Achieving Inclusive Growth in the Philippines

by

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The Philippine government views inclusive growth as sustained growth that “creates jobs, draws the majority into the economic and social mainstream, and continuously reduces mass poverty” and that is rapid enough to matter (GOP 2011). In pursuing a development strategy that revolves around this goal, the government is currently implementing a development plan with the following key features: massive infrastructure investments, higher governance standards, human development and direct poverty relief, and employment generation.

The immediately visible manifestations of the elusiveness of inclusive growth in the Philippines are low economic growth, weak employment generation, and persistently high poverty and inequality. The average annual gross domestic product (GDP) growth rate of the Philippines from 1998 to 2011 is 4.52 percent and GDP per capita currently stands at PhP61,738 or USD1,425. Unemployment has not significantly dropped from the 7 to 7.5 percent range for the last five years. More than a quarter of the population remains poor and past poverty reduction programs seem to have had little impact. The poverty incidence of the population in 1991 was 33.1 percent. As of the latest Family Income and Expenditure Survey in 2009, it was still high at 26.5 percent and this translates to more than 23 million Filipinos mired in poverty.

The Philippine Development Plan 2011-2016 assessed that these discomforting manifestations reflect deeper structural and interrelated constraints which need to be addressed in the Philippines’ key development strategy. Among these constraints are: inadequate infrastructure, gaps and lapses in governance, inadequate levels of human development, and a poor and degraded state of environment and natural resources. Weak investments and the population's lack of access to markets and social services stem from inadequate infrastructure and a resulting poor logistics network. Among the infrastructure constraints, an inefficient transport network and unreliable power supply have been identified as the most significant ones. Weak institutions and governance failures are reflected in the country's poor rank in international comparisons of bureaucratic inefficiency, perception of corruption, enforcement of law and contracts, and competition measures. Human development is low because even though basic social services are offered for free or at highly subsidized rates, poor infrastructure prevents physical access to these basic services. Moreover, the continuing deterioration of the country's environment and natural resources affect the poor greatly because many of them depend on these for their livelihood and they are most vulnerable to natural disasters and calamities.

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The Philippine government's basic development strategies

Cognizant of these constraints to achieving inclusive growth, the Philippine Development Plan 2011-2016 (GOP 2012) lays down the following development strategies, as well as the specific activities that are currently being undertaken or will be undertaken:

- Invest massively in physical infrastructure

  The country is making up for its massive infrastructure backlog. An integrated and multimodal national transport and logistics system is being planned to connect underserved but otherwise productive areas and communities to markets and social services. A priority program for areas with less than fifty percent water access is being implemented. Investments on sanitation, sewerage and septage management to ensure the health of the population are being pursued. Sustainable new water sources to meet growing demand will be developed. Traditional and new and renewable energy sources will be developed further to ensure energy security. The country's power sources, especially in Mindanao, will be diversified to address the susceptibility of hydro power plants to climate-change impacts. The government's rural electrification program is being expanded. The government is relying on the public-private partnership (PPP) scheme to implement the bulk of its infrastructure program given that government funds are limited and some projects can be more efficiently run by the private sector.

- Undertake reforms to promote transparent and responsive governance

  Reforms in the budgeting process, public procurement, and awarding of contracts are being instituted to restore public confidence in government institutions and practices. The government is implementing a zero-based budgeting (ZBB) approach, under which budgets of government departments and agencies are comprehensively scrutinized and justified in complete detail, from a zero base, and not just incrementally. The anti-corruption drive is being strengthened by pursuing strong cases involving well-known instances of corruption. The Run-After-Tax-Evaders, Run-After-the-Smugglers, and Revenue Integrity Protection Service programs are being revitalized. Measures to reverse the weak rule of law, legal uncertainty, and high costs and delays of the legal system in the country, which have historically discouraged legitimate investments, will be pursued. Strong competition policies will be promoted, including the passage of an omnibus Competition and Anti-Trust Code that operationalizes constitutional provisions against monopolistic practices and provides a transparent and predictable framework for standards and procedures for all regulatory authorities. Property rights problems in the countryside will be addressed through the continuous implementation of agricultural land reform.

- Invest more aggressively in the country's human resources

Major reforms in the education sector are being implemented. This school year marked the rollout of the "K to 12" system, or kindergarten through the 12 years of elementary and secondary education before entering university or college. In this system, basic education is extended by two years but the purpose is not simply to add two more years of education but to decongest the basic education curriculum and then enhance it. Social protection measures such as the conditional cash transfer (CCT) program are currently being implemented. The CCT program provides direct cash transfers to the poor on condition that their children continue to attend school and the family makes use of preventive health care and nutrition services. Another measure is the use of PPPs, in addition to traditional government financing, in upgrading public health care facilities.

- Generate direct employment and indirect employment opportunities

  To expand self-employment opportunities for the poor, the government is collaborating with micro-finance institutions (MFIs) and people's organizations for increasing access to microcredit, market matching, technical assistance, community organizing, and other services. The government is also directing wholesale finance institutions to coordinate with national government agencies and viable MFIs to develop innovative market-based financing schemes for microenterprises. Labor-intensive infrastructure projects can also rapidly provide employment. Supporting activities that involve products and services that are competitive in the world market can also indirectly generate employment.

- As complementary strategy, maintain a macroeconomic regime of low and stable inflation and sustainable fiscal balance

  Low and stable inflation is being pursued since high prices directly and immediately erode the purchasing power of the public and particularly impact the poor. The monetary policy will continue to emphasize low and stable inflation and the Bangko Sentral will continue to use its tools to prevent the emergence of asset bubbles. The government will persevere to control government debts and fiscal deficit because runaway public debts and deficits raise borrowing costs and dampen investments, endangering the goals of economic growth and development.

Successes and challenges of these strategies

Two years into the Aquino administration, the implementation of these development strategies have resulted in early though limited successes. Big challenges remain and lessons are being learned to hurdle these challenges.

On infrastructure investment, the PPP program has taken off and the current pipeline of priority projects is now a total of 22 projects worth USD5.75 billion. Expectations were high in 2011 but the government was able to bid out only one project—a toll road (PPP Center 2012). The primary reason is slow project development activities and a dearth of properly prepared documents to support the priority list. In order to catch up, the government is now implementing rapid capacity-building activities at the same time that transaction advisory and project tenders are going on.

The feed-in-tariff system for renewable energy is continuously being prepared and commitments for additional generation capacity are coming in, but the growing problem of supply scarcity is outpacing these developments. Just recently, from March to May 2012, the Mindanao region experienced rotating brownouts; observers fear that the Luzon region will experience the same thing if no generation capacity is added soon enough.

On the water supply and sanitation front, there are promising developments. Local governments and local water supply providers are catalyzed into action through national government investments directly benefiting the poor such as the *Sagana at Ligtas na Tubig Para sa Lahat* ("Adequate and Safe Water Supply for All") program. There are also innovative financing programs for the sector that are tapping the resources of the highly liquid domestic banking sector.

On the responsive governance and anti-corruption front, the government strictly implemented the ZBB approach by, among others, scrutinizing programmed projects, mostly infrastructure. However, because of delays in budget releases and non-implementation of some budget items, there had been a serious decline in government spending in 2010 to 2011, contributing to slower economic growth at a time when global recession is affecting the country. Although the executive defended the underspending as a consequence of the attempt to institute good governance, economists say that addressing institutional weaknesses should not result in too little macroeconomic intervention when the situation calls for a more aggressive one (Navarro and Yap 2012).

Prominent cases against tax evaders are also currently being pursued, including the case against the former president's son. The chief justice of the Supreme Court was also recently impeached for betrayal of public trust and culpable violation of the Constitution, a move that was heralded by many as the start of serious reforms in the judiciary.

On investment on human resources and direct poverty relief, the two flagship programs that are currently being implemented are the K to 12 basic education system and the CCT program. It is still too early to assess the success of the K to 12 system but Pacqueo et al (2012) expressed concern on the rushing of the K to 12 implementation and argued that mandating public subsidies for the two-year extension would impose substantial opportunity costs. This is because additional financing is currently needed to effectively and sustainably resolve the perennial classroom, teacher and educational materials shortages, as well as improve teacher remunerations and performance incentives. The CCT program, on the other hand, is now on its fifth year as it is a continuation of the past administration's program. The program has been relatively successful in increasing enrolment rates but Reyes and Tabuga (2012) raised issues on the targeting or selection of the recipients of conditional cash transfer. First, the number of poor families in the CCT target list seems to have been overestimated as it is inconsistent with the official poverty estimates. Second, the program does not differentiate between the transient poor and the chronic poor; the CCT is deemed more appropriate for the latter.

On employment, workers and employees in the services sectors continue to outnumber employment growth in agriculture and industry and employment in 2011 improved overall and seemed to have been biased toward higher productivity jobs. But the current seven percent unemployment rate still translates to 2.8 million unemployed Filipinos, implying that significant jobs creation must be pursued. What is currently posing risks to the jobs creation prospect is the increasing cost of doing business and setting up industries, due in part to increasing electricity price in the Philippines, which is now the highest in East Asia.

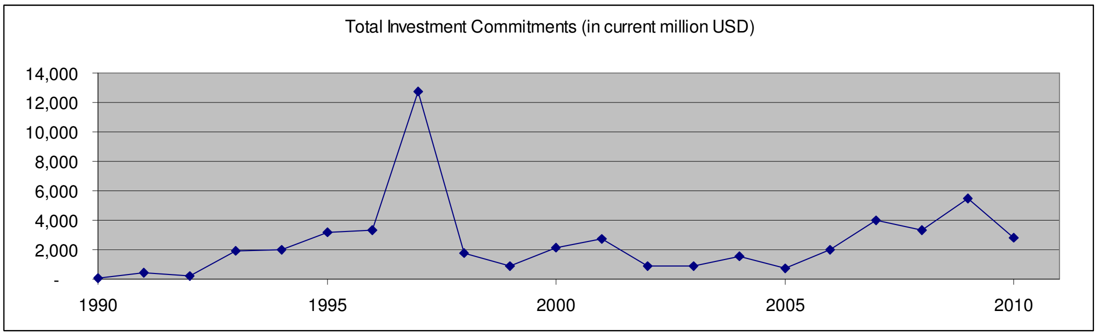
On the macroeconomic management side, the current administration takes pride in lowering the fiscal deficit and overachieving fiscal targets for the past two years, primarily because of prudent government spending and lower interest obligations, with the latter being due to the favorable impact of the Philippine peso appreciation on foreign debt. However, Navarro and Yap (2012) put forward that the decline in interest payments could alternatively be viewed as a lost opportunity to take advantage of the extra fiscal space and use government spending to boost economic growth. On the inflation front, the global recession and local calamities are putting pressures to inflation but the Bangko Sentral continues to use monetary tools (e.g., changes in overnight borrowing/lending rates) to temper inflation expectations. Nevertheless, liquidity in the banking system continue to be excessive, as reflected by the almost two trillion of pesos parked in special deposit accounts at the Bangko Sentral, and this signals another opportunity that should not be missed; this could very well be an opportunity to use private money for developmental yet viable investments, such as infrastructure investments.

How the strategies have changed over the years and in the past administrations

So much has changed in Philippine development strategies that a brief paper will not be enough to even summarize the changes. Thus, the discussions below narrow down the assessment by focusing only on certain themes in past development strategies which recur in current development strategies, as well as on the specific programs implemented by past administrations to advance the recurring themes. For brevity and to reflect a major structural break in socio-economic planning, the examined years are the post-Marcos dictatorship years: 1986-1992 (Corazon Aquino), 1992-1998 (Fidel Ramos), 1998-2001 (Joseph Estrada), and 2001-2010 (Gloria Arroyo).

<u>Public-private partnerships for infrastructure investment</u>

It was during the administration of Corazon Aquino that the first PPP law was passed. Republic Act (RA) 6957 enacted in 1990 authorized the financing, construction, operation and maintenance of infrastructure projects by the private sector. This came at an opportune time as the country was then reeling from power shortage; rotating brownouts were occurring in the early 1990s. The PPP law paved the way for aggressive investments in power generation and most of the contracts for these were signed during the administration of Fidel Ramos. The PPP policy was then fine-tuned through the enactment of RA 7718 in 1994. The major adjustments include the setting of clearer procedures for unsolicited proposals and the expansion in the types of projects that can be eligible for PPPs. The interest in PPPs drastically declined during the Estrada administration in the aftermath of the 1998 East Asian currency crisis (see Figure 1 below) and stagnated during the first half of the Arroyo administration as most infrastructure projects were financed using official development assistance. The PPP program has started to gain ground in the latter part of the 2000s and it is now one of the flagship programs of the current administration.



Source: World Bank-Private Participation in Infrastructure Database

Figure 1. PPP Investment Commitments per Financial Closure Year

<u>Responsive governance and the government's role in facilitating markets</u>

The promotion of responsive governance in past administrations has included not only anti-corruption drives but also facilitation of markets. The role of government as facilitator has been well-emphasized through the deregulation of industries, liberalization of markets, and privatization of government assets in sectors which are deemed more efficiently served by the private sector. In 1986, the Asset Privatization Trust was established to relieve the government of operating public sector enterprises with non-performing assets, many of which were Marcos crony companies. The seeds of deregulation and liberalization of the shipping, telecommunications, aviation and finance sectors were sown during the Corazon Aquino administration and germinated during the Ramos administration. The resulting greater competition in the succeeding years allowed more and better services to be enjoyed by Filipinos. For instance, the breakup of local monopolies in inter-island shipping routes resulted in more frequent ferry services and greater mobility of Filipinos across the archipelago. Corruption scandals, however, continued to hound every administration and, thus, the current administration's thrust is to address the weaknesses in institutions while letting deregulation, liberalization, and privatization take their course.

<u>Human development and poverty relief</u>

Human development and poverty relief during the administration of Corazon Aquino were anchored on a rural-based strategy, that is, promotion of rural-based enterprises and land distribution through the Comprehensive Agrarian Reform Program (CARP). The CARP, however, met limited success and up to now, many lands which are supposed to be covered by agrarian reform are yet to be distributed as exemptions to the program found its way in the implementation design (e.g., stock distribution option rather than actual physical distribution of land). During the time of Fidel Ramos, the Social Reform Agenda was crafted and the National Anti-Poverty Commission was established to coordinate poverty alleviation programs like nutrition advocacy, agriculture and fisheries modernization, certification of stewardship over indigenous peoples' ancestral domains, and community mortgage programs for housing. Many targeting tools conceptualized under the Social Reform Agenda, such as the ranking of 20 poorest provinces and the identification of the Filipinos' minimum basic needs, continue to be used today. A more experimental approach to poverty relief, one that uses direct transfers, was implemented from the time of Gloria Arroyo and is still being implemented at present.

Critical elements of the Philippine experience that have regional relevance

Perhaps the most critical elements of the Philippine experience that are worth sharing at the regional level are policy coherence and institutional strengthening. It is not being implied that the Philippines is experiencing great success in these areas. Rather, we are relaying that we took hard lessons from policy incoherence and the weakening of institutions.

With regard to policy coherence, Yap (2009) has one statement that is fitting to the current state of infrastructure in the Philippines: "Policies that enhance global economic integration may falter because of supply side constraints, particularly inadequate infrastructure." The liberalization and deregulation efforts have led to a wider potential for the Philippines to be globally competitive and achieve deeper integration in regional and global markets, but this potential has not been fully exploited because of massive infrastructure backlogs. For instance, the primary international gateway to the Philippines, the Ninoy Aquino International Airport (NAIA), remains congested and the planned development of the airport in Clark, Pampanga as the primary gateway while operating the NAIA as a secondary gateway has not yet taken off despite years of planning. It is hoped that the current revitalization of infrastructure investment policies, especially the PPP policy, could address this.

Weak institutions compromise the efficiency and effectiveness of policies, especially those meant to foster inclusive growth. There are many evidences of this in the Philippine case and one instance is the 2004 fertilizer fund scam that is currently being investigated. Investigative journalism reports alleged that fertilizer funds meant for farmers were diverted to the election campaign of the former president. The pursuit of legal cases against erring officials in this case, and in many other cases, is in the right direction. However, as Navarro and Yap (2012) posed by way of a gentle but serious reminder, the current administration must always be on guard against substituting this action for other needed reforms.

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