potent disincentive to investors, domestic and foreign, and will adversely affect economic growth. The failure of 'normal' political institutions to accommodate and address what are deemed by significant sectors of society to be fundamental inequities and injustices is at the base of the many and continued attempts at redress that are extra-institutional and even violent at times. That much of our politics since 1946 is of the headline-grabbing dramatic and extra-ordinary kind rather than the bland, ho-hum, ordinary kind is an important factor behind our poor economic performance.

7. The failure to provide adequate physical infrastructure, to curb runaway population growth, and to ensure compliance with institutional arrangements and normal political processes—some of the major reasons behind weak economic growth in the Philippines—can be traced to the weakness of the Philippine state relative to private interests. The failure to tax, the failure to penetrate and extract resources from society is clear indication of state weakness vis-à-vis powerful interests that should normally be part of any society's tax base. The failure to curb runaway population growth is largely a function of the state's failure to confront the (imagined and often exaggerated)¹² power and influence of the Roman Catholic Church (that frowns on all population control methods save so-called natural, and largely unreliable, methods such as abstinence, *coitus interruptus*, and rhythm). And the failure to implement the law or to a lesser extent, to enact sound law) is at the heart of our political instability problems. It is for this reason that we argue (a fuller argument is made in Appendix 5) that strengthening the Philippine state vis-à-vis private interests is necessary to improve our economic performance. A strengthened Philippine state must not be misconstrued as a prescription for another authoritarian experiment for the country. On the contrary, the only strong state is a democratic state. Even the most powerful states cannot preside over sustainable economic growth without social support. While authoritarian states can coerce society for some period of time, a stronger basis for growth is negotiated state power wherein states govern societies with society's approval and support. The truly strong state is the limited state. When the state makes a credible commitment to limit its power, the security of property rights and contract enforcement so dear to the new institutionalists like Douglass C. North and Mancur Olson¹³ will help spur and sustain economic growth. It is true that one can surely collect taxes when people are confronted with the naked power of gun barrels. Nonetheless, recent history shows that democratic states have better internal revenue raising records than authoritarian ones. People will contribute more taxes not when they are coerced to do so. They will contribute more when they see that their taxes are used responsibly by an accountable regime, when these same taxes are collected by a regime whose spending patterns will reflect social preferences.
8. Even as we make the above statements, we must answer the objection that the Philippines is not the only weak state in the region (or even in the world) and that other weak states have turned in better economic performance. The relative superiority of states in more prosperous jurisdictions such as the South Korean or the Taiwanese state or even the Hong Kong city state or the Singaporean city-state vis-à-vis the Philippine state is beyond question.¹⁴ But how about the

¹² A number of opinion surveys of the Social Weather Stations (SWS) indicate that an increasing number of Filipino Roman Catholics believe that they need to practice the birth control method that is acceptable to their individual consciences, rather than be limited to the methods explicitly allowed by the Church. **(Full bibliographic citation must be supplied later).**

¹³ **Full citations for North and Olson must be supplied later.**

¹⁴ That these same states were once considered weak ones does not complicate the picture. It rather makes the Philippine state poorer in comparison. For one, amongst the jurisdictions mentioned, the Philippines

states in relatively less prosperous jurisdictions such as Indonesia and Thailand? Our first response is to assert that the Philippine state is among the weakest in the region, even the weakest amongst the weak. Our crude measure of state strength is the quality of two basic agencies, the barest minimum that states must have in order to be states. These are the armed forces and the tax collectors. One needs an army to be able to collect taxes. If a state is democratic, the armed force need not be actually used to collect taxes. The credibility of state's authority, which ultimately rests on the monopoly of power and armed violence within its territorial jurisdiction, is enough to ensure acquiescence to tax laws. On the other hand, one needs to collect taxes to be able to maintain an armed force. Of course, taxes can finance the provision of public goods other than national defense and internal peace and order through an armed force. As this happens, the institutional and organization "thickness" of the state increases. But this increase in state "thickness" and strength is both dependent and will impinge upon the tax collection effort. More tax revenues will, all other things being equal, produce a stronger state. A stronger state meanwhile can collect more taxes than a weaker one.

9. If one agrees to use this crude measure, then we must recognize that the Philippine state is among the weakest within the region. It has the smallest and weakest army. It has likewise the weakest tax collection effort in the neighborhood. Since 1946, the Philippines was an American protectorate with the US 7th Fleet (HQ-ed in Subic Bay and the 13th Air Force (HQ-ed in Clark Air Base) guarding her waters and airspace. What passed as the Armed Forces of the Philippines (AFP) got tasked with internal pacification rather than defense against external (read as international) threats. The poor quality of its governmental agencies relative to Singapore may make the Indonesian state look like a weak one. For instance, its tax collection record may not be a very impressive one. However, its oil revenues have provided the Indonesian state with the wherewithal to create a credible army, finance military-related industrial ventures (such as domestic air and sea patrol craft) as well as corruption within Suharto's familial circles and the ruling party's circuits. Path dependence plays a role here. The Philippine Army has never won an international war, suffering defeats at the hands of the Spaniards, the Americans and the Japanese since the 1898 Philippine Revolution that first introduced the idea of Philippine nation-state-hood. As to the internal wars fought since the 1920s, no decisive victories can be claimed. Or even if there were (e.g., against the Huks in the 1950s and 1960s), the victory is to be shared with our American big brother who armed, supplied, equipped, and trained our officers and troops. The authors believe that we are the only jurisdiction in the world that celebrates military defeats. We celebrate annually the fall of Bataan and Corregidor

waged the first national liberation struggles amongst the colonies in Asia. Even if we take 1946 as its emergence, the Philippine state is older than the Malaysian, Singaporean, South Korean, and Taiwanese state. As in economic growth, the record of state building in the Philippines is quite similar—retrogression and/or stagnation after a promising start while other countries started with relatively-weaker states and managed to strengthen them over the decades. Economic growth and state building are apparently mutually-enforcing processes.

consoling ourselves with an exaggerated notion of the value of the resistance we put up against the Japanese.¹⁵ The emergence of the nominally independent Philippine state in 1946 was at the behest of the U.S., the world's true superpower net of the Soviet Union. In contrast, the Indonesian army that formed the core of the Indonesian state was a victorious army that fought and won independence from the Dutch colonizers. It thus enjoyed the prestige of an army of independence. The Indonesian political system was therefore dominated by a "military elite" that presided over a relatively acquiescent civil society.

10. If we use Thailand as our comparator, it is also clear that the Thai state is stronger relative to the Philippine state. Again, history is implicated here. Thailand was never a formal colony of any external power unlike the Philippines. Akin to Indonesia, the Thai political system was dominated by a bureaucratic elite or "political aristocracy" and countervailing social forces were strikingly weak. In Thailand, government service offered the greatest opportunities for wealth, security, prestige and power. Because businesspeople lacked political access, they were sometimes called 'pariah entrepreneurs' and had to contribute financially to the private incomes of protectors and patrons within government. In effect, business did not have sources of power and wealth independent of or outside the Thai state's control. In contrast, the Philippine political system is dominated by a social force that has an economic base independent of the state apparatus even as the state plays a central role on the process of wealth accumulation. In the Philippines, a powerful private business class extracts resources and privileges from a largely incoherent bureaucracy. For long, the Philippine bureaucracy was staffed by elements employed at the behest of powerful politicians and vested interests and had never developed autonomous power relative to private interests.¹⁶ During the 1970s, the Thai state was confronted by a more powerful communist insurgency compared to that mounted by the re-established Communist Party of the Philippines (CPP). Yet in the early 1980s, the Thai army managed to decisively defeat the Thai insurgents such that rural insurgency is now a thing of the past in Thailand while it still is a going concern in the Philippines. Of course, the changes in the alliances entered into by a People's Republic of China worried by resurgent Vietnamese nationalism after 1975 also shifted the fortunes of the Thai insurgents. China now wanted Thailand as an anti-Vietnam ally; accordingly, it withdrew support for the Thai insurgents. For this reason, Thailand was able to benefit from peripatetic Japanese capital after the 1985 Plaza Accord revalued the Japanese yen vis-à-vis the US dollar and forced Japanese industry to relocate to Southeast Asia to make their exports still competitive in the US market. Path dependence again plays its influence. While the mid-1980s saw the Philippines struggling with dying months of the Marcos dictatorship and the pains of re-democratization, Japanese capital was

¹⁵ According to Philippine army 'mythology', our resistance in Bataan and Corregidor supposedly delayed Japanese victory by a good few months enabling Australia and India to shore up their defenses.

¹⁶ This comparison between the Philippine, Indonesian, and Thai states draws largely from Hutchcroft (1998).

attracted to a more stable Thailand, Malaysia and Indonesia. That we did not suffer as much from the hemorrhage of portfolio capital during the Asian financial crisis of the late 1990s as these countries (because of our failure to attract massive amounts mobile capital during the late 1980s and early 1990s) gives Filipino small consolation.

- 11.** Poverty in the Philippine can be alleviated as long as stable and productive employment for the poor can be provided. The poor in the Philippines are poor not because they are unemployed; because they are poor, they cannot afford to be unemployed and income-less. Nonetheless, most of them are employed in low-paying, low-value added, unstable jobs in the informal sector. The effort to provide stable and productive employment can succeed only if the economy can succeed only if the economy can be put on a solid footing for rapid growth over a longer period—say a per capita growth of 5 percent or more over a period lasting at least a decade. According to the *Philippine Human Development Report 2002*, if the country grows at this rate, per capita income would be 63 percent more in a decade and would double in about 14 years. By contrast, the historical growth rate of 1.14 percent would raise per capita income by only a third in a decade and would require 23 years for it double. Thus any other solution will be merely supplemental or palliative.
- 12.** Given the challenges confronting the Philippines, what positive lessons from its growth history must we emphasize? For one, openness will help growth. The thrust toward more economic openness will benefit growth in several ways. First, it helps draw the needed foreign saving to finance growth. Second, our estimates show that economic openness helps improve total factor productivity (TFP). A caveat, though, would be the need to safeguard against increased vulnerability to external shocks due to openness. This calls for the strengthening of domestic institutions without necessarily reverting back to protectionism. For this reason, it is rational that financial liberalization should precede trade and capital account liberalization.
- 13.** Unfortunately, the negative lessons outnumber and outweigh the positive ones. For one, the Philippine government must adopt internally-consistent to be socially-beneficial macroeconomic and sectoral policies that will place the economy on the high road of income and employment (and consequently poverty alleviation). It must be able to resolve its perennial financial and fiscal dilemma so it could encourage a high level of investment through the provision of adequate and high-quality infrastructure. It must be able to curb runaway population growth. And through more thoroughgoing and inclusive democratization, it must be able to resolve and avert the destabilization caused by political upheavals and extra-ordinary politics. All the above will be accomplished only if the power and influence of private vested interests can be tamed and state strength can be enhanced.
- 14.** How will the strong democratic republic in the Philippines be built? The prospects apparently are bleak what with the seeming possibility that history might repeat itself in the Philippines: the first issue cast as a tragedy (Estrada elected as president in 1998) and the repetition will rightfully be considered a farce (FPJ elected as president in 2004). If this scenario will come to pass, the

country and the Filipino people will rightfully deserve the world's scorn and laughter for failing to learn and profit from repeated lessons from our rich history. A significant number of Filipinos will most likely join the 19 percent who have earlier signified (in various opinion polls conducted in mid-2002) intentions to surrender their Philippine passports for those of other countries. We have alluded to (in Appendix 5) the existence of an implicit coalition for growth and state strength that could serve as the source of change. The possibility of an FPJ victory in 2004 may decisively end the Philippine state project. However, we believe that the despair and outrage generated by this strong possibility will activate the implicit coalition for change. While we all are vulnerable to *fortuna's* embrace, while we are thrall to the iron law of surprise, we nonetheless feel the need to explicate our hopes and dreams for our country's future. Probably because whistling in the dark is definitely more comforting than swearing and cursing at dire futures.

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Appendix 1: Review of Literature on Philippine Growth

Jose Antonio R. Tan III

Measuring Economic Growth

Among the earliest studies to measure growth in the Philippines was that done by Hooley in 1968, which studied the total factor productivity (TFP) in manufacturing from 1948 to 1961. He concluded that total factor productivity in manufacturing grew by a pace of two percent per year. In 1968, Williamson and Sicat studied technical change from 1957 to 1968 and estimated the annual rate of TFP was between one to one and a half percent per year. Patalinghug (1980), utilizing census data from 1956 to 1970, estimated TFP growth at 3.6 percent per annum with large firms growing faster than small firms. In 1981, Estanislao, using corporate data from 1958 to 1978, found that TFP growth was high prior to the seventies but fell in following decade. Hooley (1985) estimated the TFP for manufacturing as a whole and 24 individual industries using data from 1958 to 1983. He found that TFP growth in manufacturing was -0.71 percent per annum in 1956-70, -2.23 percent per annum in 1971-1980 and -2.5 to -3.0 in 1981-1983. Yamagata (2000), utilizing Hooley's data, examined the procyclical behavior of the total factor productivity of Philippine manufacturing and tested whether such was associated with increasing returns to scale. Empirical estimates in the study showed little evidence of increasing returns to scale and, in fact, supported that hypothesis of constant returns to scale in aggregate manufacturing.

Recent works on TFP have been done by Cororaton *et al.* (1995), Cororaton and Abdula (1997), Cororaton and Caparas (1999) and Cororaton and Cuenca (2001). Unlike previous work where industry and corporate data were used, the more recent studies used national income accounts data. Cororaton and Caparas, using data from 1980 to 1996, found that TFP improved right after the crisis in mid-1980s but this was not sustained and, subsequently fell in 1990s. Cororaton and Cuenca, using updated data from 1980 to 1998 and a modified TFP estimation procedure vis-à-vis Cororaton and Caparas, found that although the contribution of TFP was negative for the whole period, there was an improvement in 1990s.

Identifying economic policy regimes

The choice of economic policies has tremendous impact on economic growth. Oshima (1983) expounds on the inappropriateness of heavy industrialization policies in Asian development. Oshima (1987) proposes that an agriculture-based development program is better suited for the Philippines as opposed to the import-substitution policies adopted in early 1950s and lasting until the early 1980s. Bautista, Power et al. (1979) provide an opposite assessment of industrial policies. They emphasize the need for industrial promotion as a key ingredient for growth. In their study, they assess the industrial promotion policies in the Philippines and offer recommendations to improve them.

Monetary, fiscal and trade policies are also crucial in the development process. Krugman *et al.* (1992) released a report, which critiqued the trade, industrial, debt management, monetary and fiscal policies from the 1970s to the late eighties. They found that these policies contributed to unsustainable growth. Lim (1996) studied the macroeconomic developments from 1970 to 1993 and the policy regimes adopted during the period. Notably, he characterizes the recession of the early to mid-eighties as an outcome of the debt crisis, extreme monetarist contractionary policies and the general loss of confidence. This sharp depression and the slight dip in the early 1990s have led to the lower saving rate and the slow growth of capacity in the economy.

Development of Markets

The importance of markets for economic development must not be undermined. This is particularly true for the financial markets through which financial resources are mobilized and allocated. Villanueva (1966) provides an early literature on the role of financial markets in economic development. He finds that the financial system has a permissive role in economic development, i.e., it cannot trigger, *per se*, economic development. However, he notes that financial innovations are required for sustained economic development. Paderanga (1996) reviews the evolution of the Philippine financial system from 1980 to 1995, and highlights the interaction between real and financial sides of the economy. The study identified key events and milestones in the liberalization of Philippine financial markets.

Related Social Issues

In recent years, much work has been done on social issues that are related to economic growth. Balisacan and Fujisaki (1999) provide a compilation on the studies on the causes of poverty. It deals with the proximate determinants of poverty and its relationship with economic growth and globalization. It likewise studies specific sectoral and policy concerns, like labor, education and local governance, which have implications on poverty. Balisacan (1997) studies the growth-poverty-inequality nexus in the Philippines. He finds that the growth process has not had strongly adverse impact on the poor.

Orbeta and Pernia (1999) review the relationship between population growth and socioeconomic development in the Philippines. They focus on the interaction between population growth and following areas: economic growth, human capital investments, poverty and the environment. They find that high population growth partly contributes to the slow economic development. It has a negative impact on education and health. Likewise, it is difficult to reduce poverty when the population grows faster. Environmental problems also may be expected to deteriorate with rapid population growth.

While it appears that research on social issues such as poverty and population growth is extensive, there might be a need to strengthen the literature on the relationships with economic growth.

Appendix 2: Historical Foundations of the Modern Philippine Economy¹

Amado M. Mendoza, Jr.

The Philippine nation-state had to be born twice since its first edition was aborted by American colonialism in the early 20th century. For our purposes, this account covers a period that starts with the colonization of the islands by Spain in the 16th century to the end of the Second World War and the grant of independence by the US in 1946.

Even as the archipelago was colonized by Spain since the mid-16th century, the modern Philippine political economy can be traced to a 19th century process of agricultural commercialization led by British and American commercial houses, Chinese traders, and an increasingly powerful landed elite consisting predominantly of Filipino-Chinese *mestizos* and friar orders. Prior to the 19th century, elite interests centered on the lucrative yet erratic galleon trade. Manila served as the trans-shipment point between southern China and Mexico, with high-valued Chinese cash goods such as silk moving westward and Mexican silver moving eastward. Since galleon space was at a premium, local Philippine products were largely ignored and the economic potential of local agriculture and industry remained untapped (Corpuz 1997, Schurz 1959).

The turning point was the opening of the colony to international trade following the opening of the Suez Canal in the early 19th century. As Spain was a declining European power, this decision had two important consequences. First, it allowed non-Spanish commercial and economic interests ample opportunities to establish important footholds in the local economy even if it was still under the Spanish flag. Second, with the opening of provincial ports apart from Manila to international trade and the development of export crop monopolies and sectors (e.g., tobacco, abaca, sugar, and coffee), the decentralized dynamic of the Philippine political economy was laid out. Strong provincial elites in several parts of the archipelago emerged independent of the control of the Manila-based central bureaucracy and whose economic base was firmly outside the state apparatus (Aguilar 1998, Cullinane 1982, de Jesus 1981, Lopez-Gonzaga 1991, McCoy 1982, Owen 1982, and Torres-Mejia 2000).

This group of relatively autonomous landowner-compradors with links to foreign economic interests unmediated through Manila, the colonial capital, formed the primary social base for the first Republic of the Philippines, established in the late 19th century. When the US subsequently began conquering the islands, American colonials tried to entice these local elites in a process of 'benevolent assimilation' intended to undermine support for the national liberation struggle. The American colonial government successfully co-opted local caciques into newly formed political institutions (e.g. Partido Federalista). In the process, the caciques' power base at the local level was not only strengthened but was also extended upward to both the provincial and the national level (Hutchcroft 2000). The creation of a national legislative assembly in 1907 enabled provincial elites to consolidate their hold on the national state and fostered the creation of

¹ This account borrows greatly from de Dios and Hutchcroft (forthcoming).

a national oligarchy (Anderson 1988). This oligarchy took advantage of its independent power base to be able to exercise a significant degree of control over elements of the colonial state apparatus for particularistic ends.

The colonial trade relations established between the Philippines and the US reinforced the predominantly agricultural character of the latter's economy. As of 1902, only sugar milling and cigar/cigarette manufacturing gave factory employment. The Philippines, according to Americans, are ill prepared for industrial entrepreneurship since Spain had no history of industrialization to share with the Philippines and there was little capital available for such ventures. Filipinos and Spaniards traditionally invested excess wealth in real estate, while the Chinese reinvested it in commerce and/or remitted it to or hoarded it till their eventual retirement back in China. This situation did not change much during the American period and reciprocal free trade with America tended to simply encourage further development of agriculture and extractive industries (Carroll, 1965).

The local market had little incentive to develop the manufacturing industry since it will be in competition with American manufacturers and, at that time, consumers overwhelmingly prefer imported products. This may have been exacerbated by the concentration of wealth, notably among the landed gentry or *hacendados*, noted by Tan (1976). The concentration of land among a few has its roots in the *encomienda* system. The expropriation of *encomiendas* and the so-called friar estates during the American occupation was not in the manner of effective land reform but simply a transfer of ownership from religious organizations to individuals. Given the country's feudal social structure, this was simply a strategy by American colonizers to win over the country's elite and reduce resistance.

Under the American colonial regime, the oligarchs responded to countless new opportunities for enrichment. One source came in the form of preferential access for Philippine agricultural products (primarily sugar, coconut, and abaca) in American markets. Under the Payne-Aldrich Act of 1909, quotas were initially imposed on Philippine sugar and tobacco in response to US producer pressure. These were lifted under the Underwood-Simmons Act of 1913 (Constantino 1975, Hawes 1987). A second source came from the effective manipulation of the growing colonial state apparatus at the national level. A glaring example was the plundering of the Philippine National Bank, established to support the export crop industries, between 1916 and 1921 (Stanley 1974, Nagano 1999).² Third, at the local level, effective manipulation of state agencies provided a diverse range of means, including intimidation and terrorism, through which local chief executives and legislators could acquire land and favorable access to timber, mineral and marine resources (Sidel 1999).

On the eve of World War II, Philippine elites so enjoyed the arrangements provided by the American colonial regime that they were averse to make the transition to independence. When independence was indeed granted in 1946, it was accompanied by provisions that were clearly advantageous to the landed oligarchy controlling the state.

² Nagano (1999: 79) reminds us that American businessmen in Manila also "benefited very much from the irregular operations of the Philippine National Bank."

These included a bilateral trade agreement that guaranteed access to the US market for Philippine sugar products up to 1974, a mutual defense and military basing agreement that shifted the burden of external defense of the archipelago to the US Navy and Air Force, and a fixed peso/dollar exchange rate. These arrangements ensured the ready availability of external resources and discouraged the difficult efforts to make the economy a more efficient one.

Some of these same elites collaborated with the enemy during the Japanese occupation of the country. After the war, the collaboration issue was resolved by granting political amnesty to the offenders, an illustration of a high degree of class solidarity and social irresponsibility within the Filipino political class. The unduly heavy influence of the 'great liberator', Gen. Douglas MacArthur was also a factor as he favored Manuel Roxas over Sergio Osmeña to become the first president of third Philippine republic (Steinberg 1967, Gleek 1993).

Appendix 3: Macroeconomic Policies, Variables and Growth

Jose Antonio R. Tan III

This appendix briefly reviews the relationship between fiscal and monetary policies and growth and examines the behavior of such macroeconomic variables as savings, investments and employment, including shifts in sectoral employment and underemployment.

Fiscal-monetary policies and growth

Figures A3.1 and A3.2 plot the growth in real fiscal expenditures against that of GDP and the fiscal balance-to-GDP ratios. In the 1960s, it appears that the growth of real government spending co-moves with GDP growth with neither lead nor lag. This, however, changed in the 1970s when real fiscal expenditure leads GDP by about one period. The correlation coefficient between GDP growth and real fiscal expenditures lagged one period is 0.47. This suggests that the government in the 1970s engaged in pump priming to help prop the economy. It should be noted that it was during this time that state enterprises were mushrooming all over the country. Attempts to pump prime the economy continued in early 1980s in attempts to avert the economic slowdown. Pump priming had to be stopped when the economy went into a crisis since resources were no longer available for such activities. The fiscal deficit had ballooned to nearly five percent of GDP. Also, the IMF had caused the initiation of an austerity program to restore fiscal discipline. Pump priming was resumed as the economy emerged from the crisis in the late 1980s. However, the program was not continued for an extended period. By the 1990s, pump priming was no longer resorted to boost the economy.

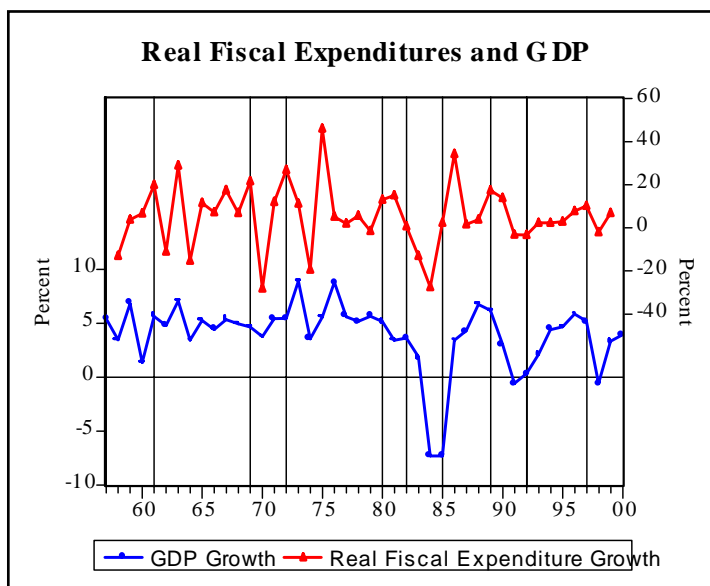


Figure A3.1

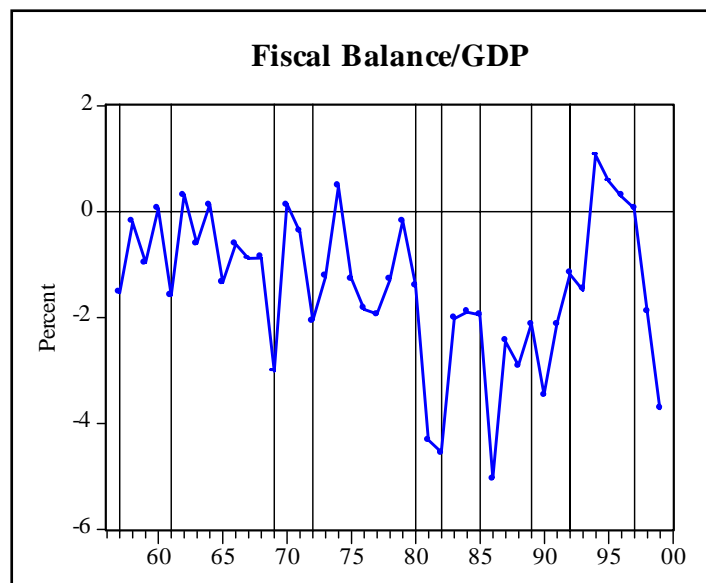


Figure A3.2

Table A3.1
Real Fiscal Expenditure Growth vs. GDP Growth, 1957-99

	Correlation Coefficient
Real Fiscal Expenditure Growth _t , GDP Growth _t	0.47
Real Fiscal Expenditure Growth _{t-1} , GDP Growth _t	0.33
Real Fiscal Expenditure Growth _{t-2} , GDP Growth _t	0.16

Unlike fiscal variables, growth in monetary aggregates was more contemporaneous with GDP growth. This can be observed in Figure 2.6. Also, correlation coefficients show positive correlation between contemporaneous variables. This suggests that monetary authorities, while concerned about economic growth, had other target variables such as price and exchange rate stability in mind. The more relevant financial variable appears to be real credit to the private sector. While there is still some contemporaneousness, real credit growth at times leads GDP growth.

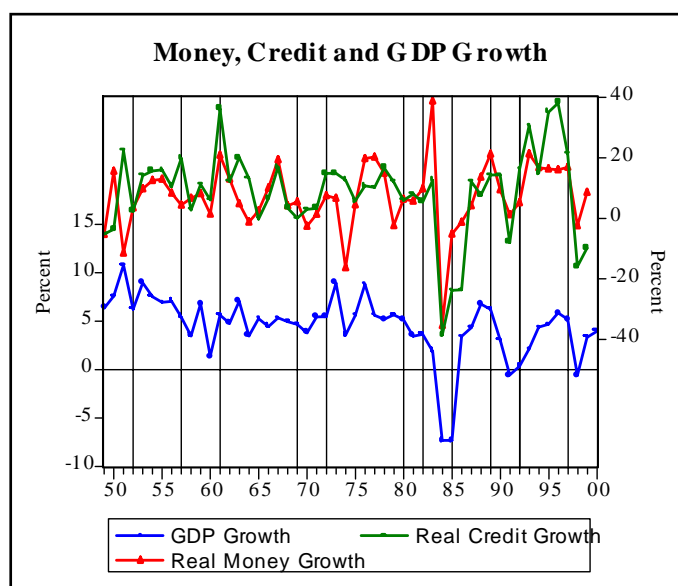


Figure A3.3

Table A3.2
Real Money and Private Credit Growth vs. GDP Growth, 1949-99

	Correlation Coefficient
Real Money Growth _t , GDP Growth _t	0.39
Real Money Growth _{t-1} , GDP Growth _t	0.06
Real Private Credit Growth _t , GDP Growth _t	0.58
Real Private Credit Growth _{t-1} , GDP Growth _t	0.22

Investment, Saving and Employment

Investment and Saving Behavior

A cursory investigation of the saving and investment behavior from 1946 to 2000 would yield the following stylized facts. First, prior to 1980, the investment-saving gap tends to turn positive during economic booms. This is true during the post-war reconstruction years, the import substitution period, the exchange de-control and Marcos industrialization periods. This indicates that during boom periods, foreign savings played a major role in financing capital accumulation.

Second, it is also observable that prior to 1980, except for the 1949-1952 period when the saving rate in the prior period was exceptionally high, the saving rate does not drop, and, in fact increases during times of busts. This suggests that during those times, people tend to hold on to their incomes when the economy weakens.

Third, saving and investment behavior changed immensely after 1980. During the crisis of 1983-1985, the saving rate fell but investment had a sharper fall. And, since then, the saving rate had been trending downward. Investments did recover in the crisis. Although its rate of recovery was quite steep, the crisis had caused the investment rate to cut by half between 1983 and 1985 (from 28.7 percent to 14.4 percent). It would take four years before a positive investment saving gap was attained. Since 1989, the investment-saving gap has been widening, indicating increasing dependence on foreign capital. By 1997, the gap has widened to nearly 11 percent of GDP. The Asian financial crisis caused the narrowing gap as both saving and investment rates, on the average, fell.

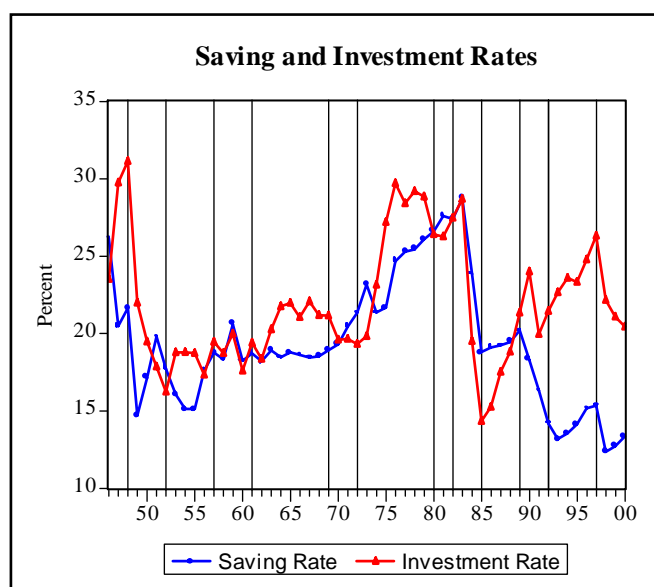


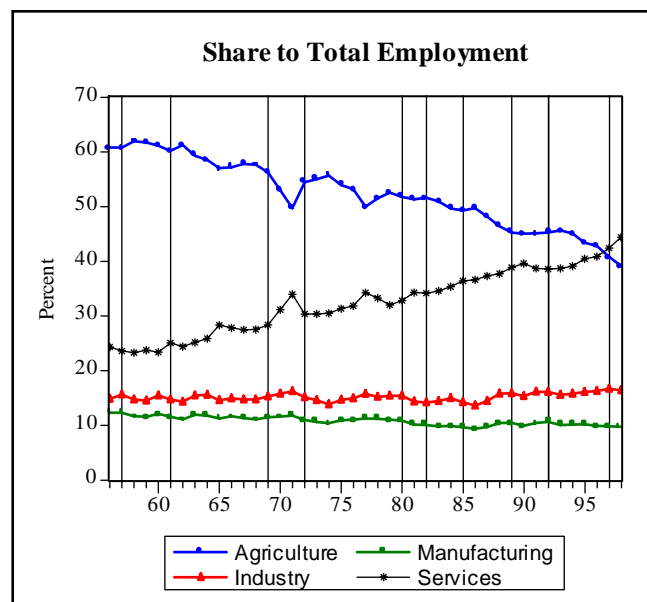
Figure A3.4

Finally, with the saving rate having a downward trend, gross domestic saving are currently at their lowest level in the post-war period. Such occurrence suggests that capital accumulation will always be tied up with the availability of foreign savings. It also means that a growth pattern that is hinged on high capital accumulation, as will be shown in later sections of this paper, will not be sustainable in the Philippine case.

Shifts in Sectoral Employment and Unemployment

Shifts in sectoral employment in the Philippines are quite straightforward and do not fluctuate with the business. This is mainly driven by the change in industrial structure, primarily the movement from agriculture toward service. In 1956, agricultural employment accounted for more than 60 percent of the employment, and this gradually fell to 39 percent in 1998. Services, on the other hand, increased from 24 percent in 1956 to 44 percent in 1998. Since the transition from agriculture to services bypassed the industrial sector, the employment by industry and manufacturing stagnated for more than 40 years.

Figure A3.5



Between 1956 and 1999, apparently the unemployment rate shifted around five times. In 1956, the economy had a double-digit unemployment rate, which was unusual since 1956 was still considered a year of rapid growth that resulted from the import substitution program. The unemployment was brought in succeeding and from 1959 until 1965 had stabilized around six percent level. Subsequently, unemployment again rose to the seven to eight percent region from 1967 to 1970. The rapid expansion in the 1970s brought about the reduction of the unemployment rate to an average of around 4.3 percent. The 1983-85 crisis resulted in a severe economic dislocation causing the

unemployment rate to breach ten percent. In the years following the crisis until 1999, unemployment rate was between the 8 to 9 percent level.



Figure A3.6

Appendix 4: Estimating Total Factor Productivity

Jose Antonio R. Tan III

Methodology

In the estimation of total factor productivity, this paper assumes a constant returns to scale Cobb-Douglas production function given by:

$$(1) \quad Y_t = A_t K_t^{*\beta} L_t^{*1-\beta},$$

where Y is gross domestic product, K* is capital service, L* is total employment adjusted for the quality of labor, A is total factor productivity and β is the factor share of capital. K* is equal to real capital stock (K) adjusted for capacity utilization (CU). L* is total employment (L) multiplied by an index for quality of labor (H). Taking the log difference and adding a stochastic error term yields the regression equation:

$$(2) \quad \Delta y_t = \Delta a_t + \beta \Delta k_t^* + (1 - \beta) \Delta l_t^* + u_t,$$

where the lowercase letter denotes the logarithm of the variable and u is the stochastic error term. The estimator of the factor share, $\hat{\beta}$, is then used to estimate total factor productivity growth using the identity:

$$(3) \quad \Delta a_t = \Delta y_t - \beta \Delta k_t^* - (1 - \beta) \Delta l_t^*.$$

Data Sources

Annual data are used to estimate total factor productivity. GDP data are taken from the National Accounts of the Philippines. The data for total employment are obtained from the Yearbook of Labor Statistics. Following Collins and Bosworth (1996), the quality of labor, H, is based on educational attainment and is defined as follows:

$$(4) \quad H_t = \sum_{j=1}^7 W_j P_{jt},$$

where P_j is the share of the population that completed the level of education j where j varies from 1 (corresponding to the share of the population with no schooling) to 7 (corresponding to beyond secondary education), W_j are aggregation weight based on the observed relative earnings of different education groups. P_j data are taken from the Yearbook of Labor Statistics and W_j data use the weights implied by a 7 percent return to schooling taken from Collins and Bosworth.

Real capital stock (K) is generated from the gross fixed capital formation (GFCF) and depreciation (D) data taken from the National Accounts of the Philippines using:

$$(5) \quad K_t = K_{t-1} - D_t + GFCF_t.$$

The initial level of real capital stock and capacity utilization are estimated using the methodology adopted by Cororaton and Cuenca (2001). A two step procedure is adopted in estimating initial capital stock. Investment is regressed against a time trend to obtain its average growth and a trend value of investment at the beginning of the sample, 1946.

Initial capital stock is computed as

$$(6) \quad K_0 = GFCF_0 / (g + d)$$

where g is the average investment growth and d is the average depreciation rate. Capacity utilization is estimated using the peak-to-peak method. Capital services is computed using

$$(7) \quad K_t^* = K_t \cdot CU_t.$$

Estimation Results

Stationarity tests were conducted on Y , K^* and L^* and all variables were found to have unit roots. Given this, the estimation of the production function in log difference form is justified. To deal with the endogeneity problem of the explanatory variables, instrumental variable (IV) estimation was adopted. The choice of instruments followed Yamagata (2000).¹ The regression results are given below in Table 2.19.

Table A4.1
IV Regression Results

	Coefficient	t-statistic
Δa	-0.011	-1.854
Δk^*	0.492**	2.570
R^2	0.353	
Adjusted R^2	0.337	
DW	1.907	
LM(1)	0.080	
LM(2)	5.381	
F-statistic	1.861*	
Sample	1957-99	

** significant at 5%; *significant at 1%

¹ The following instruments were used: the first difference of the federal funds rate, the log difference of average petroleum prices, the log difference of US per capita GDP and import index and the log difference in Japanese per capita GDP and import index.

The estimated β of 0.492 appears to be consistent with the recent econometric work of Senhadji (2000) where he estimated the factor share of capital to be 0.47. The estimate also approximated the estimate of Yamagata (2000), although the latter's data were limited to the manufacturing sector.

Table A4.2
Comparison of Estimated of the Factor Share of Capital

	Estimate
Mendoza and Tan (2002; economy-wide)	0.492
Senhadji (2000; economy-wide)	0.470
Yamagata (2000; manufacturing only)	0.492

Annual estimates of total factor productivity growth are shown in Figure 2.10. It can be seen that TFP growth had, on the average, performed better prior 1974, after which TFP growth has been largely negative. Over the entire period, average TFP growth was -1.19 percent, thereby having a negative contribution to growth of -30 percent. The principal source of growth was capital input that grew by 3.13 percent, accounting for 80 percent of growth. Labor input, on the other hand, grew by 1.98 percent, accounting for 51 percent of GDP growth. Table 2.21 shows the behavior of factor productivity across the economic cycles, while Table 2.22 computes for the contribution of factor inputs and TFP to growth.

Figure A4.1

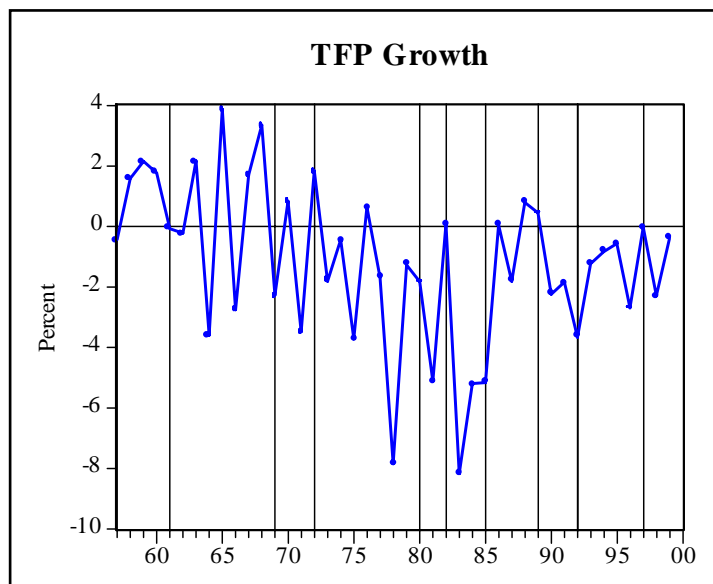


Table A4.3
Average Growth Rates of Factor Inputs and Productivity

	Capital	Labor	TFP	GDP Growth
1957-61	1.79	1.73	1.00	4.53
1962-69	2.77	1.93	0.28	4.99
1970-72	2.60	2.55	-0.27	4.88
1973-80	6.01	2.29	-2.24	6.05
1981-82	5.15	0.89	-2.52	3.52
1983-85	-0.56	2.48	-6.18	-4.25
1986-89	3.05	2.25	-0.13	5.17
1990-92	1.75	1.76	-2.58	0.93
1993-97	3.69	1.82	-1.07	4.44
1998-99	1.50	1.21	-1.34	1.37
1957-99	3.13	1.98	-1.19	3.91

Table A4.4
Contribution to Growth

	Capital	Labor	TFP	GDP Growth
1957-61	39.56	38.29	22.15	100.00
1962-69	55.58	38.70	5.71	100.00
1970-72	53.31	52.18	-5.49	100.00
1973-80	99.30	37.78	-37.08	100.00
1981-82	146.13	25.38	-71.51	100.00
1983-85	-13.17	58.40	-145.23	100.00
1986-89	58.90	43.59	-2.48	100.00
1990-92	187.52	189.23	-276.76	100.00
1993-97	83.07	40.95	-24.02	100.00
1998-99	110.02	88.38	-98.40	100.00
1957-99	79.92	50.56	-30.48	100.00

Compared to subsequent periods, the growth performance from 1957 to 1972 was rather more stable averaging at around 4.83 percent. However, the effect on TFP on output growth was declining. From 1957 to 1961, TFP growth averaged at 1 percent. This declined to an average of 0.28 percent from 1962 to 1969. By the next sub-period, 1970 to 1972, the average turned negative to -0.27 percent.

1973 to 1979 was a high growth period for the Philippines with GDP growth averaging over 6 percent. However, it is noticeable that growth is not due to TFP growth but rather was attributable to high capital accumulation. TFP growth was -2.24 percent

while capital was accounting for 99 percent of GDP growth. This huge deluge of capital was made possible by the aggressive borrowing strategy of the Marcos government.

Capital accumulation continued to drive growth in from 1980 to 1982 but the labor growth sharply contracted in the 1982. The contribution of labor to growth fell to 25 percent when the unemployment rate nearly doubled. Adding to this, TFP growth further deteriorated to -2.52 percent in the same period. With the access to capital restricted in the next sub-period, capital growth sharply reversed to -0.56 percent. TFP registered a negative growth of -6.18 percent. By this time, the economy was in a crisis. The only positive source of growth was labor.

The reform program was restarted in 1986 as a new government took over. Average TFP growth from 1986 to 1989, though still negative, improved to -0.13 percent. After several years of negative or near zero TFP growth rates, positive TFP growth were achieved in 1986, 1988 and 1989. A factor contributing to this improvement was the structural reforms introduced during this period. It must be noted, however, capital accumulation played a major role in attaining the GDP growth rates for the period accounting nearly 60 percent of the total.

As the economy entered into a mild recession in 1990 and as the power crisis loomed, TFP shrank by an average of -2.58 percent between 1990 and 1992. Similar reductions in the growth of capital and labor were also observed.

With the entry of the Ramos government, more reforms were done to deregulate and liberalize the economy. TFP growth, while improving, remained negative from 1993 to 1997. From -1.24 percent in 1993, TFP growth steadily improved to -0.56 in 1995. The sharp drop in the unemployment rate in 1997 increased the contribution of labor to GDP growth, thereby undermining TFP. By 1997, TFP growth was close to zero. Similar to previous sub-periods, growth was driven by capital accumulation, accounting for 83 percent of GDP growth. The impact of the Asian financial crisis was felt starting 1998. From 1998 to 1999, the growth rates of factor inputs and productivity were adversely affected. TFP growth again worsened to -1.34 percent.

The review of the sources of growth by factor input reveals that Philippine economic growth has been driven primarily by capital accumulation. This situation may be no different from Singapore where capital accumulation is said to underlie the rapid economic growth. The major difference between the Philippines and Singapore is that former has been unable to sustain the high rate of capital accumulation. Internally, the saving rate is quite low. On the other hand, not enough foreign savings have been attracted since the country is rather late in opening its capital accounts.

Comparison with Previous Studies

It is worthwhile to compare the estimates with previous works. The decadal averages can be compared to the results of Cororaton and Cuenca (2001), Hahn and Kim (2000), Collins and Bosworth (1996), and Hooley (1985). The decadal patterns of

average TFP growth are similar, although the magnitudes differ. Hooley (1985) utilized manufacturing data, in contrast to this paper that used economy-wide data. Aside from the differences in the data used, a possible reason for difference in magnitude is that each study has different values for factor shares. Cororaton and Cuenca (2001) used factor shares derived from the National Accounts of the Philippines where the factor share of capital ranges from 0.705 to 0.755. Hahn and Kim (2000) and Collins and Bosworth (1996) both assumed 0.35 as the share of capital.

Table A4.5
Comparison of TFP Growth Results

	Mendoza & Tan (2002)	Cororaton & Cuenca (2001)	Hahn & Kim (2000)	Collins & Bosworth (1996)	Hooley (1985; mfg. only)
1957-69	0.56		0.50 (1960-69)	0.70 (1960-73)	0.56 (1956-70)
1970-79	-1.69		-0.59	-1.30 (1973-84)	-1.23 (1971-80)
1980-89	-2.59	0.27 (1981-89)	-2.00	-0.90 (1984-94)	
1990-99	-1.58	-0.98 (1990-98)			

Comparing Philippine TFP Growth with ASEAN-4

Hahn and Kim (2000) provide a recent compilation of sources of growth in East Asian Economies. Comparing the Philippines with ASEAN-4 (i.e., Indonesia, Malaysia, Singapore and Thailand), Philippine productivity was better than Singapore and Indonesia in the 1960s. Since then, Singapore has continuously improved its TFP growth in the next decades. Indonesia, on the other hand, showed substantial improvement in TFP growth in the 1970s. Malaysia and Thailand, like the Philippines, exhibited declining TFP growth rates over the three decades. The top three economies, namely, Malaysia, Thailand and the Philippines, exhibited declining TFP growth rates over the three decades. However, the deterioration of Philippines TFP growth was substantially sharper. And, considering that the Philippine TFP growth was lower than the other two countries, negative growth rates were registered in the 1970 and 1980s.

Table A4.6
Sources of Growth: TFP

	1960s	1970s	1980s
Philippines	0.50	-0.59	-2.00
Indonesia	-0.73	1.84	0.07
Malaysia	0.80	0.54	-0.41
Singapore	-0.14	1.29	1.50
Thailand	1.91	0.93	0.38

Source: Hahn and Kim (2000).

Growth of the five economies was primarily driven by physical capital. There is, however, a large disparity between Philippine physical capital growth and the other ASEAN economies. In the Philippines, growth of physical capital per worker did not reach five percent across the three decades. In contrast, the other countries were growing at least twice as fast. This only shows that while the Philippines is no different from other Southeast Asian economies in terms of importance of physical capital in propelling growth, the rate at which capital is accumulated varies widely across countries. Having a low saving rate, capital accumulation in the Philippines is much lower than its neighbors.

Table A4.7
Sources of Growth: Physical Capital per Worker

	1960s	1970s	1980s
Philippines	3.99	4.73	2.03
Indonesia	1.28	8.56	7.36
Malaysia	6.70	6.81	5.35
Singapore	12.75	10.15	7.19
Thailand	9.47	6.36	5.27

Source: Hahn and Kim (2000).

Economic Liberalization and Total Factory Productivity Growth

As discussed in previous sections, the Philippines embarked on economic liberalization as early as 1980 with financial liberalization. In 1981, import liberalization and tariff reforms were introduced. However, the economic crisis of 1983 caused the reversal of reforms. It was only in 1986 when the reforms were re-introduced, and was continued until and completed in the mid-1990s. The last set of reforms focused on capital account liberalization. This was started in late 1991 and took full effect in the following year. This section studies the impact of the series of economic liberalization programs on total factor productivity. As measure of financial deepening, the ratio of M2 to GDP is used. Trade liberalization is measured by the total trade (i.e., export plus imports) as a ratio to GDP. Finally, the gross foreign investment flow (i.e., inward foreign investments plus outward foreign investments) as percent of GDP is used as an indicator of capital account liberalization. Movements of these indicators are shown in Figure 2.11.

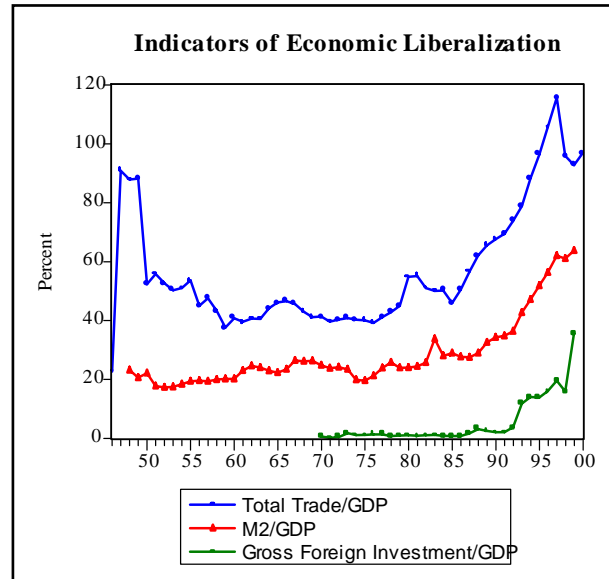


Figure A4.2

An OLS regression is estimated to determine the effect of the liberalization measures on total factor productivity. Interaction dummy variables (i.e., D81 for financial liberalization, D86 for trade liberalization and D92 for capital account liberalization) are introduced to ascertain whether the reforms led to a positive change in the coefficient. A positive and statistically significant coefficient indicates that the reforms had positive effects on TFP growth. A time trend is also included to capture the long-term behavior of TFP growth. The results are shown in Table 2.26. Adjustment for auto-correlation was made because the Lagrange multiplier tests indicated the presence of second-order auto-correlated errors.

Table A4.8
OLS Regression Results
Dependent Variable: Total Factor Productivity Growth

	Coefficient	t-statistic
Constant	14.473*	4.795
Gross Foreign Investment Flow/GDP	0.759**	2.309
M2/GDP	-0.280*	-3.034
Total Trade/GDP	0.041	1.045
D92*Gross Foreign Investment/GDP	-0.456	-1.480
D81*M2/GDP	0.067**	2.082
D86*Total Trade/GDP	0.081*	6.692
Time	-0.422*	-5.110
AR(1)	-0.831*	-4.152
AR(2)	-0.521**	-2.583
R ²	0.727	
Adjusted R ²	0.590	
DW	2.097	
LM(1)	0.892	
LM(2)	3.294	
F-statistic	5.319*	
Sample	1972-99	

** significant at 5%; *significant at 1%

The positive and statistically significant coefficient of the D81*M2/GDP indicate that financial liberalization did help improve TFP growth. However, the negative sign for M2/GDP shows that financial deepening has not totally eradicated the inefficiencies of and distortions in the financial sector. Some selective credit facilities still exist. Likewise, the cost of intermediation remained high. Possible causes of this are the high statutory and liquidity reserve requirements that at some instances reached 25 percent even with liberalization. Bank spreads have also remained high in years, either due to the high risk premia or intermediation cost.

The results also suggest that trade liberalization contributed to TFP growth. There may be several reasons for this. One is that foreign competition caused domestic producers to improve efficiency. Also, the opening of the goods markets may have exposed Philippine export manufacturers to global best practices. Access to imported capital goods may have helped close the technology gap between domestic and foreign manufacturers.

The benefits of capital account liberalization with respect to productivity gains, however, have not yet been felt. There might be several reasons for this. First, while the regulations have virtually opened the capital account, the degree of financial integration has not reached the threshold that is needed to impact on TFP growth. Tan and Paderanga (1998), which concluded that the degree of financial integration while increasing is still

low, support this. Second, a large portion of the capital flows attracted by the capital account opening is portfolio capital (“hot money”) that has no direct beneficial effect on TFP growth. Foreign direct investments would have more impact on TFP growth. Finally, the Asian financial crisis might in a way have made investors more cautious and risk averse. Hence capital inflows tend to be limited in spite of a liberal foreign exchange regime.

Appendix 5: Economic Performance and Strong Republics¹

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During the late 50s and early 60s, the Philippines was toasted as the “next Japan” after growing at an annual rate of 6-9 percent and having successfully built an indigenous industrial structure through an import-substitution-industrialization program (ISI). During this period, the country’s tycoons managed to established Asia’s first flag-carrier airline (ahead of Japan) and earned additional plaudits in other circles for marrying the first Miss Universe and Miss International. In the subsequent decades, the Philippines lost ground steadily as its economy went into an erratic boom-and-bust long-term cycle and failed to sustain growth. In contrast, East Asia and several Southeast Asian neighbors managed to overtake the country and exceed its performance in terms of economic growth, poverty alleviation, and overall human development.

What went wrong? Why did the country, earlier deemed to be the most likely to succeed, end up being the region’s basket case? To many observers, the non-performance of the Philippine economy since 1946 is to a large extent connected to the weakness of state-building efforts in the country. The failure of a weak Philippine state to ensure political stability over the long haul is one adverse factor. This stems from the inability of the political system to contain the rivalries of competing elite fractions within safe confines as well as satisfy the clamor of the underclasses of a bigger share of economic and political resources in the country. For this reason, much of the Philippine state’s history is marked by instability, expensive and fraudulent elections, festering insurgencies, failed coups, rising criminality and public apathy, and unconventional expressions of popular power and energies.

The capability of vested private interests to either raid the public treasury or thwart the formulation or implementation of coherent and socially-beneficial policy is seen as another key reason behind the dismal Philippine record despite a very promising start in the late 1940s and early 1950s. While the import-substitution period succeeded in building an indigenous industrial base in the country, the failure to withdraw protection for perpetually-infantile domestic manufacturing firms and attendant policy aberrations (including the maintenance of an over-valued peso) has stunted the further development and deepening of the industrial structure. Of course, the refusal of the landlord-dominated Filipino elite to effect land reform in the face of a raging peasant insurgency fixed the limits of import-substitution industrialization (ISI). It is a truism that the costs of industrial products will go down as the scale of production increases—the magic of economies of scale. A late-industrializer cannot hope to sell its industrial products to the established industrial world as well as fellow developing economies. Initially, it cannot

¹ A shorter version of this paper was published by *Businessworld* on 7 August 2002 under the title “How will the strong republic be built?”. I am grateful for the ideas and comments of Noel de Dios, Paul Hutchcroft, Raul Fabella, Temario Rivera, Joseph Capuno, and Ann Rose Pimentel. Of course, all errors and shortcomings of this paper remain the author’s responsibility.

compete with the latter's products in the world market. It can therefore sell only to its domestic market. Serving this market will be the country's laboratory and school for industrialization. Hence the notion that the domestic market must be protected to nurture infant industries. However, if its domestic market is narrow and shallow because of widespread poverty and glaring inequities, then the average cost of domestically produced industrial products will not go down. Thus, these products will not be competitive in fiercely-contested markets.

In the 1960s as the possibilities of import-substitution-industrialization were being exhausted, Filipino elites turned to massive extraction of the country's natural riches as an alternative. The country's timber stands, marine life and mines were exploited almost "to the max" for all the foreign exchange they could earn in Japan and other industrial-input markets without any due regard to the requirements of succeeding generations. Having encountered the limits of inward-looking industrialization, much of these foreign exchange earnings financed conspicuous consumption, electoral bids and appurtenant private armies, and forays into the services (especially real estate, trade and finance). Meanwhile, the population kept on growing as gross national product grew on an extensive basis.²

The failure of the politico-economic system to sustain economic growth and satisfy the needs of a growing and increasingly-restive population ultimately led to a major change in the so-called "rules of the game". The unprecedented re-election of President Ferdinand Marcos in 1969 (in what is undoubtedly considered the dirtiest and most fraudulent elections the country has witnessed thus far)³ gave us an inkling of the future. Previously, fractions of the elite alternated in power; for four years, one set was the "ins" while the other was the "outs". The operative principle for incumbents was summed up by a candid senator in the classic: "What are we in power for?"

The early 1970s saw the emergence of a national security-developmental state, like in many parts of the developing world, established and initially accepted on the basis of a new social contract: in exchange of suspending democratic politics, deemed a luxury available only to prosperous societies, the authoritarian leader promised rapid economic growth and prosperity. This social contract bore fruit in East Asia, especially in South Korea and Taiwan. It did not in the Philippines; its legacy is a massive foreign debt, white-elephant monuments to the dictator's folly (such as the moth-balled US\$2 billion Bataan nuclear power plant), and incalculable loss in terms of human lives and suffering.

Why did authoritarianism fail to produce good economic results in the Philippines unlike in East Asia? One clear difference: land reform in South Korea and Taiwan in the 1950s—at the same time that the Philippines was responding to the peasant insurgency

² An economy experiences extensive growth if more and more inputs of production (i.e., land, labor and capital) are deployed. However, a better kind of growth is intensive growth, which is realized when the economy is able to extract more output from the same amount of production inputs. This is usually the result of the application of superior technology, improvements in management and productive efficiency, among others.

³ His opponent complained: "We were out-gunned, out-goosed, and out-gold(ed)," in an apparent allusion to the tried and tested 3-G formula for winning Philippine elections.

with military might and CIA-inspired ‘psy-ops’. Thus in East Asia, a larger domestic market and a broader political base for industrialization was secured. Also in South Korea and the Philippines, the authoritarian regimes of Park Chung Hee and Ferdinand Marcos were predictably not immune to corruption and cronyism. Both regimes lent state credits heavily to favored economic interests under so-called export-oriented industrialization programs. But the similarity ends there. The South Korean state was astute and strong enough to subject Korean industrialists who are beneficiaries of state-allocated funds to an impartial test—success in the world export market. If one succeeds in an arena—the world market—that the dictator cannot even control, then they deserve continued state support. In contrast, the strength of the Philippine authoritarian state was illusory. While the Marcos regime sought to emulate the South Korean experience in the late 1970s, it was unable to prevent the Marcos family and its cronies (who received state largesse) to salt the funds abroad or to finance scandalously-conspicuous consumption. The maintenance of an overvalued peso was a disincentive to export and the cronies instead embarked on controlling local commodity monopolies (sugar and coconut), building local conglomerates (which grouped industrial, trade, finance, real estate and other diversified concerns)⁴, and a new bout of import-substitution industrialization (in the 11 major industrial projects of the late 1970s). Fortunately, the lack of external finance frustrated this new folly.

The dictatorship was overthrown through the euphoric EDSA Revolution, an explosion of popular power that earned plaudits the world over. However, the first post-dictatorship presidential regime of Corazon Aquino had to deal with the many ills of authoritarian decompression. The recovery during the 1986-89 period was arrested by two man-made shocks—the almost-successful December 1989 coup and the 1990-91 Gulf war; and two natural shocks—the destructive 1990 earthquake (that registered 7.3 on the Richter scale) and the once-every-600-years eruption of Mt. Pinatubo in 1991.

In recent years, significant economic advances were achieved during the presidency of Fidel V. Ramos only for the efforts to be rolled back once more during the short-lived Estrada presidency.

Last 22 July 2002, the incumbent president Gloria Macapagal Arroyo (GMA) announced her plan to build a ‘strong republic’ in her state-of-the-nation-address. Asked to comment, opposition senator Rodolfo Biazon quipped: “Strong words do not make a strong republic.”

Nobody will quarrel with the need to build a strong republic in the Philippines if a strong republic means good governance. The demand for good governance at the nation-

⁴ The Herdis group of companies (of presidential crony Herminio Disini) started as a one-room P60,000 trading firm with only two employees (the Philippine Tobacco Filters Corporation) that grew, on the basis of a presidential decree that gave it the monopoly to import cigarette filters, to a P16 billion conglomerate by the early 1980s. Disini is the same person used by Westinghouse as “special sales representative” to wrest a nuclear power plant contract from General Electric in the late 70s. While the original bid was \$600 million for two 300-megawatt plants, the single 320-MW plant built in Bataan province in an area bisected by earthquake fault lines near a dormant volcano, ultimately cost a whopping \$2 billion.

state level is almost universal. The more relevant and interesting question is a question of supply. How do strong states develop? How are ‘strong republics’ built?

If one considers the history of state making in Western Europe (where the nation-state was born), the US, the USSR (yes there once was a Soviet Union), and the states divided by the Cold War, international war was the cruel crucible. Centuries of warfare forced the nascent states to steadily build their capacities to penetrate and extract resources from their societies and to coordinate variegated functions and programs. The test of statehood was war; weak and incompetent states such as Poland, Tsarist Russia, and Manchu China, usually sustained military defeats and debacles. More recent examples indicate that international war, even if of the “cold” kind, continue to be the forgers of strong states. Taiwan, South Korea and West Germany built strong states, with the help of the United States, as they competed with their communist alter egos.

In principle, the Philippine state rejects international war as an instrument of national policy. In truth, the weak Philippine state is not in any position to wage international war. In lieu of this option, our leaders, especially after Marcos, had chosen the neo-liberal solution, or closer integration into the global economy, as the way to bring about good governance and a strong state. The international capital market will supposedly impose disciplinary strictures on local political and economic actors, public and private. This view has a noble lineage; classical writers like Adam Smith, David Hume, and Montesquieu saw capital mobility as a powerful antidote to bad princes.⁵

Where mobile capital goes will depend on the quality and competitiveness of immobile factors of a particular location. These immobile factors include the **hard** ones—land, roads and bridges, information and communications systems, and the like; and the **soft** ones such as law enforcement, contract enforcement, property rights protection, and public service delivery systems—governance in short.

The burden of attracting mobile capital falls squarely on the immobile factors of a country. From the viewpoint of international capital, the ultimate competitiveness of each location depends upon the attractiveness of the package of immobile factors it offers. Previously, competition for mobile capital among and within developing economies had largely taken the form of providing more attractive **hard** immobile factors as well as investment incentives such as tax credits and strike-free industrial estates. More recently, the greater salience of governance had been recognized.

⁵ Adam Smith wrote in the Wealth of Nations that:

The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at his ease.

During much of its history as a modern and “independent” state, the Philippines had been an American protectorate. Our elites have been babied by their foreign patrons with air and naval cover, free trade, and aid. They therefore have not bothered nor forced to build a credible army and a competent bureaucracy—the sine qua non of effective states. Couple that with the “natural resource curse”. Since 1946, the same elites got content earning foreign exchange through the export of commodities (desiccated coconut, sugar meal, mineral ore, logs) very close to their natural form and with minimal processing and very low value-added. In contrast, the elites in more austere and frontline jurisdictions as South Korea and Taiwan had to go into industry and manufacturing in a big way. Of course, it helped that the landlord class was disenfranchised politically and economically through land reform.

While our political economy has in fact been changing since the 1970s, the decisive policy break in favor of export industrialization has apparently never been made. Temario Rivera suggested, among others, that this was due to continued intertwining of landlord and capitalist, comprador and exporter, financier and industrialist, amongst our elites. The economy’s integration into the international capital markets, which received a great boost with President Ramos’ liberalization of the capital account, was apparently the preferred path. Our local elites have been able to share in the bonanzas brought about by fluctuations in capital flows, especially those in short-term portfolio movements. Almost all of our elite families have interests in financial institutions or are in joint venture with foreign financial interests and hot money flows, as in other emerging economies, were heftier than direct foreign investments.

Since fund managers can still make money even in the short run, they may not share the concerns of those who make longer term capital investments in say factories, industrial estates, and the like. Consequently, their placement decisions stimulates governments in the so-called “emerging markets” like the Philippines to pay attention to short-run goals like improving the economic indicators (inflation, exchange rates, budget deficits, balance of payments, and the like)—the checklist items that are more readily measurable and understood by economists and fund managers the world over. Rather than the more difficult and tedious tasks of improving the law enforcement and justice dispensation systems, reducing or eliminating corruption, reforming the bureaucracy, strengthening the political party system through campaign finance reform, among others.

This is not to say that fixing our macro-economic indicators is not necessary. But it may not be sufficient to attract the kind of capital, domestic and foreign, that creates jobs—jobs that matter in a labor-surplus economy. These jobs can in fact keep a large number of Filipinos from going to their “Saudis” and avoid the social costs of being away from their families for a long time.

Mobile capital may indeed be a corrective to bad governance. However, extremely mobile capital may lack the patience for good governance to emerge over time in particular jurisdictions. This is short-sightedness. Capital mobility and the changed nature of on-the-cutting-edge products (being more a bundle of ideas rather than a package of tangible or material inputs) make property rights even more important today

than ever before. Public agencies such as nation-states are still tasked with the enforcement and protection of these same rights even as they cooperate with each other through international issue-area regimes (such as the GATT-Uruguay Round with its TRIPs, TRIMs, etc). After all, mobile capital still belongs to people who are rooted one way or the other to a particular jurisdiction.

Thus good governance matters for mobile capital even as the latter induces the former. But as Harvard's Dani Rodrik warned, the priorities implied by integration into the global economy will arguably not always coincide with those of a more fully developmental national agenda. Consider the following trade-offs:

- Education. What should the government priorities be in its education budget? Should it train more bank auditors and accountants, even if it means fewer elementary and secondary school teachers?
- Corruption. How should government focus its anti-corruption strategy? Should it target the “grand” corruption that foreign investors complain about, or the petty corruption that affects the average person the most?
- Legal reform. Should the government focus its energies on “importing” legal codes and standards, or on improving existing domestic legal institutions? Reforming the existing legal system for the benefit of foreign and domestic investors might be a better strategy in the long run.
- Public health. Should the government pursue tough policies on compulsory licensing and/or parallel importation of basic medicines (to make low-cost drugs available to the poor), even if that may mean running afoul of existing World Trade Organization (WTO) rules?
- Industrial strategy. Should the government simply open up and let the chips drop wherever they might, or emulate East Asian experience of industrial policies through export subsidies, directed credit, and selective protection?
- Social protection and safety nets. How much can the government afford to spend on social protection and safety programs in view of financial constraints imposed by market “discipline”?

How could governance at the state level be improved? A general prescription is to reduce the state's intervention in the economy. The argument here is that the over-reaching state will consequently be an incompetent one since its grasp will fall short of its reach. If the state reduces the scope of its activities, its competence will improve. The retreat of the state from direct intervention and involvement in the economy in turn requires new governance and regulatory capacities. Where markets do not exist or where markets do exist but are unfree, state action is needed either to help create markets, to free existing ones, and to maintain the freedom of existing ones. This is the so-called “orthodox paradox” of market reform. The “orthodox paradox” stipulates that while

market reform calls for less intervention of the state in the economy, it requires the same state to initiate and sustain these changes. While there is debate about the state's "limited agenda," Raul Fabella, dean of the UP School of Economics, notes a consensus on three basic items:

- The state should stay clear of areas where markets can function properly;
- The state, should, at best, regulate in areas where market failures are endemic (as with prudential rules for banks where moral hazard is eminent) rather than acquire ownership;
- The state should improve its performance in the Smithian agenda: that is, it must ensure internal peace and order and external defense; provide for a reliable system of property rights protection and contract enforcement; and help provide critically-needed infrastructure such as roads, ports and communications systems.

Retreating from the overreaching agenda of the past is the political challenge confronting the Philippine state and society. Alongside this necessary retreat is the need to change the prevailing culture of entitlements. As far as the Philippine state is concerned, it is both a case for retreat and advance. In many cases and levels, state action is sorely lacking. In this sense, the state is a weak and soft one. In instances where the state is overbearing, this is usually when and where the intervention is in favor of vested interests.

Reverting to a minimalist agenda is not problem-free. Several questions need to be answered. Where will the impetus to dismantle the overreaching soft state come from? From the state leaders and bureaucrats themselves (even if they benefit from the state's softness)? From the rent-seeking special interest groups? From the general public who also benefit from the transgression of rules via the contagion effect?⁶

All these questions are derivatives of the more fundamental questions: where do good institutions come from? How are they built and how are they sustained? A number of the greatest minds tried answering these questions, including the participants of the 1999 conference on second-generation reforms organized by the International Monetary Fund (IMF). Rodrik noted that the choice lay between importing wholesale a "blueprint" from the more advanced countries and relying on the expertise of technocrats and foreign advisors or relying on hands-on experience, local knowledge, and experimentation. The local knowledge approach relies on mechanisms for eliciting and aggregating local information. The most reliable forms of such mechanisms, according to Rodrik, are participatory political institutions since democracy helps build better institutions for

⁶ Fabella argues that the ambiguity of the welfare effects of some rules eventually lead to a contagion effect that afflicts law enforcement and law abidance. For example, smuggling (dodging tariffs) may benefit private interests. To the extent that smuggling lowers the prices of imported goods and make them accessible to the ordinary consumer, the public may not develop any interest in enforcing such rules and in fact benefit from their transgression. The violation of rules becomes both socially and privately beneficial. Furthermore, once the public realized benefits from subverting such rules, their attitude towards rules in general erodes. The cynicism of the public meanwhile encourages both regulators and private interests to subvert rules and profit from them.

achieving prosperous societies. He also argued that democratic regimes are associated with significantly lower levels of aggregate economic instability since democracies have a greater propensity than non-democracies to moderate social conflict and induce compromise.

One of the usual laments about under-developed societies in general, and the Philippines, in particular, is that there is supposedly “too much politics” and that therefore, the road ahead would be better if politics were reduced. Kenneth Shepsle, a noted political scientist, warned against naïve prescriptions which call for the creation of institutions that are depoliticized, that is, purged of politics, such as those contained in the World Bank-produced World Development Report 1997. Politics may be a problem but it must be part of the solution since institutions are inherently political and therefore those engaged in the design of appropriate institutions and social reform must “take politicians and political motivations as a fixture and try to design institutional arrangements in light of these, not despite them.” In the end, Shepsle sees hope in the competition between uber-officials and unter-officials, between older and younger politicians, where ambition is pitted against ambition. Older uber-officials with shorter time-horizons will discount the future heavily and may be partial to present consumption (or predatory behavior, if you will). The future welfare of his people will thus depend on his (or the lack of) altruism. On the other hand, younger unter-officials have greater valuations of the future and may therefore prefer investments to current consumption for future growth. To the extent that uber-officials need the cooperation of unter-officials to implement policy or changes in policy, then the latter can temper the excesses of the former. All these arguments are made in appreciation of the fact that successful economic development requires sacrifices in the short-term for long-term gain.⁷

However, politicians of whatever age, as a rule, have short time horizons. While some of them may genuinely desire prosperity and equity for the people, most of them are mainly concerned with their personal interests and advancement. Uber-officials want to remain as such while unter-officials want to become uber-officials. Furthermore, the pressures and demands exerted on them by their constituents and patrons are for gratification in the short-run. Should we pine for monumental changes in the behavior of our political leaders and our citizens? Or should we design solutions in due recognition of the fact that most men, officials and citizens, are ambitious and self-interested. Thus, the solution is not “political will” nor “impeccable non-corrupt behavior” because if these were available there would not be a problem in the first place. Enlightenment and incorruptibility are in short supply and properly designed institutions may serve as substitutes.

We have already alluded to one source of hope and change. The difference in age and valuations among politicians, even as they are as a rule with short time horizons, will lead the rising ambitious set to oppose actions by the current incumbents to run down the privileges, authority, and capital assets associated with the higher offices to which they

⁷ One can actually disagree with the reputable Shepsle and argue that it is the unter-official who has a short-term horizon and get-rich-quick mentality and the uber-official who is more likely to display statesman-like behavior. I owe this point to Murray Heasley of the UP English Department.

aspire. Shepsle also notes that even if all politicians were predatory, the presence of organizations with longer lives and therefore, longer time horizons, which represent interests to whom politicians are beholden for their political survival—political parties, labor unions, corporations, churches and religious organizations, etc.—will also serve as countervailing powers. The most important implication of this analytical line is that non-state actors, which normally have longer-time horizons than politicians, must be thoroughly integrated into a society's political life. In this sense, therefore, Shepsle's institutional preferences are compatible with those of Rodrik even as they are no more than a general principle rather than a well worked-out or fully operational plan. This is where local learning and experimentation will come in.

We return to the question. Will the strictures of the international capital markets be enough to discipline and create strong nation-states in the contemporary globalizing world? While mobile capital may be a corrective to bad governance, it will not suffice by itself. A large part of the reason depends on the nature of capital itself and the differing time horizons of players in the international money markets. After the warnings raised by ISAFP head Col. Victor Corpus about the dangers of 'narco-politics', we are more convinced that mobile capital lacks teeth. If fabulous wealth can be made in the nefarious world of jueteng, drugs, kidnapping, murder and mayhem, who needs the "seal of good housekeeping" from the IMF and the international banks? Why would vested interests engaged in these activities want the emergence of a strong and competent state? They would in fact prefer a feeble one so they could go about their unholy business unmolested, using even state resources as capital.

If one can profitably operate a firetrap, masquerading as a decent family hotel, by bribing regulatory authorities, who wants honest public servants? If one can overload a decrepit inter-island vessel to the rafters, who needs a competent coast guard? If one earns oodles of dollars from the smuggling of aliens, who wants an efficient immigration service?

If they could not be bought or compromised, then judges, prosecutors, policemen, generals, journalists, bankers, border guards, customs officials, and politicians can be killed.

The generals in Yangon, the drug lords of Colombia and the Philippines, the white slavers of the Ukraine and Belarus, the warlords in Afghanistan and Central Asia—all can thumb their noses at the international community and not be cowed by the hostile ratings of Moodys or Standard and Poor. They are happily responding to a more powerful constituency—the affluent drugs and sex markets in Japan and the West.

While estimates of profits and financial flows related to crime vary wildly and are not fully reliable, they are indicative of their staggering size. In 1994, for instance, the United Nations Conference on Global organized Crime estimated that global trade in drugs amounted to \$500 billion a year. This volume is supposedly larger than the global trade in crude oil.

Manuel Castells had observed that in the past two or so decades, criminal organizations have increasingly organized their operations transnationally, boosted by globalization and advances in communication and transportation technologies.

The strategy adopted is logical and deadly-efficient: “to base their management and production functions in low-risk areas, where they have relative control of the institutional environment, while targeting as preferential markets those areas with the most affluent demand, so that higher prices can be charged.”

Thus if one surveys the prospects for building a strong republic in the Philippines, one has to recognize that the venture will essentially be a grand political struggle. The emergence of a strong Philippine state will benefit some elite groups and interests and the broad populace but will adversely affect other vested interests. We must take note of the political and economic forces aligned against each other in this political fight. A new coalition composed of imperial capital (some foreign governments, multi-lateral financial institutions such as the International Monetary Fund, the World Bank, and the Asian Development Bank, and transnational corporations), the internationalist faction of the domestic elite, and the civil society groups from the middle and under-classes are for good governance, a competent and efficient public bureaucracy, an upright judiciary, police and military—in short, a strong Philippine democratic state. This coalition is opposed by an array of domestic (including a distinct faction of the ruling elite) and international groups and interests who profit from the weakness of the Philippine state and the corruption of the bureaucracy. They are those involved in lucrative criminal activity, massive corruption and rent-seeking.

The pro-strong state coalition is a newly-formed one and civil society groups even from the under-classes (like the peasantry, workers, and the urban poor) find common ground with imperial capital to the extent that a strong state may protect property rights, secure a market environment friendly to profit-making, ensure compliance with electoral laws and fairly-honest elections, and provide adequate police protection to all concerned. Imperial capital and the internationalist faction of the domestic elite (except for some technocrats) may not be too keen on property reform, an issue dear the under-classes. The organized under-classes and some middle class intellectuals are also allergic to the neo-liberal pro-market orientation of their new coalition partners. This newly-formed coalition could be strengthened and consolidated if a better understanding of the need to utilize both market and asset reform in reducing poverty and stimulating economic growth must be reached. The experience of the East Asian states that adopted policies that reduced poverty and income inequality, such as the provision of high quality basic education and the implementation of agrarian reform, is highly instructive.

Redistributive reformers in the past often underestimated the dependence of their proposals on more robust and freer markets. As a result, even if the poor obtained some education or land, the products and incomes from these new resources were restricted by market or price distortions. Conversely, market reformers since the 1980s had denigrated the complementary role of state redistributive reform simply because the state has fallen in disfavor. Free marketers have eschewed redistribution largely because states, which

they see as inferior institutions. What they overlook is the fact that states are the principal, though not the only agencies that carry out reforms, including market and asset reform. These market reformers fail to see that people with neither adequate nutrition, education, or land are often unable to capitalize on new market opportunities.

Several problems must be confronted and overcome. If the Philippine state is currently weak, this means that the state itself is the object of reform. At the same time, the state (or at least, key elements of the state) is tasked with the responsibility of leading the reform effort and consolidating the reform coalition. But the state apparatus is also populated with elements, groups and interests hostile to the reform process that will result in a strong state. These are the grafters, rent-seekers, influence peddlers, and the hoodlums in robes, business suits and uniforms. In effect, the state is both target and agent of reform. The state itself is the arena for the political struggle to build a strong republic.

The pro-reform and anti-reform factions of the domestic elites are likewise not organized along coherent party lines. Even within the ruling Arroyo administration, some are not too keen on reform. Within the political opposition are kindred spirits hospitable to the reform project. Will President GMA, who is unique among the post-Marcos presidents since she can run for the presidency in 2004 after serving the unexpired term of President Estrada, be able to lead in building a broad reform coalition that will cut across party, class, religious, gender, age, and ethnic lines?

In the end, the strength or weakness of a state is simply a reflection of the strength or weakness of a particular society. Is Philippine society up to the urgent challenge of building a strong republic? With the US poised to resume its role as big-brother and protector of the Philippines, the sad answer seems obvious. The bare bones of a state rest on two organizations: an armed force and tax collectors. One needs armed men to be able to collect taxes; one needs tax revenues to maintain an army. Being a US protectorate will not build a strong army in any way. We have likewise been plagued with weak tax collection. In a recent report Morgan Stanley estimates the country loses 10% of its GNP to tax evasion annually—about US\$7.6 billion measured in nominal 2001 dollars. This adds up to \$205 billion since 1965, the start of Marcos' first term. The country collects around 10% of its GDP in revenue, compared with 25% in Malaysia and 17% in Thailand. To further compound the problem, corruption adds to the leakage of resources from productive and social welfare-enhancing activity.

Building a strong republic requires that the Philippines builds a credible army, successfully stamps out or reduces corruption, and improve its tax collection. Then that strong republic can nurture a prosperous economy.

Appendix 6: Appendix Tables

Appendix Table 1

	GDP (PHP M)	Trend GDP (PHP M)	Trend GDP Growth (%)	Deviation from Trend (%)
1946	61128.00	71051.14		-13.97
1947	85269.00	82180.81	15.66	3.76
1948	99628.00	93211.25	13.42	6.88
1949	105926.00	104074.10	11.65	1.78
1950	113958.00	114765.20	10.27	-0.70
1951	126246.00	125298.86	9.18	0.76
1952	134081.00	135681.37	8.29	-1.18
1953	146070.00	145928.45	7.55	0.10
1954	157054.00	156039.84	6.93	0.65
1955	167952.00	166016.68	6.39	1.17
1956	179739.00	175870.27	5.94	2.20
1957	189457.00	185631.25	5.55	2.06
1958	196013.00	195368.95	5.25	0.33
1959	209357.00	205190.95	5.03	2.03
1960	212211.00	215211.29	4.88	-1.39
1961	224130.00	225585.65	4.82	-0.65
1962	234828.00	236439.72	4.81	-0.68
1963	251408.00	247884.63	4.84	1.42
1964	260074.00	260015.38	4.89	0.02
1965	273769.00	272962.24	4.98	0.30
1966	285886.00	286856.02	5.09	-0.34
1967	301107.00	301835.63	5.22	-0.24
1968	315998.00	318030.27	5.37	-0.64
1969	330712.00	335561.85	5.51	-1.45
1970	343162.00	354531.96	5.65	-3.21
1971	361791.00	374993.69	5.77	-3.52
1972	381497.00	396886.43	5.84	-3.88
1973	415529.00	420017.56	5.83	-1.07
1974	430314.00	444040.54	5.72	-3.09
1975	454260.00	468563.96	5.52	-3.05
1976	494265.00	493059.13	5.23	0.24
1977	521954.00	516854.34	4.83	0.99
1978	548950.00	539289.93	4.34	1.79
1979	579909.00	559757.24	3.80	3.60
1980	609768.00	577744.19	3.21	5.54
1981	630642.00	592940.25	2.63	6.36
1982	653467.00	605355.11	2.09	7.95
1983	665717.00	615375.47	1.66	8.18
1984	616962.00	623869.17	1.38	-1.11

1985	571883.00	632207.44	1.34	-9.54
1986	591423.00	641692.47	1.50	-7.83
1987	616923.00	653023.18	1.77	-5.53
1988	658581.00	666395.81	2.05	-1.17
1989	699448.00	681645.57	2.29	2.61
1990	720690.00	698529.57	2.48	3.17
1991	716522.00	716982.90	2.64	-0.06
1992	718941.00	737162.28	2.81	-2.47
1993	734156.00	759219.81	2.99	-3.30
1994	766368.00	783125.39	3.15	-2.14
1995	802224.00	808598.25	3.25	-0.79
1996	849121.00	835190.09	3.29	1.67
1997	893151.00	862388.84	3.26	3.57
1998	887905.00	889821.73	3.18	-0.22
1999	917382.02	917423.65	3.10	0.00
2000	953582.00	945110.28	3.02	0.90

Source of basic data: National Accounts of the Philippines

Appendix Table 2

Weighted Growth Rates, Aggregate Demand (%)

	Private Consump- tion	Govern- ment Consump- tion	Gross Domestic Capital Forma- tion	Gross Fixed Capital Forma- tion	Exports of Goods and Non- Factor Services	Imports of Goods and Non- Factor Services	Statistical Discre- pancy
1947	31.28	5.81	17.99	16.27	33.46	70.63	21.58
1948	10.13	1.90	6.64	4.64	12.90	-1.11	-15.83
1949	11.29	1.03	-7.77	-5.29	-9.02	14.94	25.73
1950	3.37	0.50	-1.03	-1.92	-0.61	-31.30	-25.95
1951	5.80	0.17	0.31	1.15	3.50	6.01	7.02
1952	6.44	0.77	-0.61	-0.64	3.87	-3.73	-7.99
1953	8.90	0.27	4.22	3.01	-0.47	2.55	-1.42
1954	6.94	0.38	1.43	-0.21	1.39	3.23	0.62
1955	5.57	0.32	1.23	0.74	2.35	3.92	1.40
1956	3.10	0.19	-0.18	2.49	-3.23	-2.23	4.90
1957	3.01	0.23	3.18	2.78	0.70	4.46	2.75
1958	2.97	0.27	-0.07	-0.56	0.65	-3.43	-3.79
1959	2.99	0.16	2.62	2.28	-0.61	-2.48	-0.83
1960	2.91	0.58	-2.16	-1.89	1.22	2.49	1.31
1961	3.66	0.42	2.91	2.25	0.60	0.41	-1.56
1962	4.23	0.19	-0.18	-0.76	2.83	0.17	-2.11
1963	4.49	0.54	3.34	2.84	3.75	-0.99	-6.04
1964	2.96	0.29	2.25	2.69	1.31	3.85	0.49
1965	3.65	0.30	1.37	1.15	3.05	1.31	-1.78
1966	3.78	0.00	0.01	-0.23	1.47	1.05	0.20
1967	3.77	0.74	2.21	2.94	-3.54	5.04	7.19
1968	3.45	0.50	0.15	0.03	-2.25	1.62	4.72
1969	2.94	0.43	0.96	0.62	-0.74	0.89	1.95
1970	2.19	0.47	-0.83	-1.47	3.18	-1.40	-2.65
1971	2.48	0.71	1.13	1.34	0.61	-0.13	0.37
1972	2.37	1.01	0.71	0.47	2.20	0.66	-0.19
1973	4.05	0.98	2.29	0.81	3.01	1.16	-0.25
1974	3.34	1.26	4.13	2.68	-2.28	3.17	0.28
1975	3.32	0.73	5.57	5.73	0.60	1.41	-3.25
1976	3.43	0.20	5.13	4.32	2.15	0.38	-1.73
1977	3.49	0.08	0.29	0.75	2.85	1.42	0.30
1978	3.44	0.26	2.30	1.89	1.16	2.80	0.80

1979	3.20	0.31	1.27	0.88	0.83	3.79	3.81
1980	2.96	0.31	-1.07	1.89	7.60	5.07	0.42
1981	1.73	-0.25	0.75	3.00	2.40	-0.23	-1.45
1982	2.24	0.58	2.21	1.37	-2.87	0.69	2.15
1983	0.39	-0.38	1.76	2.30	0.80	-0.85	-1.55
1984	0.17	-0.88	-10.62	-8.29	1.07	-4.64	-1.71
1985	-0.80	-0.07	-6.22	-7.02	-4.26	-3.36	0.68
1986	2.45	0.03	1.44	0.16	4.06	2.24	-2.32
1987	2.97	0.36	3.01	1.11	1.85	6.68	2.80
1988	4.57	0.67	2.57	2.69	4.04	5.64	0.54
1989	3.65	0.53	3.85	3.88	2.65	4.89	0.42
1990	3.88	0.52	3.38	3.08	0.57	3.51	-1.80
1991	1.67	-0.17	-4.15	-3.26	1.89	-0.42	-0.24
1992	2.47	-0.07	1.56	1.27	1.38	3.23	-1.79
1993	2.38	0.47	1.69	1.83	2.09	4.63	0.12
1994	2.93	0.49	1.96	1.67	6.91	6.37	-1.54
1995	2.99	0.45	0.83	1.08	4.82	7.72	3.31
1996	3.59	0.34	2.91	2.77	6.61	8.94	1.34
1997	3.83	0.37	2.90	2.80	8.02	7.95	-1.99
1998	2.64	-0.16	-4.28	-2.88	-10.96	-9.34	2.83
1999	2.10	0.42	-0.38	-0.47	1.50	-1.53	-1.85
2000	2.76	0.01	0.16	-0.35	6.80	1.21	-4.59

Source of basic data: National Accounts of the Philippines

Appendix Table 3

Weighted Growth Rates, Aggregate Supply (%)					
	Agriculture	Industry	Manufac- turing	Services	GDP
1947	12.57	15.59	7.27	11.34	39.49
1948	2.25	10.06	6.00	4.53	16.84
1949	2.28	-0.34	3.35	4.38	6.32
1950	2.56	2.11	3.15	2.92	7.58
1951	2.86	4.54	3.11	3.39	10.78
1952	1.49	0.45	1.13	4.27	6.21
1953	3.13	3.26	2.36	2.56	8.94
1954	3.63	0.95	2.44	2.94	7.52
1955	0.87	2.64	2.66	3.43	6.94
1956	0.54	4.28	2.99	2.21	7.02
1957	0.84	2.34	1.37	2.22	5.41
1958	1.31	0.92	1.71	1.23	3.46
1959	1.92	2.64	2.14	2.25	6.81
1960	-0.16	-0.06	0.64	1.59	1.36
1961	2.01	1.64	1.04	1.97	5.62
1962	1.38	1.25	1.32	2.15	4.77
1963	2.14	2.98	1.85	1.94	7.06
1964	0.10	1.48	0.84	1.87	3.45
1965	2.16	1.69	1.03	1.42	5.27
1966	1.14	1.63	1.76	1.65	4.43
1967	0.72	2.65	2.19	1.95	5.32
1968	1.89	1.46	1.63	1.60	4.95
1969	1.13	1.57	0.95	1.95	4.66
1970	0.13	1.90	2.09	1.74	3.76
1971	1.14	2.45	1.84	1.84	5.43
1972	1.49	2.44	1.58	1.51	5.45
1973	2.07	4.61	4.05	2.24	8.92
1974	-0.87	2.46	1.15	1.97	3.56
1975	0.42	3.17	0.81	1.97	5.56
1976	2.47	4.22	1.64	2.12	8.81
1977	1.09	2.90	1.75	1.62	5.60
1978	0.92	2.22	1.83	2.03	5.17
1979	0.77	2.91	1.32	1.96	5.64
1980	0.96	2.01	1.16	2.18	5.15

1981	0.85	1.88	0.54	0.69	3.42
1982	0.18	1.02	0.44	2.42	3.62
1983	-0.77	0.62	-0.09	2.03	1.87
1984	-0.20	-4.65	-2.64	-2.47	-7.32
1985	-0.44	-6.08	-2.00	-0.79	-7.31
1986	0.90	0.81	0.45	1.71	3.42
1987	0.79	1.39	1.38	2.13	4.31
1988	0.79	3.03	2.38	2.94	6.75
1989	0.71	2.60	1.49	2.90	6.21
1990	0.11	0.91	0.68	2.02	3.04
1991	0.31	-0.95	-0.11	0.06	-0.58
1992	0.09	-0.19	-0.44	0.44	0.34
1993	0.48	0.57	0.19	1.07	2.12
1994	0.59	1.98	1.24	1.82	4.39
1995	0.19	2.33	1.68	2.15	4.68
1996	0.82	2.28	1.41	2.75	5.85
1997	0.65	2.19	1.07	2.35	5.19
1998	-1.33	-0.76	-0.28	1.51	-0.59
1999	1.16	0.31	0.40	1.85	3.32
2000	0.68	1.25	1.37	2.01	3.95

Source of basic data: National Accounts of the Philippines

Appendix Table 4**Decomposition of Growth by Factor Input and Productivity**

	Capital	Labor	TFP	GDP Growth
1957	2.56	3.28	-0.43	5.41
1958	1.07	0.81	1.59	3.46
1959	3.15	1.50	2.15	6.81
1960	-0.20	-0.21	1.77	1.36
1961	2.38	3.31	-0.07	5.62
1962	1.69	3.30	-0.22	4.77
1963	3.59	1.30	2.17	7.06
1964	2.37	4.67	-3.59	3.45
1965	3.23	-1.85	3.88	5.27
1966	2.37	4.81	-2.75	4.43
1967	3.39	0.23	1.70	5.32
1968	2.91	-1.32	3.35	4.95
1969	2.64	4.29	-2.27	4.66
1970	1.84	1.09	0.84	3.76
1971	3.03	5.88	-3.48	5.43
1972	2.93	0.67	1.84	5.45
1973	5.00	5.73	-1.82	8.92
1974	3.65	0.35	-0.44	3.56
1975	6.21	3.06	-3.71	5.56
1976	8.66	-0.50	0.64	8.81
1977	6.45	0.83	-1.68	5.60
1978	6.15	6.86	-7.84	5.17
1979	5.97	0.95	-1.28	5.64
1980	5.98	1.00	-1.82	5.15
1981	5.21	3.33	-5.12	3.42
1982	5.08	-1.54	0.08	3.62
1983	4.40	5.64	-8.17	1.87
1984	-2.42	0.28	-5.19	-7.32
1985	-3.67	1.52	-5.16	-7.31
1986	1.58	1.78	0.05	3.42
1987	2.24	3.89	-1.82	4.31
1988	3.96	1.99	0.80	6.75
1989	4.40	1.35	0.45	6.21
1990	3.25	2.03	-2.24	3.04
1991	0.72	0.54	-1.84	-0.58

1992	1.28	2.72	-3.66	0.34
1993	2.32	1.03	-1.24	2.12
1994	3.54	1.68	-0.83	4.39
1995	3.61	1.63	-0.56	4.68
1996	4.52	4.02	-2.69	5.85
1997	4.46	0.74	-0.02	5.19
1998	0.62	1.08	-2.29	-0.59
1999	2.39	1.33	-0.40	3.32

Appendix Table 5

Fiscal and Monetary Indicators (%)				
	Real Fiscal Expenditure Growth	Fiscal Balance/GDP	Real M2 Growth	Real Private Credit Growth
1949			-5.31	-5.26
1950			15.56	-3.60
1951			-11.44	22.30
1952			3.49	2.33
1953			9.72	14.11
1954			12.51	15.63
1955			12.92	16.06
1956			8.36	10.50
1957		-1.54	4.38	19.84
1958	-13.06	-0.21	6.64	2.79
1959	3.73	-0.96	8.19	11.22
1960	6.58	0.06	1.43	6.06
1961	19.90	-1.58	20.89	36.05
1962	-11.06	0.32	13.04	12.13
1963	28.85	-0.60	4.83	20.19
1964	-15.23	0.14	-1.23	13.18
1965	11.57	-1.34	2.48	-0.28
1966	7.22	-0.62	10.09	6.67
1967	17.50	-0.88	19.37	16.96
1968	6.87	-0.88	4.13	3.36
1969	21.63	-3.01	5.47	0.01
1970	-28.16	0.15	-2.58	2.98
1971	11.95	-0.38	1.35	3.31
1972	26.88	-2.06	7.46	14.85
1973	11.23	-1.24	6.64	14.84
1974	-19.35	0.48	-16.29	12.60
1975	46.06	-1.26	4.48	5.75
1976	5.18	-1.85	19.75	10.77
1977	1.96	-1.93	20.27	10.18
1978	5.66	-1.30	14.91	16.63
1979	-1.51	-0.17	-2.40	12.00
1980	13.02	-1.39	6.37	5.94
1981	15.13	-4.32	5.72	8.05
1982	0.73	-4.54	9.79	5.42
1983	-12.95	-2.02	38.77	12.52
1984	-27.51	-1.90	-35.39	-38.56
1985	2.33	-1.95	-5.18	-23.81
1986	34.22	-5.03	-1.26	-23.62
1987	1.65	-2.45	4.17	12.17

1988	3.83	-2.91	13.61	7.74
1989	17.32	-2.11	21.21	14.35
1990	13.84	-3.45	9.43	14.35
1991	-3.21	-2.11	1.19	-7.94
1992	-3.26	-1.18	5.18	16.14
1993	2.30	-1.48	21.31	30.63
1994	2.34	1.07	16.74	14.98
1995	2.87	0.58	16.32	35.04
1996	7.77	0.29	16.07	38.13
1997	10.13	0.06	16.88	21.24
1998	-2.04	-1.87	-2.45	-15.90
1999	6.87	-3.73	8.60	-9.79

Source of basic data: National Accounts of the Philippines; International Financial Statistics

Appendix Table 6

External Indicators, Saving and Investment Rates (%)					
	Gross International Reserves less Gold (\$M)	GIR less Gold in Months of Import	Trade Balance/GDP	Saving Rate	Investment Rate
1949	232.75	4.77	-10.62	14.71	21.98
1950	295.75	10.47	-0.24	17.13	19.48
1951	240.75	5.96	-1.52	19.81	17.86
1952	230.75	6.57	-1.94	17.71	16.24
1953	234.75	6.23	-1.30	16.06	18.78
1954	201.75	5.06	-1.81	15.13	18.80
1955	139.00	3.05	-3.21	15.13	18.73
1956	139.00	3.29	-1.07	17.62	17.33
1957	65.00	1.26	-3.43	18.77	19.46
1958	82.00	1.74	-1.26	18.35	18.74
1959	84.76	1.96	0.16	20.60	20.00
1960	111.67	2.08	-0.30	18.23	17.59
1961	26.59	0.35	-3.25	18.72	19.41
1962	34.00	0.69	-1.84	18.20	18.35
1963	81.00	1.57	0.69	18.90	20.26
1964	100.00	1.53	-2.20	18.47	21.76
1965	155.45	2.32	-1.86	18.80	21.97
1966	149.50	2.10	-0.47	18.61	21.05
1967	120.00	1.35	-3.54	18.45	22.08
1968	99.00	1.02	-3.98	18.53	21.19
1969	76.00	0.80	-3.39	18.93	21.16
1970	195.00	2.10	-0.98	19.31	19.59
1971	309.00	3.14	-1.11	20.44	19.65
1972	479.80	4.52	-2.15	21.34	19.31
1973	992.78	7.42	2.77	23.17	19.83
1974	1458.93	5.57	-3.04	21.37	23.14
1975	1314.50	4.58	-7.72	21.68	27.20
1976	1596.80	5.29	-6.25	24.68	29.71
1977	1479.36	4.53	-4.01	25.28	28.41
1978	1763.04	4.47	-5.86	25.44	29.20
1979	2249.70	4.40	-5.72	26.09	28.84
1980	2846.14	4.45	-5.97	26.60	26.42
1981	2065.94	3.12	-6.45	27.59	26.26
1982	887.76	1.39	-7.22	27.40	27.48
1983	746.93	1.20	-7.74	28.73	28.70
1984	602.08	1.22	-2.08	23.86	19.51
1985	614.89	1.47	-1.33	18.80	14.35
1986	1728.18	4.11	-0.79	19.10	15.27

1987	968.27	1.72	-3.19	19.25	17.52
1988	1003.39	1.48	-3.00	19.45	18.82
1989	1416.96	1.63	-6.24	20.22	21.35
1990	924.35	0.91	-9.25	18.30	24.00
1991	3245.95	3.23	-7.17	16.32	19.96
1992	4403.26	3.65	-8.97	14.20	21.46
1993	4675.69	3.17	-11.96	13.19	22.67
1994	6017.47	3.39	-12.53	13.56	23.59
1995	6372.44	2.89	-12.03	14.14	23.33
1996	10029.70	3.77	-13.85	15.17	24.78
1997	7266.26	2.42	-13.29	15.35	26.32
1998	9225.56	3.73	-0.29	12.35	22.16
1999	13229.70	5.16	7.71	12.73	21.08
2000				13.37	20.44

Source of basic data: National Accounts of the Philippines; International Financial Statistics

Appendix Table 7

Unemployment and Sectoral Share to Total Employment (%)					
	Unemploy- ment Rate	Agriculture	Industry	Manufac- turing	Services
1956	10.03	60.82	14.83	12.33	24.34
1957	7.14	60.78	15.64	12.33	23.58
1958	7.21	61.96	14.72	11.68	23.32
1959	5.92	61.72	14.52	11.57	23.76
1960	6.33	61.15	15.45	12.13	23.40
1961	6.36	60.20	14.74	11.57	25.06
1962	6.45	61.26	14.31	11.10	24.43
1963	4.58	59.32	15.48	11.94	25.20
1964	6.41	58.52	15.58	11.77	25.90
1965	6.16	57.06	14.60	11.25	28.34
1966	6.98	57.20	14.94	11.65	27.86
1967	7.72	57.80	14.73	11.33	27.47
1968	7.91	57.69	14.72	11.11	27.58
1969	6.74	56.31	15.31	11.49	28.38
1970	7.66	53.04	15.79	11.63	31.17
1971	5.28	49.77	16.26	11.77	33.97
1972	5.36	54.48	15.14	11.01	30.37
1973	4.77	55.01	14.62	10.59	30.37
1974	3.21	55.67	13.84	10.42	30.49
1975	4.24	53.96	14.67	10.93	31.36
1976	5.19	53.21	14.94	11.05	31.85
1977	4.45	50.01	15.73	11.26	34.25
1978	4.12	51.50	15.21	11.23	33.29
1979	4.00	52.59	15.41	11.05	32.00
1980	5.05	51.78	15.41	10.88	32.82
1981	5.27	51.33	14.36	10.17	34.31
1982	9.38	51.63	14.19	10.07	34.18
1983	7.88	50.96	14.44	9.83	34.60
1984	10.63	49.66	14.97	9.91	35.38
1985	11.07	49.31	14.25	9.67	36.44
1986	11.06	49.77	13.61	9.36	36.62
1987	9.11	48.21	14.44	9.71	37.35
1988	8.33	46.46	15.79	10.45	37.75
1989	8.42	45.26	15.86	10.49	38.88
1990	8.13	45.06	15.33	9.96	39.62
1991	8.98	45.12	16.14	10.45	38.73
1992	8.64	45.27	16.13	10.65	38.60
1993	8.87	45.68	15.60	10.08	38.71
1994	8.43	45.09	15.77	10.14	39.14
1995	8.35	43.41	16.12	10.19	40.47

1996	7.41	42.83	16.29	9.91	40.87
1997	7.85	40.83	16.71	9.86	42.46
1998	9.64	39.17	16.42	9.73	44.41
1999	9.37				

Source of basic data: Yearbook of Labor Statistics

Appendix Table _8

Indicators of Economic Liberalization (%)			
	M2/GDP	Total Trade/GDP	Gross Foreign Investment/GDP
1946		22.63	
1947		90.84	
1948	23.15	87.84	
1949	20.60	88.18	
1950	22.18	52.31	
1951	17.74	55.80	
1952	17.30	52.67	
1953	17.47	50.25	
1954	18.36	51.03	
1955	19.39	53.58	
1956	19.60	44.98	
1957	19.38	47.56	
1958	19.95	43.28	
1959	20.18	37.63	
1960	20.18	40.79	
1961	22.97	39.58	
1962	24.61	40.64	
1963	24.00	40.54	
1964	22.93	44.18	
1965	22.30	46.11	
1966	23.40	46.57	
1967	26.44	45.64	
1968	26.18	42.89	
1969	26.30	41.12	
1970	24.78	41.34	0.63
1971	23.78	39.66	0.19
1972	24.13	40.32	0.37
1973	23.42	40.85	1.73
1974	19.83	40.31	1.13
1975	19.56	40.09	1.20
1976	21.25	39.17	1.32
1977	23.89	41.14	1.30
1978	25.82	42.88	0.74
1979	23.93	44.96	0.99
1980	24.03	54.81	1.05
1981	24.42	55.10	0.90
1982	25.69	51.07	1.00
1983	33.77	50.08	1.20
1984	28.03	50.18	0.82
1985	28.91	45.91	0.75

1986	27.61	50.49	0.78
1987	27.50	56.58	1.66
1988	28.96	62.08	3.08
1989	32.57	65.55	2.53
1990	34.25	67.58	2.10
1991	34.80	69.45	2.07
1992	36.34	73.82	3.76
1993	42.69	78.87	11.78
1994	47.12	88.28	14.03
1995	51.85	96.31	13.88
1996	56.30	105.69	16.04
1997	62.03	115.66	19.56
1998	61.02	95.92	15.92
1999	63.75	92.81	35.71
2000		97.00	

Source of basic data: National Accounts of the Philippines; International Financial Statistics; Bangko Sentral ng Pilipinas