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The Philippine Economy: An Overview

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1. Introduction

The Philippines has long been viewed as the "East Asian exception". Although suffering massive wartime destruction, in the 1950s and 1960s its economic prospects were considered to be favourable. While very poor, its per capita income was somewhat higher than most of its neighbours. In the post-colonial era it neither closed off from the global economy — as China, Indonesia and Myanmar did — nor was it overwhelmed by the conflict that engulfed Indochina. Its civil society and polity appeared to be among the most robust in developing East Asia. And it retained close commercial and political ties with the undisputed global super power of that era, the United States. As a vote of confidence, Manila was selected to be the headquarters of the Asia Pacific's premier development finance institution, the Asian Development Bank, in 1966.[1]

However, these early high expectations were not realized. From the late 1960s the Philippines increasingly parted company with its neighbours, as first the four Asian NIEs, then the ASEAN four (i.e., Indonesia, Malaysia, Thailand, together with Singapore) and, most important of all, China began to register exceptionally high rates of economic growth. By contrast, Philippine economic growth began to falter, especially from the late 1970s, and particularly during the country's deep economic and political crisis in the mid-1980s. The collapse of the two-decade Marcos rule in early 1986 was accompanied by the sharpest economic contraction in the country's economic history as an independent nation state. The economy was in free fall, with GDP declining by about 15 per cent in the years 1984–86 and poverty incidence rising sharply.[2] Thereafter, a fragile political system was gradually constructed, punctuated by periodic political instability and extended debt negotiations. This was the country's lost decade, as most of East Asia boomed, fuelled by a newly dynamic China and the relocation of labour-intensive manufacturing from Northeast to Southeast Asia. At the turn of the century, Philippine per capita income (PCI) had not progressed beyond that achieved in 1980.

Comparative surveys of Asian economic development have highlighted, and puzzled over, the country's divergent economic path. A leading contributor to the literature on growth empirics speculated that the country was "a democratic dud" (Pritchett 2003). The landmark World Bank (1993) "Asian miracle" study focused on the exceptionally strong performance of seven East Asian economies, which are the four NIEs and the four ASEAN countries (Singapore being a member of both groups). Perkins (2013) drew attention to the comparative record by estimating by how many multiples PCI had risen in the East Asian economies for the half century 1960–2010. The conclusion was a stark one: whereas the most successful economies increased their PCI by 12- to 15-fold, and most of the major ASEAN economies by a still-impressive 6-fold or more, the Philippines managed to only double its PCI. The World Bank's Growth Commission report (2008) highlighted a similar trend. We return to these empirical patterns in section 3 below.

The good news for the Philippines is that these "exceptional" observations are no longer being made. Since the early 1990s the country's growth performance, while not stellar, has not diverged noticeably from the ASEAN norm. The country avoided the worst of the 1997–98 Asian financial crisis (AFC) that so severely affected

Indonesia, Malaysia and Thailand. As Noland (2000) colourfully observed, the "sick man avoided pneumonia". During the global financial crisis (GFC) of 2008–9, the country's growth remained surprisingly robust, again in contrast to the traditionally dynamic export-oriented economies — Malaysia, Singapore and Thailand. And since 2010 the Philippines has registered historically strong growth, of about 6 per cent per annum, that has placed it alongside China and India as one of Asia's fastest growing economies. It has now recorded a historically unprecedented twenty-four quarters of continuously positive economic growth. Moreover, in spite of the new administration still finding its bearings, and for all the complexities of governance in a nascent democracy, the political system embodied in the 1987 Constitution appears to be maturing, with peaceful regime change at six-year intervals commencing in 1992.

This renewed economic dynamism, its sustainability, and the socio-economic challenges the country faces in graduating to the ranks of the upper-middle-income group of developing economies are the central themes of this volume. The contributors look backwards and forwards: backwards in surveying the development record and the salient lessons learnt from it, and forward to the manifold policy challenges to sustain the recent growth. A notional target to graduate to the high-income group was embodied in the "Filipino 2040" (*AmBisyon Natin 2040*) document prepared by the outgoing Aquino administration. This chapter introduces these key issues and provides an analytical survey of the historical and institutional context. As part of the Filipino 2040 study, and in addition to a broad survey of the Philippine economy by Ramon L. Clarete in chapter 2, seven core issues are identified for analysis. These are energy, the environment, urbanization and infrastructure, education, health, financing development, and governance and institutions.

Our organization is as follows. By way of background, section 2 briefly articulates ten stylized facts that characterize Philippine development. Section 3 reviews development outcomes since the 1960s in comparative context. Section 4 summarizes the contents of this volume. Section 5 concludes by returning to our key themes as well as providing an early look at the development priorities and outcomes of the Duterte administration.

2. The Philippine Economy: Ten Stylized Facts

In this section we identify ten "stylized facts" that characterize some salient features of the Philippine economy, its history and its institutions. These facts reflect both the continuities and the changes that are a feature of the country's development trajectory. To illustrate both the continuities and the changes, if this volume was being written in the early 1980s, the dominant themes would surely have been how to reinvigorate the economy, how to strengthen macroeconomic management, how to achieve trade liberalization, how to overcome the country's entrenched inequality, and how to break out of the authoritarian politics of the Marcos regime.

It is a reminder of the country's progress that some — but by no means all — of these challenges are in the process of being addressed. That is, the economy is now growing quite strongly, macroeconomic management (especially monetary policy) is much improved, the country's trade regime has been significantly liberalized, and a functioning democracy restored. A major continuity is, of course, the high inequality and the frustratingly slow pace of poverty reduction. Meanwhile, new challenges, such as those analysed in this volume, have emerged as major development priorities.

I. Highly Episodic Development Outcomes

Philippine growth has been episodic over the past half century, with three main sub-periods evident. The first was moderate economic growth through to around 1980. Growth was somewhat slower than most neighbouring countries, and generally also more volatile owing to periodic balance of payments crises. But the record was still respectable by global standards. The second was the 1980s decade, dominated by the deep economic crisis in 1984–86, followed by a hesitant recovery. This was the period when Philippine economic development departed significantly from the East Asian mainstream of rapid growth, structural adjustment, and reform.[3] The third period, commencing around 1990, saw a return to moderate growth. Since then the Philippines has generally grown somewhat more slowly than the region's high-performing economies, but the difference has narrowed, and all but disappeared since 2008. Philippine growth has also become less volatile, as the earlier boom and bust pattern had been mitigated by the macroeconomic reforms discussed below.

Outcomes in these three sub-periods were of course interconnected. The adventurous macroeconomic policies of the 1970s — the large increase in foreign debt, combined with an appreciating real exchange rate and proliferating "crony capitalism"[4] — laid the foundations for the mid-1980s crisis, accentuated as it was by regime collapse and transition. The painful lessons of the crisis in turn paved the way for far-reaching economic reforms, especially in the conduct of monetary policy, and hence improved economic performance.

II. Unusual Sectoral Growth Patterns

Agriculture performed well during the 1960s and 1970s (David 2003) but, consistent with the theory of economic development, its share of output and employment has fallen since the 1960s (Clarete, chapter 2). In other respects, however, the country's sectoral drivers of growth have been unusual. In particular, manufacturing growth has been anaemic for much of the period since 1980, and its share of GDP has actually declined.

The Philippines was the first Southeast Asian country to embark on a comprehensive import substitution strategy. But, as it approached the limits inherent in such a policy regime, it struggled to switch to export orientation, a problem compounded by the 1980s economic crisis (Medalla et al. 1995/96). Eventually, a reasonably comprehensive trade liberalization programme was introduced, but supply-side factors — infrastructure, labour market regulations, restrictions on foreign investment — have continued to hold back manufacturing. Like India, the Philippines has not achieved the large-scale, export-oriented, labour-intensive industrialization that has been such an important driver of growth, and poverty reduction, in the successful East Asian economies.[5]

In addition, in spite of considerable mineral prospectivity, this sector has been relatively unimportant. A considerable proportion of the country's mineral deposits are in conflict-affected areas, especially Mindanao, and this has obviously deterred potential investors. But, more important, the mining industry and its critics have struggled to develop a "compact" that provides the basis for efficient operations to the benefit of all parties. The critics have included environmental groups, who worry about weak enforceability of safeguards, local communities whose livelihoods are disrupted with little compensation, and tax administrators who are concerned about the corruption of fiscal and regulatory arrangements. Elements of the Catholic Church have also been vocal. During the periods of authoritarian government, these critics were largely pushed aside. However, in the democratic era they have been a powerful and often effective voice.[6]

The failure to achieve comprehensive export-oriented industrialization has had two implications for growth patterns and drivers. First, the share of the services sector is unusually high for a country at current Philippine income levels.[7] This is a highly heterogeneous sector in terms of enterprise scale, factor proportions, geographic location, and international orientation. It ranges from the modern sector of the country's business process outsourcing (BPO), as well as finance, education and health, through to "last resort" activities such as petty trading and a vast informal sector. The major explanation for the size of the services sector is the lack of industrial and agricultural dynamism. But the strong growth of some service sectors has also been a factor, particularly BPO, in which the Philippines is emerging as a major international player, second in the developing world only to India.

Second, Philippine export patterns are unusual compared to most of its neighbours. Services constitute a relatively high proportion of the country's total exports. In 2015, for example, remittances totalled about $27 billion, while BPO earned about $22 billion. These two items alone were not far short of merchandise (goods) exports of some $58 billion that year.[8] The prominence of remittances and BPO reflect the Philippines' comparative advantage in semi-skilled and unskilled labour-intensive activities, both abroad in the former case and at home in the latter. The failure to achieve similar export success in manufactures reflects key policy weaknesses, particularly in logistics, business, and labour regulation. We return to this issue below.

III. Major Macroeconomic Reforms

In important respects, the single most significant and durable economic policy reform since the 1960s was the establishment of a high quality, independent central bank, the Bangko Sentral ng Pilipinas, BSP, in 1993 (Gochoco-Bautista and Canlas 2003). Prior to this the country suffered periodic balance of payments crises. These were "textbook" macroeconomic crises that so many developing countries have experienced. That is, they originated in fiscal deficits, often in election years, that were in turn monetized by an accommodating central bank. This triggered higher inflation, but the central bank hung on to a fixed nominal exchange rate, out of fear of the inflationary consequences of a devaluation or the increased value of the debt in peso terms, or simply for reasons of national pride. In any case, the inevitable consequence was an appreciation of the peso in real terms. Moreover, the government frequently invested this deficit spending in uneconomic projects. Hence, competitiveness was adversely affected by both the misaligned exchange rate and uneconomic investment, resulting in a debt and/or balance of payments crisis.

The reconstituted Philippine central bank has navigated effectively through a period of great volatility, with occasionally severe external and domestic shocks. In effect, the exchange rate has operated as a "shock absorber", enabling the economy to adjust to these shocks. Although not widely appreciated in the broader community, central bank reform is the key to understanding why the Philippines has not experienced a serious economic crisis since the early 1990s, and indeed hardly a year of negative economic growth. In addition, financial sector supervision has been greatly improved, in turn easing the monetary policy tasks of the BSP.

IV. Gradual but Partial Economic Liberalization

The strident nationalism of President Duterte, and the evident support his rhetoric receives from much of the community, is testimony to the country's ambivalence towards globalization. In spite of gradual but partial reforms over the past three decades, the country still remains less open to trade and investment than most of its neighbours.

The Philippines was the first Southeast Asian economy to deliberately turn inwards. The "temporary" protectionist measures introduced in response to a balance of payments crisis in the late 1940s became embedded in the country's political economy (Power and Sicat 1971) and were largely resistant to reform in the ensuing four decades. The trade regime that was constructed over this period resulted in a bias against agriculture, employment and exports, thereby contributing to the slower and more unequal growth. It also corrupted the political system through the proliferation of rent-seeking opportunities in the complex trade and foreign exchange regimes. In spite of partial liberalizations in the 1970s, the country therefore missed out on much of the East Asian export-oriented boom that took hold in the region from the late 1960s.

Eventually the reformers were in the ascendancy, and significant trade liberalization was implemented from the late 1980s. There was a confluence of factors at work (Bautista and Tecson 2003; Bernardo and Tang 2008): first, the decades of analytical work by professional economists, based mainly at the University of the Philippines; second, the demonstrated success of liberalizing reforms in neighbouring economies, including even reform laggards such as Indonesia; third, a weak peso from the early 1980s, removing any pressure for compensating "exchange rate protection"; fourth, largely bipartisan political support, with the Ramos administration of 1992–98 particularly reform-oriented; and fifth, low-key analytical support from international agencies, mainly the World Bank.

Trade reform resulted in some export success, including the country's increased participation in the then emerging global production networks (GPNs) centred on electronics. But the results were arguably less than might have been expected, for several reasons. First, as noted, the Philippines missed out on the first major wave of industrial relocation from Japan and the NIEs during the 1980s, while in the 1990s China was attracting the lion's share of labour-intensive FDI. Second, the reforms were incomplete, in the sense that the FDI regime remained quite restrictive, while labour regulations introduced after 1987 deterred some investors. Infrastructure and logistics remained problematic. Third, the reform momentum began to falter, and political instability rise, under the Estrada administration of 1998–2001, just as the GPNs entered a new growth phase.

The Philippines has a clear stake in unfettered access to international markets for service exports, as is illustrated by its success with BPO and labour exports. But it has been rather slow to liberalize its services policy regime. It is a huge labour exporter, but its policies towards labour inflows are more restrictive than those of Singapore, Malaysia and Thailand. Its constitutional provisions that place a ceiling on the share of foreign investment in most sectors continue to limit the country's access to international equity markets, and the attendant sources of capital, technology and export market access (Sicat 2014).[9]

V. An Infrastructure Deficit

As documented by Arturo Corpuz in chapter 3 (see also Llanto 2016), the Philippines has one of the lowest levels of infrastructure investment and performance in East Asia. According to almost every comparative indicator, it ranks poorly, whether for urban traffic congestion, rural infrastructure provision, the speed and quality of logistics at international nodes (both ports and airports), electricity costs and reliability, and even e-commerce facilities (the latter notwithstanding the BPO success). This underperformance really matters. On efficiency grounds, it limits the country's participation in global production networks, where seamless best-practice logistics are essential. On equity grounds, poor infrastructure (e.g., badly maintained rural roads) restricts employment opportunities for the poor and increases the cost of marketing farm produce. Poor infrastructure also reduces environmental quality; for example, traffic congestion contributes to high air pollution levels in Manila and other major cities. Not surprisingly, therefore, infrastructure is a very high priority of the current and recent administrations. From very low levels, and as economic growth has rebounded, public and private infrastructure investments have been picking up in recent years.

Infrastructure is a subset of the general investment climate, and thus the factors that explain low investment in general also apply to infrastructure. But infrastructure also has several unique characteristics. First, it has long time horizons, spanning presidential administrations in the case of the Philippines, and therefore perceptions of uncertainty (for example, major policy reversals) will deter investors. Second, the government will inevitably be heavily involved — as direct investor in many projects, and regulator in others. Therefore the health of public finances and the quality of regulatory capacities are critical variables. Third, and related to this, there is a widespread public perception that large infrastructure projects are a major source of corruption (both personally and to secure political support), and thus there needs to be special safeguards to protect the public interest and ensure transparency. Fourth, and also related, for most infrastructure projects there is no ready "market" for the service, in terms of competitive supply alternatives and price benchmarks, and thus benchmarks for competitive evaluation. Fifth, the responsibility for infrastructure provision extends across multiple jurisdictions, and as noted below the country has sometimes struggled to coordinate the activities of central and local governments.

All these factors are relevant in understanding Philippine outcomes. Stronger public finances are essential to fund more infrastructure projects. But Philippine public finances were battered for at least a decade in the wake of the 1980s crisis, while for several years during the decade 2000–2010 congressional logjams and political uncertainty stymied the ability of the government to raise revenue. To attract more private investment, including foreign investors, there need to be assurances, from both the executive and the legislature, that the policy settings will be stable. The country has a history of occasional high profile, protracted and costly legal disputes with major foreign infrastructure suppliers. The quality of the national government's main departments and the associated regulatory agencies is therefore of paramount importance. In particular, high quality regulatory capacity is required for the many cases of infrastructure investment that have natural monopoly characteristics (e.g., major toll roads, power generation and transmission). With regard to private finance, the domestic capital market is sometimes too small to meet the requirements of scale and payoff periods.[10] Therefore, foreign investment is needed, and is available if the investment climate is attractive, secure and open. As noted, the Philippines currently meets only some of these prerequisites (Llanto, chapter 8).

In addition, given the country's archipelagic geography and regional socio-economic disparities, much of the infrastructure deficit is in the regions, especially the poorer ones. Local governments (the LGUs) play a critical role in local infrastructure provision, especially the rural road network. Most LGUs have arguably underinvested in infrastructure, and there is therefore a role for the national government to provide a framework of incentives — and penalties — to induce them to play a larger role. Improving inter-jurisdictional coordination, among the LGUs and between them and the national government, is also needed.

VI. A Continuing but Shrinking Educational Advantage

In the early post-colonial period, the Philippines enjoyed a head start in education compared to almost all its neighbours. This education advantage is central to an understanding of the country's development record. Combined with widespread English-language fluency, it laid the foundations for the country's strong comparative advantage in semi-skilled activities. In turn it explains why, when technological change accelerated the internationalization of business services, the country quickly became a leader in BPO, without the need for significant government assistance. It also explains why, as the economy slowed and international employment opportunities expanded, the Philippines became one of the largest remittance-recipients in the developing world, typically ranking fourth after only China, India and Mexico. And the high levels of literacy were surely a factor in the country's successful return to a functioning democracy after 1986.

However, as Winfred Villamil emphasizes in chapter 4, the country's earlier education advantages are eroding. While the country performs strongly in niche private sector segments, the backbone of the system — reasonably effective universal public education at the primary and secondary levels — has failed to keep pace, while other countries are catching up through stronger public investments in education. Given the country's entrenched high levels of inequality, education is the single most important policy tool to redress deep-seated inequities. Uneven educational outcomes also have a geographic dimension, in that poorer regions typically also register weaker schooling outcomes. In conflict-prone areas, the gap is particularly evident. Conversely, one traditional strength of the system remains largely intact; namely, that gender inequalities are among the lowest in East Asia.

International experience clearly shows that, on both efficiency and equity grounds, public education funds are best directed towards ensuring a high quality, universal system of primary and secondary education. The Philippines already has a well-established system of public education, and therefore it has the absorptive capacity to spend additional funding, including better physical facilities, more attractive remuneration for teachers, and enhanced IT provision for open learning. An unusual feature of the country's 1991 Local Government Code is that education has remained a national government responsibility. However, this administrative feature can be employed effectively to ensure that minimum national standards are met throughout the country.

Given its earlier education advantages, the Philippines could have become a major regional centre for the rapidly internationalizing higher education sector. However, Malaysia has assumed that role in Southeast Asia (apart from Singapore at the very top end). This missed opportunity was the result of restrictions on the operations of foreign educational institutions (another illustration of the cost of the restrictive approach to FDI) and political-security uncertainty as the internationalization process took root.

VII. Narrow Growth

Reflecting its colonial and agrarian origins, the Philippines has always had high levels of inequality, with little long-term change in the various measures of inequality since they were first estimated comprehensively in the early post-colonial period.[11] Poverty has therefore been less responsive to economic growth; combined with the generally slower growth, this explains why poverty incidence has fallen more slowly than in most neighbouring countries (Clarete, chapter 2). In spite of the egalitarian rhetoric, most administrations have failed to introduce broad-based measures to overcome the historical legacy. First, the lack of agricultural dynamism since the 1980s has meant that the sector in which the majority of the poor works does not provide dynamic income-earning opportunities. (Although, as noted, agriculture performed quite well in the 1960s and 1970s.) Second, the Philippines has not experienced export-oriented, labour-intensive industrialization on a mass scale, East Asian style. Thus, the growth of non-agricultural employment in the formal sector has been correspondingly slow, resulting in the country's inability to reach the "turning point" in economic development commonly characterized as the end of labour surplus, when there is a broad-based increase in real wages. Third, in the post-1986 democratic era, labour regulations — in particular high minimum wages relative to the country's per capita income — have discouraged formal sector employment growth. Fourth, as documented in chapters 4 and 5 of this volume, there has been insufficient public investment in targeted high-quality, universal primary and secondary education, or in public health, to equip the poor to productively enter the labour market. Fifth, there have been very few explicitly redistributive policy measures of any significance. The Comprehensive Agrarian Reform Program (CARP) is generally regarded as having had rather limited beneficial impact at an aggregate level, although no doubt there have been individual beneficiaries.[12] There is little, if any, progressivity in the tax system. The recently introduced conditional cash transfer programme arguably constitutes the first serious redistributive programme, means testing the payments and making them conditional on continuing school attendance.[13]

There are also gender, regional and business dimensions to these poverty and inequality outcomes. As noted, gender inequality is relatively modest by East Asian standards, especially with respect to education outcomes. However, female-headed households are proportionately over-represented in poverty incidence, while there are pronounced labour market and earnings differentials among higher income groups.

Spatial inequality continues to be very high. In this, the world's second-largest archipelagic state, the data show that poverty incidence in the poorest regions, such as the Autonomous Region of Muslim Mindanao (ARMM), is many multiples of that of the National Capital Region and the areas surrounding Manila (see Clarete, chapter 2). As best as can be documented given the changes in administrative boundaries, the level of spatial inequality has hardly changed during the past half century. In fact, it has probably worsened during the frequent periods when conflict has intensified in Mindanao and other regions.[14]

The Philippine business sector is frequently characterized as highly concentrated, reflecting the country's unequal wealth distribution. A small number of "oligarchs", in the form of rich families, is alleged to dominate the country's business and politics. The business–politics connections are emphasized, consistent with the notion of "crony capitalism". Such a pattern is said to be reinforced by limited regulatory constraints on collusive behaviour, and by restrictions on the entry of foreign capital that might otherwise increase competitive pressures.[15]

In this vein, one of the most knowledgeable academic observers of the Philippines concludes pessimistically as follows:

> [The] persistence of oligarchic firms in the Philippines comes with some marked costs.… The country's … recurring crises [have arisen] arguably from a fusion of political power and rent seeking, reducing both opportunity and prosperity. For the foreseeable future, it seems unlikely that the Philippines will undertake the 'broad institutional reforms and shifts in oligarchic control' that would allow it to move beyond the [country's] 'corruption, poor legal protections and perverse state institutions'. (McCoy 2015, p. 185)[16]

While there can be no doubting the high levels of business concentration, precise documentation of both levels and trends remains elusive. In a widely cited paper, Claessens et al. (2000) found that in 1996 the Philippines had the highest share of family control of corporate assets among nine East Asian economies, as measured by the shares of the top family and the top five families, and the second-highest shares for the top ten and fifteen families. However, the authors' analysis is confined mainly to publicly listed companies, a limitation they seek to rectify with a more detailed analysis of the country's premier business group, the Ayala family. Another crude indicator of business concentration is billionaire wealth relative to GDP, and the concentration of the very rich in "crony sectors". A survey by *The Economist* (15 March 2014) found the Philippines ranked sixth highest out of twenty-three countries on this indicator, with a high proportion of business wealth in what it termed "crony sectors". However, these data need to be interpreted with caution: three dynamic East Asian economies — Hong Kong, Malaysia and Singapore — ranked higher still according to these criteria.

Notwithstanding the persistence of very wealthy and influential families, there is arguably more social and occupational mobility than is sometimes portrayed. For one thing, there are dynamic new entrants on to the business scene. The best known of these, the fast food business Jollibee, which now has a global reach, is a little more than forty years old. The Gokongwei business empire had its origins somewhat earlier, in the late colonial period, but most of its growth occurred in the post-independence era. In addition, the public education system has at least allowed a steady flow of able students from families of modest means to progress through to higher education and beyond. Overseas remittances constitute another source of socio-economic mobility, however limited.

VIII. Institutions: Progress and Complexity

The Philippines has an unusually complex set of institutional and governance characteristics, which are analysed in chapter 9 by Ronald U. Mendoza and Rosechin Olfindo, who also provide a comprehensive reform agenda.

Since the mid-1980s, political reform in the Philippines has proceeded faster than other forms of institutional reform (De Dios and Hutchcroft 2003). The country has held presidential elections on a regular six-year timetable, together with more frequent congressional and local government elections. The Philippines has a vigorous and largely free media.[17] The country also successfully implemented major governance reform through decentralization of administrative and financial resources to local governments, beginning in 1992.

Nevertheless, there has been limited "deep" institutional reform of the system of governance, including the bureaucracy, the legal system and the police. In fact, for a country that, on current trajectories, will reach upper-middle-income developing status within a decade or so, it is striking how little serious bureaucratic reform has occurred over the past three decades of democracy.[18] In spite of their limitations, the comparative governance indicators presented in the next section do portray the key features of the current system; notably, that the country performs considerably better on indicators of democracy and accountability than it does on government effectiveness, control of corruption, and business regulation.

Three additional factors are relevant to any understanding of the Philippine system of governance. First, the one-term presidential limit creates very short political time horizons, compounded by the fact that each new administration appoints its own senior executive, not just at the secretary level but often reaching down two or more levels. This power of presidential appointments inhibits the ability of the country to develop a strong and competent civil service culture that can attract able young graduates to its ranks. It also tends to undermine the development of institutional memory. Moreover, since some of these appointments may not necessarily be based on merit and open competitive selection processes, quality may be problematic unless there is a far-sighted and powerful occupant of Malacanang. These comments apply at the national level, but they operate with additional force at the local level.

Second, although as noted the term "oligarchs" is somewhat overused in the Philippine context, particularly with pejorative connotations, there can be no doubting the immense political power and influence of the country's most wealthy families. While at the national level this power is moderated by the larger pool of competitors (including the emergence of new commercial players) and a more diverse media, at the local level powerful clans frequently maintain a strong grip on government across generations (De Dios 2007).

Third, generalizations concerning bureaucratic quality obviously need to be cognizant of the considerable variation in governance quality across departments and tiers of government. Within the bureaucracy, for example, there are ample examples of diligent and professional staff who are poorly remunerated alongside egregious cases of corruption and job buying. But the "islands of excellence" found throughout the country, involving agencies with greater autonomy and the ability to offer adequate remuneration packages to their staff, are testimony to the proposition that there is a large reform dividend in effecting broad-based institutional change. At the national level, as noted, the BSP is a highly regarded institution. Specialized agencies such as the Philippine Export Zone Authority also perform effectively.

These two examples illustrate that a package of clear assignment of objectives, managerial autonomy, transparency and performance-based incentives produce beneficial results. A similar observation applies at the local level, given the uneven quality of LGUs.

IX. Armed Conflict

Although the Philippines had a relatively smooth transition to independence and it has not hosted a major theatre of war, it has in some respects struggled against lawlessness and violence, particularly in various parts of the country. The communist New People's Army has been able to operate low-level insurgencies in the countryside for decades. But the most serious conflict has been the decades-long insurgency between the government and disparate opposition groups, mainly Muslim-oriented, in the southern island of Mindanao. In spite of various peace accords and agreements, the conflict remains just as serious as ever, as illustrated most recently in the protracted warfare in and around the city of Marawi. The presence of private armed groups engaged in criminal activities (e.g., kidnap-for-ransom) in the area is a complicating factor. The human casualties have been extensive, with thousands of Filipinos in effect internally displaced refugees in their own country. There are also regional and international ramifications. Jihadist groups with battle experience in the Middle East and Afghanistan have found sanctuary in Mindanao, after being hounded out of Indonesia and Malaysia (Hutchcroft 2016).

At one level, and notwithstanding the shocking personal costs, the conflict could be said to be relatively minor. The conflict-affected areas are a small part of the national economy, their economies accounting for less than 5 per cent of national GDP. Life in the country's major cities elsewhere is little affected. Even within the main island of Mindanao there are quite dynamic regions in the northern and eastern regions. Moreover, unlike other countries with protracted conflicts (e.g., Pakistan), there has not been a major diversion of resources into the military.[19]

But there are costs, and not just for those Filipinos caught up in the conflict. The social indicators of the most affected region, the ARMM, are among the worst in Southeast Asia. Mindanao is a frontier, resource-rich region with great commercial potential and environmental significance if peace were to be achieved. It was these resources that historically attracted predominantly Christian migrants from the rest of the country in the first place, and that in turn laid the foundations for the present conflict. Governments (and foreign donors) have concentrated a disproportionate share of their resources in Mindanao to promote socio-economic development. When serious insurgencies occur, as they do on a fairly regular basis, the international media attention they attract has adverse national reputation effects, for investors, tourists and the country's image abroad. More generally, while to be sure this is a deeply complex problem with no easy solutions, the failure to reach a durable peace underlines the limits of the Philippine state, in both authoritarian and democratic eras.

X. Environmental Fragility

As documented by Roumasset and colleagues in chapter 6, most indicators of Philippine environmental amenity and quality point to a steady long-term deterioration.[20] Deforestation has been extensive, to the point that very little of the country's original forest resources still exist. Maritime resources have been overexploited, including the already fragile coastal ecology. Most inland water systems are heavily polluted. Air quality in the major urban centres is poor, critically so in some districts, and with serious health consequences (Banzon and Ho, chapter 5). Extreme weather events evidently occur with increased intensity and frequency, as illustrated with dramatic effect in the case of Typhoon Haiyan, which battered the country in November 2013. This was one of the most intense tropical cyclones ever recorded, with fatalities of over six thousand people and damage estimated to be in excess of $3 billion.

In some respects, this is a conventional story of the so-called "Environmental Kuznets Curve" at work. That is, countries grow first and then, beyond some income threshold, the environment is accorded a higher priority. Overexploitation of the forests and the marine resources occurs because of weak property rights, and the limited remit of institutions that are designed to protect them. Agricultural activities extend into fragile upland regions as farmers, lacking alternative income sources, seek to eke out a marginal existence. (Separately, as noted, there is a debate in the Philippines over whether agrarian reform programmes may have adversely affected the maintenance of agricultural lands owing to tenure uncertainty.) Elements of the mining industry have a questionable record of environmental management, whether due to weak regulatory design, poor enforcement capacity or just plain corruption with impunity. As noted, such outcomes explain much of the community's ambivalence towards this sector. Urban air quality suffers owing to lax transport emission standards, in turn a result in part of the pressure to maintain low fares. (As Corpuz notes in chapter 3, the underinvestment in cleaner forms of public transport, most notably rail, exacerbates the problem.) For similar reasons, factories are allowed to dump industrial waste in waterways. In addition to all these factors, the inexorable population growth places greater strain on the country's ecosystems.

There are no simple solutions to these and other complex issues. But the challenges are of such magnitude that the country cannot postpone addressing them until it is rich. Moreover, as Roumasset et al. (chapter 6) point out, there are "win win" strategies that can be implemented now. Stronger protection of maritime resources results in a sustainable fishing industry, as well as having beneficial tourism and other effects. An efficient mass transit system is both economically viable (especially at the very low real interest rates currently on offer, as Llanto emphasizes in chapter 8) and pro-poor. Moreover, as Ravago et al. (chapter 7) point out, the Philippines already obtains a relatively high proportion of its power generation from renewable energy sources, and it may well be able to exploit this factor in the ongoing international climate negotiations. In addition, climate change mitigation initiatives have a very high socio-economic payoff, and may also attract international support.

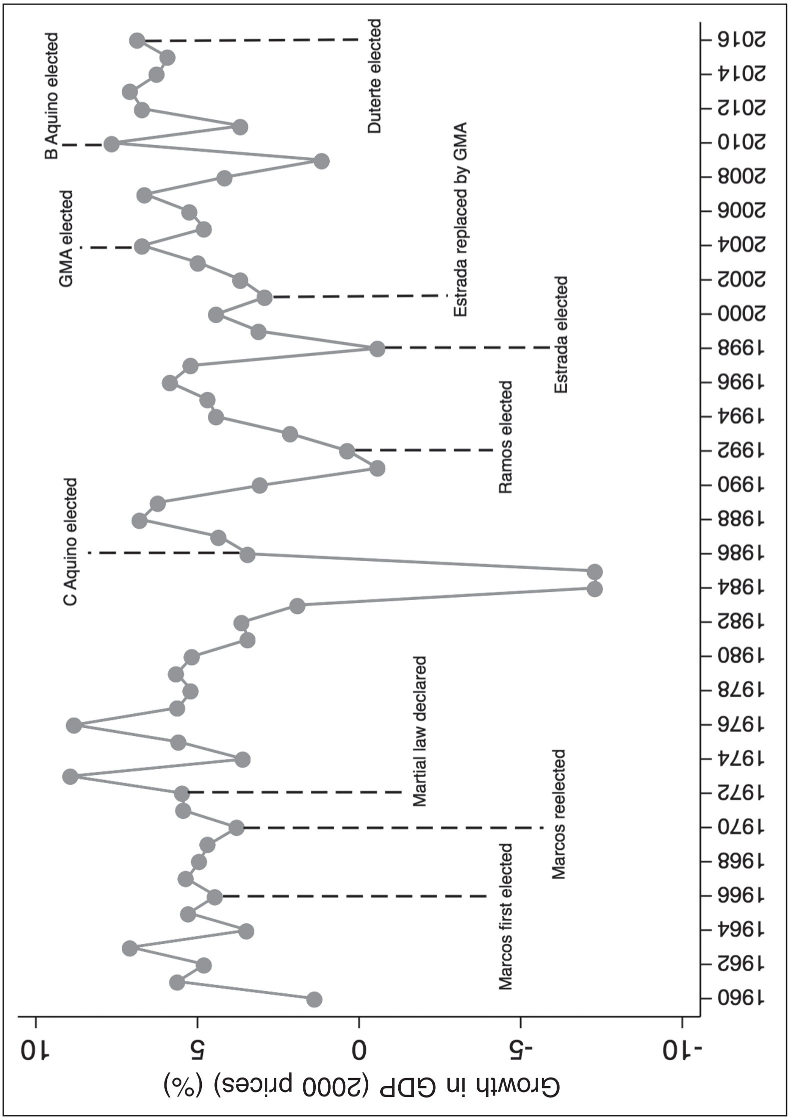
3. Philippines Development Dynamics[21]

This section reviews Philippine economic development since the 1960s, where data permit. It provides empirical support for some of the stylized facts articulated in the previous section, and as a prelude to the more detailed analysis that is summarized in the following section. We focus on the past half-century, since socio-economic development is a long-term process, while also drawing attention to the three major episodes identified above. In addition, we place the Philippine record in comparative international perspective. As comparators, we choose three neighbouring countries: Indonesia, Malaysia and Thailand. Thailand is arguably the most relevant given the similarities in geographic size and (earlier) in population. Indonesia shares the Philippines' archipelagic geography and, a decade apart, deep economic and political crises leading in turn to a sudden transition from authoritarian to democratic rule, and a significant decentralization of financial and administrative authority.

Economic growth: Figure 1.1 charts the growth record since 1960.[22] It shows the first phase, of moderate growth during the 1960s, a brief debt-driven growth spurt in the mid-1970s after the declaration of Martial Law, then a return to moderate growth for the rest of that decade. The economic decline from around 1980 marks the beginning of the second phase, with negative growth being registered in the wake of the public assassination of the leading opposition figure Senator Benigno Aquino, Jr. in August 1983. There followed the deep recession of 1984–85, of almost 10 per cent in per capita terms in each of these two years, and President Marcos' failed bid to recapture the political momentum through a snap election in February 1986. The election in turn led to the famous EDSA People's Power revolution later that month that ushered in the restoration of electoral democracy under President Corazon Aquino. Notwithstanding the signal achievement of democratic consolidation, the economic recovery was fragile for most of her term, which ended in negative growth. Complex debt negotiations, corporate and financial sector indebtedness, fluid politics and periodic military meddling held back economic growth.

Although it was not apparent at the time, with the benefit of hindsight the early 1990s marked a turning point in Philippine economic history, as it clearly marked the end of economic decline. The election of President Fidel Ramos in 1992 ushered in a period

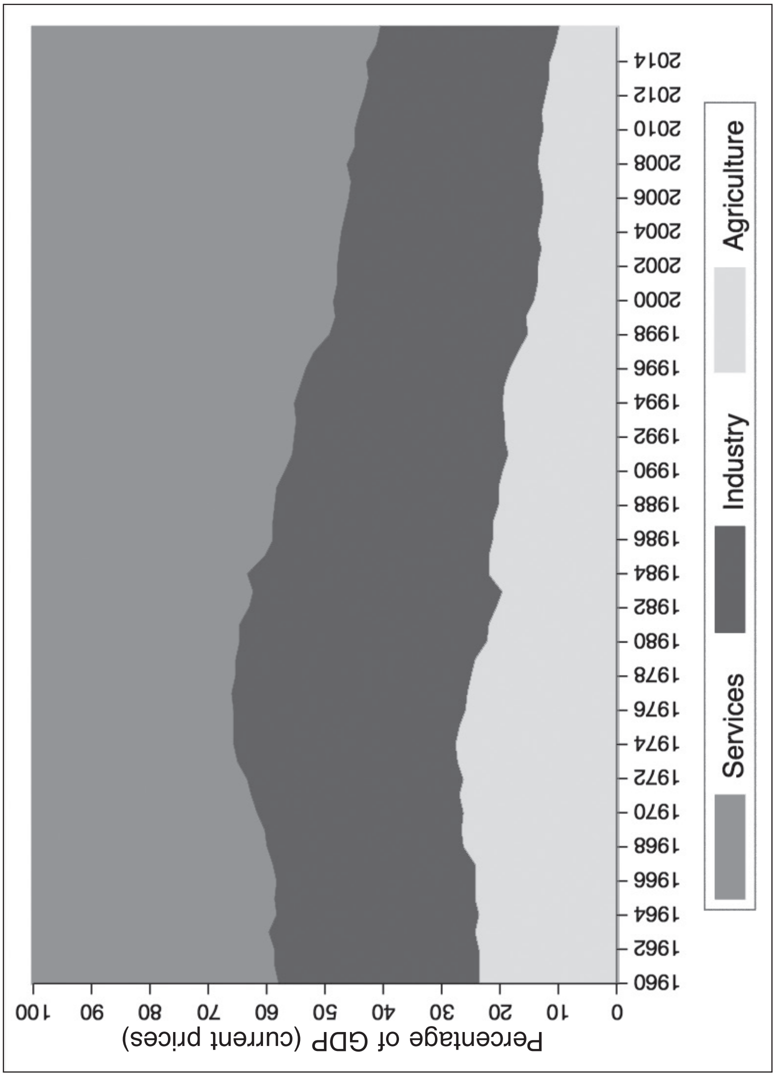
FIGURE 1.1
Philippines, GDP Growth, 1960–2016



of reform, political stability and stronger growth. The economic momentum slowed only in the last year of his administration, and mainly due to external factors; namely the AFC, the effects of which were anyway comparatively mild. The brief Estrada presidency saw the return to moderate growth, punctuated by political uncertainty in 2001 with renewed political instability and the controversial ascension to power of President Gloria Macapagal-Arroyo. Although scarred by recurring challenges to her political legitimacy, arising from events in both 2001 and her formal election in 2004, Philippine economic growth averaged around 5 per cent during her nine-year term. As with the Ramos administration, her term also ended with slower growth, again owing mainly to external factors, in this case the GFC, which the Philippines navigated with little difficulty. Winning power in the wake of the GFC, the Benigno S. Aquino III presidency, 2010–16, saw the strongest economic growth of any six-year period in the country's history.

Structural change: As noted above, the process of structural change in the Philippines has been a mixture of the conventional and the unusual (Figure 1.2). Even though long-term economic growth has been slow, the share of agriculture in GDP has fallen substantially, from around 24 per cent in 1960 (and about 27 per cent in the mid-1970s) to just under 10 per cent in 2016. After quite strong growth in the 1960s and 1970s, mainly the result of effective adoption of high-yielding food crop varieties, especially in favoured irrigated areas, the share of agriculture has declined continuously since around 1980, more or less independently of the overall rate of economic growth. Six interrelated factors explain the decline. These are high population growth, progressively converting the Philippines from a moderately well-endowed economy to a resource-poor one; the exhaustion of frontier land expansion opportunities; the conflict in Mindanao, where what little of the frontier remains; the under-provision of public investment in aspects such as irrigation, rural roads and R&D; anaemic private investment, in part owing to tenure uncertainty in the wake of the agrarian reform programme; and policy distortions in the food market, principally through the operation of the National Food Authority.

FIGURE 1.2
Philippines, % of GDP from A, I, S Sectors, 1960–2016 (current prices)



The unusual feature of Philippine structural change is that almost all the increase in GDP shares has occurred in the service sector. The current share of industry,[23] about 31 per cent, is similar to that prevailing in the early 1950s, and about 10 percentage points lower than that around 1980. Most of the decline has occurred in the major sub-sector, manufacturing, as the country failed to make the transition from import substitution to export orientation. The share of services has risen sharply since the 1970s, from about 35 per cent to almost 60 per cent. As noted, the rising services share is arguably more the result of slow growth in the goods sectors than of services dynamism, with the notable exception of BPO over the past decade.

Employment shares have followed these trends, with a lag. The very low relative labour productivity in agriculture is indicative of labour "trapped" in this sector. That is, agricultural labour productivity is about a third that of the economy-wide average, a figure that has been declining over time. Services labour productivity is similar to the economy-wide average, although this conceals large intra-sector variations, while that for industry continues to be by far the highest.

The changing composition of exports confirms these trends. Manufactures dominate Philippine merchandise exports, accounting for about 85 per cent of the total. The once important agricultural exports, including sugar and coconuts, now constitute little more than 5 per cent of the total. Mining exports are similarly unimportant. Within manufacturing, the share of electronics rose rapidly during the 1990s, peaking at 53 per cent of total exports in 2000 as the country successfully engaged with the rapidly growing global production network trade. However, policy and political uncertainty around the turn of the century deterred some key foreign investors and the country's share of this trade has since stagnated. Note that these data refer to merchandise exports and do not include the booming BPO exports. The latter explain the rapidly rising share of services in total exports, to about 21 per cent of the total, more than double that at the beginning of the century.[24] Recent work by, among others, Pasadilla and Wirjo (2017) and Serafica (2017) using OECD's Trade in Value Added (TiVA) database suggests, however, that the contribution of services to total Philippine exports is actually larger when services that are either embodied in merchandise exports or

FIGURE 1.3
Philippines, % of Employment from A, I, S Sectors, 1987–2016

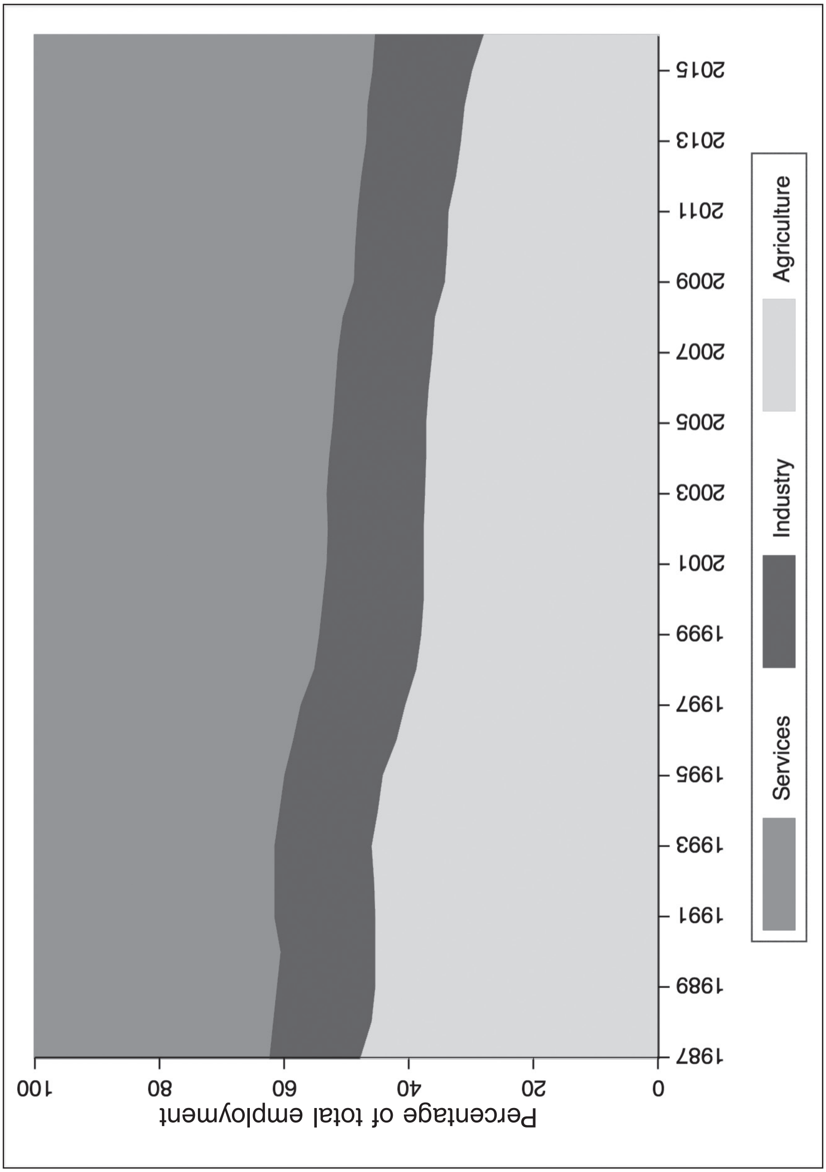
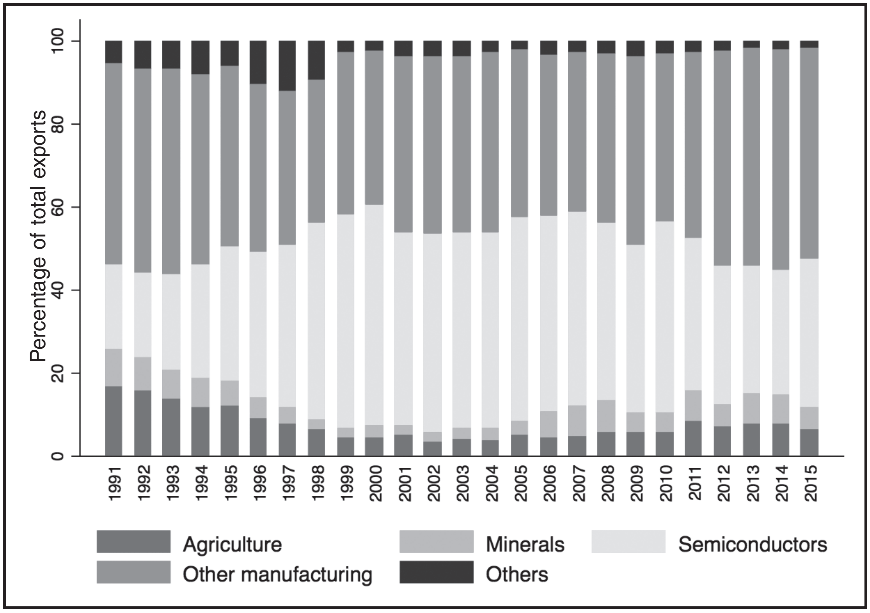
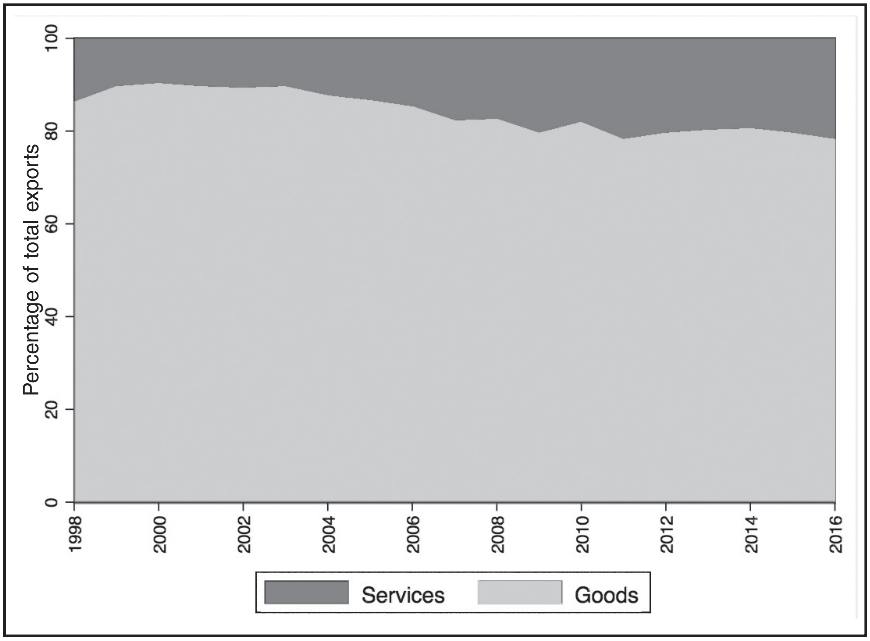


FIGURE 1.4
Philippines, Export Composition, 1960–2016 (% of total)





bundled with their sale are considered.

Macroeconomic management: Two key interrelated parameters aptly summarize Philippine macroeconomic management over this period. First, for reasons explained above, historically the country struggled to control inflation (Figure 1.5). There were several years of double-digit inflation in the 1970s and early 1980s, driven by fiscal deficits and the global oil shock. Then there was a major inflationary episode in the mid-1980s, triggered initially by the Marcos administration's attempts to spend its way out of the mounting political crisis, and subsequently by the sharp fall in the value of the peso. Inflation was a continuing challenge during most of the Cory Aquino administration. The reconstituted central bank, the BSP, marked a turning point, and the country has recorded inflation above 10 per cent just once in the past quarter century, and onlymarginally so (10.4 per cent in 1994). In recent years the low global inflation environment has facilitated this record, but it is important to emphasize that the achievement predated this development.

Figure 1.5 also illustrates the second outcome, the successful transition to inflation targeting and a flexible exchange rate regime. Through to the early 1980s, like many countries, the Philippines pegged its currency to the U.S. dollar within a narrow range and with occasional, albeit lagged, nominal depreciations that attempted to restore competitiveness. This regime collapsed around the time of the mid-1980s crisis, leading to a historically large nominal depreciation. The rate stabilized then for almost a decade, before declining further during the AFC. However, the decline was much less than for those of the crisis-affected neighbours. During this century the nominal rate has again stabilized, declining mainly during periods of political turbulence, such as the sudden regime change in 2001. It was little affected by the GFC, and in fact began to appreciate during the years of strong growth under President Benigno Aquino III.

Poverty and inequality: As documented in great detail by Clarete (chapter 2), the Philippines has struggled to reduce both poverty and inequality, even during periods of moderately strong growth. Figure 1.6, which is based on the periodic family income and

FIGURE 1.5
Philippines, Annual Inflation Rate and Peso/Dollar Exchange Rate, 1960–2015

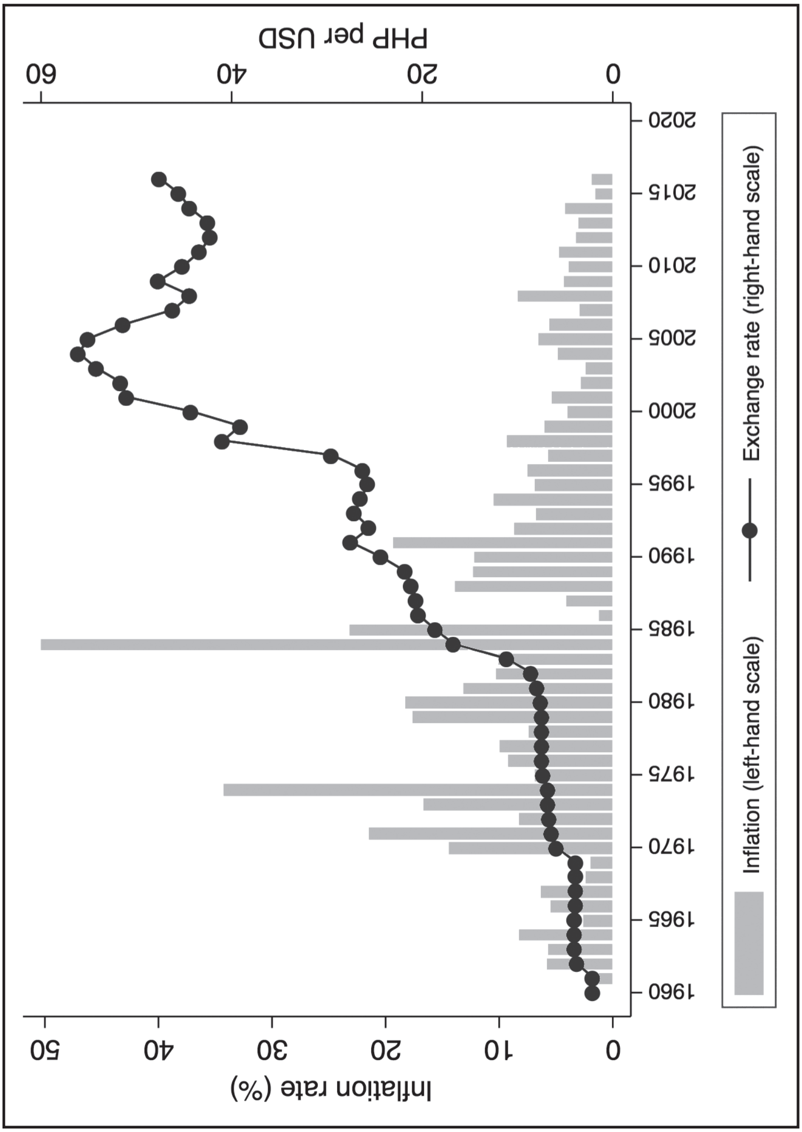
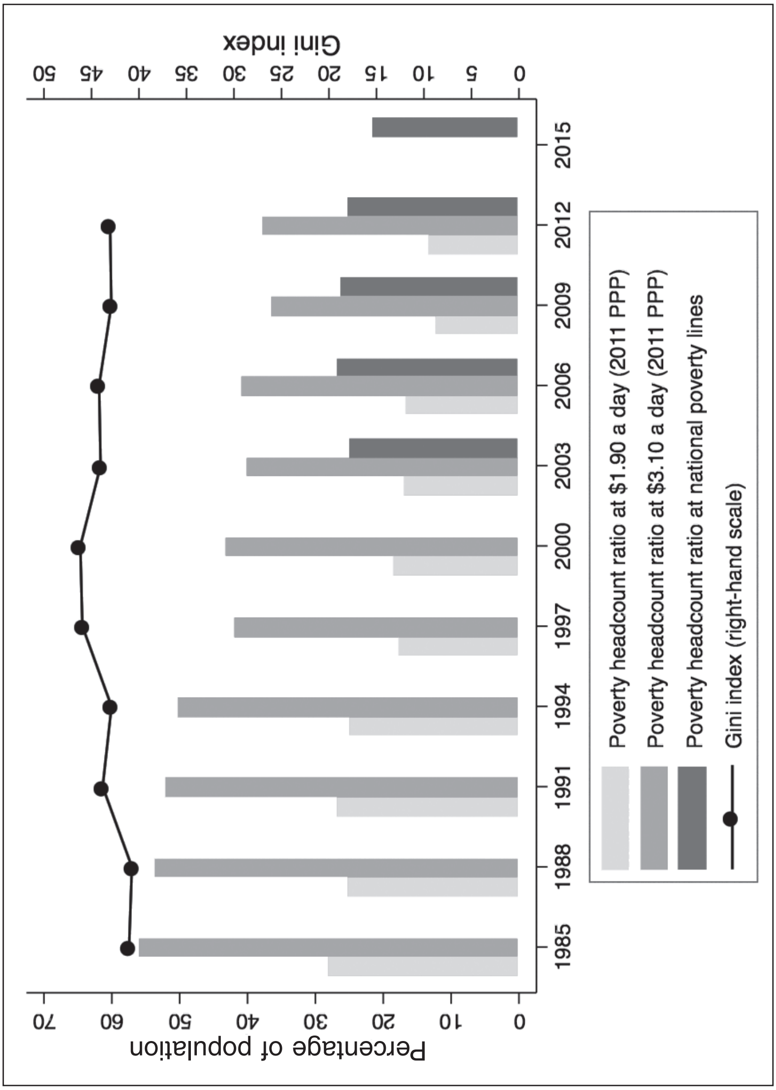


FIGURE 1.6
Philippines, Poverty and Inequality



expenditure surveys (FIES), reports the trends since 1985, which have been computed on a comparable basis.[25] Five consistent head-count poverty estimates are shown, corresponding to the national poverty line (from 2003) and the international benchmarks of $1.90 and $3.10 per day. Inequality is measured by the gini ratio.

Inequality has been broadly stable throughout this period, with minor fluctuations caused mainly by external shocks such as the AFC and GFC. As noted, there have been no explicitly redistributive policies of any significance, except for the recently introduced CCT. As also noted, the decline in poverty incidence has been slower than for most neighbouring countries owing both to slower economic growth and to a lower poverty-growth elasticity. But contrary to much popular perception, poverty incidence has at least been declining.[26] Since 1985, the percentage of the population below the lower, "destitution" measure has halved. The percentage below the higher threshold has also declined, albeit more slowly. The fact that more than a fifth of the population remains below the latter threshold, with a very large number of people "precariously non-poor", illustrates the continuing magnitude of the Philippine poverty challenge.

Comparative indicators: So far we have focused on key Philippine socio-economic outcomes. What of the country's development record in comparative perspective, in this case compared to three of its Southeast Asian neighbours?

A useful first comparison is with reference to "initial conditions". As proxies, we select a range of socio-economic indicators for 1960. By then, all four countries were independent nation states and the quality of readily comparable international statistics had greatly improved.[27]

Around 1960, Philippine per capita income was almost double those of both Indonesia and Thailand, and not far short of Malaysia (Table 1.1). Its international orientation was similar to that of Thailand, less than Malaysia, and more than Indonesia (though the latter's statistic excludes its very large unrecorded trade at that time). The Philippines led the other three countries by a significant margin in its education indicators; the margin for Indonesia is particularly striking. Its health indicators were similar to Malaysia's and well ahead of the other two, again particularly Indonesia. Combined with other political

TABLE 1.1
Comparative Socio-economic Indicators: "Initial Conditions", ca. 1960

Country	GDP per capita (constant 2010 $)	Trade (% of GDP)	Years of schooling, for aged 15 and above	Years of schooling, for aged 25 and above	Life expectancy at birth (years)	Infant mortality (deaths per 1,000 lives)
Indonesia	577	11.6	1.57	1.11	47.0	166.7
Malaysia	1,408	85.7	2.83	2.26	57.9	81.1
Philippines	1,059	38.3	3.46	3.01	57.1	86.5
Thailand	571	34.9	2.55	2.07	53.3	108.9

and institutional indicators, the optimistic tone of the development literature of this period concerning Philippine prospects was therefore not surprising.

The same indicators for 2015 present a clear picture of comparative development dynamics (Table 1.2). The Philippines now had the lowest per capita income. The Philippine–Thai relativities were practically reversed: whereas the Philippines was almost double that of Thailand in 1960, fifty-five years later Thailand was more than double that of the Philippines. Indonesia had also overtaken the Philippines, in spite of its deep crisis in 1997–98, with a per capita income almost 50 per cent higher.[28] The gap in social indicators was less pronounced. The Philippines retained its educational advantage, at least over Indonesia and Thailand, but the gap had narrowed considerably. Philippine health indicators were similar to those of Indonesia, but lagged Malaysia and Thailand significantly.

The Philippine growth performance relative to its neighbours is further illustrated with reference to the changing PCI across various periods. Over the whole period 1960–2015, real Philippine per capita income rose just 2.5-fold, in contrast to 10.1 for Thailand, 7.7 for Malaysia and 6.6 for Indonesia. Taking 1980 as the base year, the gap is still large, with the increase in PCIs of the neighbours all at least double that of the Philippines, even though the other three economies were more seriously affected by the AFC. However, during the twenty-first century the gap disappears, as Philippine growth accelerated while those of its neighbours slowed. Thus, the Philippines was a clear outlier in the second half of the twentieth century, but it is no longer the "exception" this century.

A final set of comparative indicators relates to business and governance indicators (Table 1.4). Although generally subjective and arbitrary, they reinforce the observations elsewhere in this volume about the need for deep reform in the Philippines. The country receives the smallest value of foreign investment, as revealed by the stock of realized FDI relative to GDP; its business environment is perceived to be the most difficult to operate in; levels of corruption are among the highest; and its logistics efficiency performance is the weakest. These indicators are discussed in greater detail by Mendoza and Olfindo in chapter 9.

TABLE 1.2
Comparative Socio-economic Indicators: "Initial Conditions", 2015

Country	GDP per capita (constant 2010 $)	Trade (% of GDP)	Years of schooling, for aged 15 and above	Years of schooling, for aged 25 and above	Life expectancy at birth (years)	Infant mortality (deaths per 1,000 lives)
Indonesia	3,834	41.9	7.61	7.26	68.6	25.0
Malaysia	10,878	134.2	10.44	9.75	74.5	6.8
Philippines	2,640	63.0	8.43	8.18	68.0	23.2
Thailand	5,775	126.8	7.99	7.30	74.1	11.2

TABLE 1.3
Comparative Economic Growth

Country	2015 GDP per capita (constant 2010 US $)	2015 & 2000	2015 & 1980	2015 & 1960
Indonesia	3,834	1.8	3.5	6.6
Malaysia	10,878	1.6	3.3	7.7
Philippines	2,640	1.6	1.6	2.5
Thailand	5,775	1.7	4.1	10.1

TABLE 1.4
Comparative Institutional and Business Indicators

Country	Ease of doing business, 2016 (rankings: 1–190)	Stock of FDI, 2015 (% of GDP)	Corruption perceptions index, 2016 (rankings: 1–176)	Logistics performance index, 2016 (rankings: 1–160)
Indonesia	91	25.6	90	63
Malaysia	23	40.1	55	32
Philippines	99	19.9	101	71
Thailand	46	44.8	101	45

4. Major Themes and Findings

The eight chapters that follow provide comprehensive, analytical and policy-oriented accounts of the many complex issues facing the Philippines, looking both backwards and forwards.

In chapter 2, Ramon L. Clarete commences with the observation that the eradication of poverty and hunger and the availability of decent jobs should be the most important objectives of Philippine governments. His chapter examines the factors behind the Philippines' poverty problem and the recent economic growth performance. He asserts that increasing incomes would be more effective in reducing poverty if the issue of inequality is also addressed. His simulations show that poverty could be eliminated within fifteen years if per capita income grows annually by 8.3 per cent and the Gini index is reduced yearly by 3 per cent. However, if inequality is not reduced, it would take at least thirty-six years to eradicate poverty with the same growth in income. His policy analysis includes several pro-poor structural reforms that would potentially sustain high growth as well as addressing inequality and poverty.

Cities are engines of economic growth and venues of poverty reduction, supported by an infrastructure system that provides quality services and affordable housing. These form efficient and connected networks of sustainable settlements. However, Arturo G. Corpuz in chapter 3 argues that the state of infrastructure in the Philippines is way below existing requirements, even though the current urban growth trend (that is, slow growth of Metro Manila and rapid growth of regional centres) is consistent with the long-term vision of vibrant cities. To achieve accelerated infrastructure development, regional framework plans, including that for Mega Manila, are proposed to define urban expansion areas, integrate various infrastructure plans, incorporate disaster risk reduction and identify measures for higher quality planning and urban management.

Winfred M. Villamil frames chapter 4 around the proposition that the long-term economic success of a nation depends to a great extent on sustained increases in its endowment of human capital — the accumulated knowledge, skills and capacities of its workforce. The first section of his chapter commences with a brief discussion of the role of education and training in economic development. The next section provides a baseline assessment of education and training in the Philippines using indicators of educational *access*, *quality*, *achievement* and some indicators of workers' training. These are benchmarked against the performance of other ASEAN countries. The third section identifies the key issues that have to be addressed in the Philippines. Finally, he proposes strategic policy options that can influence the performance of education and training. Performance targets consistent with that of a middle-income economy like the Philippines are compared with the performance indicators associated with upper-middle and high-income economies.

In chapter 5, Eduardo Banzon and Beverly Lorraine Ho commence with a survey of the current health status and issues in the Philippines. They note the progress with regard to lowering the infant mortality rate, while stressing the slow progress and persistent inequalities across households. They also draw attention to the very limited financial coverage for healthcare provision and support. There has been a significant increase in public spending on health in the Philippines, albeit from a very low base and with indifferent efficiency. There is a shift towards a demand-driven system, but remnants of the earlier supply-driven system remain. They further argue that there is scope for strengthening the power and authority of the national health insurance programme, known as Philhealth, even while the Department of Health's regulatory functions continue to lag. Decentralized health delivery systems also need to be strengthened, and the private sector needs to be harnessed to better meet national goals.

Chapter 6 turns to environmental issues. James A. Roumasset, Majah-Leah V. Ravago, Karl Robert L. Jandoc and Clarisa Joy A. Arellano maintain that, while Filipinos aspire to improved living standards in vibrant and resilient communities, such an outcome will only be achieved if total environmental degradation and depletion of natural capital (TDD), partially estimated at 5 per cent of national income, will decline in the next twenty-five years. With improved environmental and resource management, TDD could shrink to as low as 0.6 per cent of national income by 2040. The authors then introduce the concept of comprehensive national income (CNI) to measure the country's well-being. Potential sources of CNI growth include effective environmental-resource conservation, disaster preparedness and removal of policy distortions. These are all relevant to attaining the Sustainable Development Goals (SDGs), a new global development agenda to be used by the government as a guide to improving Filipinos' future well-being.

In chapter 7 Majah-Leah V. Ravago, Raul V. Fabella, Ruperto P. Alonzo, Rolando A. Danao and Dennis S. Mapa examine electricity supply, pricing and regulation. They argue that this major industry bears heavily on every aspect of Philippine business and community life. By focusing on the generation sector, they present two possible scenarios for the next twenty-five years and illustrate how policy reforms on fuel mix can potentially reduce blended generation charges that make up 47 per cent of the total electric bill of households. The authors also provide an assessment of the power sector's performance and suggest key reforms and alternative pathways needed for the sector to contribute to the overall vision of strong economic growth and improved well-being.

Gilbert M. Llanto examines the financial resources needed to sustain the Philippine development momentum in chapter 8. He investigates three main sources of funds — households and firms, donors, and foreign investors. He assesses the long-term implications with reference to taxation, the overall financial system, public-private partnerships (PPPs), official development assistance (ODA), and remittances. Looking forward, he argues that it is imperative for the government to substantially raise tax revenues and rely more on domestic borrowing. ODA and PPPs should be used to strategically finance infrastructure needs and emerging regional public goods, respectively. Finally, financial reforms should be geared towards providing access to poor households and micro, small and medium-sized enterprises, as well as financial education for overseas Filipinos and their families, to widen their investment horizons.

Institutions determine the possibilities for effective governance and collective action. Both the state and the market need institutions to function well. Otherwise, market failures and governance failures could litter the landscape instead of properly provided public goods and services. In chapter 9, Ronald U. Mendoza and Rosechin Olfindo maintain that the success of the Philippines' overall development strategy is contingent on successful collective action over time, involving the elimination of governance and market failures through the formulation, implementation and institutionalization of key governance reforms. They assert that the challenge is not simply to eliminate corruption, but to provide public services and public goods much more efficiently and equitably. Their chapter maps the institutional development challenges of the Philippines and considers some of the possible pathways towards stronger and more sustained governance outcomes in the context of the country's ongoing institutional development. It outlines the main reform levers to build stronger institutions, including political and economic reforms and public finance reforms. The authors also argue that governance mechanisms need to be embedded in policy design in order to incentivize good governance outcomes.

5. Summing Up and Looking Forward

1. Summing Up

This is a crucial period in Philippine economic history. The country has long been considered the "sick man of Asia", a country that has failed to live up to its early promise. Yet, unusually, the Philippines has been one of the world's most dynamic economies in recent years, at par with China and India. The record of recent strong growth is all the more creditable given the sluggish and volatile state of the global economy. In fact, the bases of this historically unparalleled growth were established over the past quarter century: a functioning democracy, effective monetary policy, and a measure of trade liberalization. The country was able to weather both the Asian and global financial crises more effectively than most of its ASEAN neighbours. Moreover, once stable and credible government was established, the country was able to tap into global commercial opportunities, particularly in services trade.

The chapters that follow lay out key elements of a reform agenda that will be needed to maintain the recent development momentum. The agenda is a daunting but feasible one. As explained in these chapters, the agenda includes the following. First, how to overcome the deeply entrenched socio-economic and political inequality. Second, how to make cities both more liveable and more functional. Third, how to regain the educational advantage and to ensure better schooling outcomes regardless of socio-economic class. Fourth, how to improve health outcomes — and the efficiency of public spending — beyond the urban middle class. Fifth, how to address environmental fragilities without jeopardizing economic growth. Sixth, how to ensure energy availability and reliability at reasonable cost. Seventh, how to lift, and finance on a sustainable basis, the country's low level of private and public investment. And eighth, how to develop a system of governance and a set of institutions that underpin durably rapid and equitable economic growth.

2. Looking Forward: "Dutertenomics"

Rodrigo Duterte was elected President in May 2016 on the back of a promise to bring change to a nation impatient for relief from the daily inconvenience of poverty and the seeming inability of government to deal with urgent concerns — the worsening urban traffic, an inefficient public transport system, stalled post-disaster recovery, among others. With the reputation of a strongman[29] and a facility with populist rhetoric, Duterte tapped into a deep vein of discontent among the country's poor and middle classes, and even a segment of the affluent, to obtain a 39 per cent plurality of votes and win the presidency over four other aspirants.

Soon after assuming office, President Duterte launched an all-out war against the illegal drug trade, based on a narrative that the key to peace and progress is to rescue Philippine society from narco-politics. Invoking nationalism and independence in foreign policy, he has sought to distance his administration from the United States, a traditional development partner and military ally. He has also declined development assistance from the European Union. He has embraced China — the South China Sea dispute notwithstanding — expanded relations with Japan, and signalled greater openness to assistance from Russia.

Critical of the way development has favoured the national capital region ("imperial Manila"), the president has energized moves to shift from the current unitary structure towards a federal form of government. Early in his term he had called for the resumption of peace negotiations with the communist[30] and Muslim insurgents, even as he has expressed readiness to use force against armed extremist groups, particularly those operating in Mindanao. The president has also threatened to declare martial law, if necessary, to solve the drug problem, and denigrated human rights advocates as "criminal coddlers" for criticizing the brutality of his war on drugs.[31] In spite of his obvious authoritarian instincts, including attempts to disable critics and the free media and build support with the Marcoses and their constituency, his popularity, especially with the common people, remains high.[32]

In May of 2017, Duterte declared martial law in Mindanao following fighting that ensued between government forces and an armed group identifying itself with the Islamic State (IS) that had taken control of Marawi City. As the destruction continued and casualties on both sides mounted, the president obtained approval from both houses of Congress in July to extend martial law from sixty days until the end of the year.

At the time of writing, about a year into the Duterte presidency, it is too early to predict the likely course of events, much less pass judgment on the record to date, especially because the settling-in process for new administrations in the Philippines is extended not only by the need to obtain congressional approval for key appointments (e.g., in cabinet departments) but also by the steep learning curve faced by the political appointees and the people they bring onboard. Putting aside the various controversies, what can be said about the economic record? In particular, is there early reassurance that the economic momentum of recent years can be maintained? The Philippines has a history of nipping progress in the bud. Is the Duterte administration likely to be yet another example of this phenomenon?

It needs to be emphasized that predicting the future course of policy in the Philippines is exceptionally difficult because of institutional weakness and uncertainty. That is, from 1992 onwards, Philippine elections have in the main produced clear results. However, institutional reform has lagged behind political and economic progress. Thus, the prospects for each incoming administration are hard to predict because, in the absence of deeply embedded institutional strength, they depend more than anything else on the credibility of presidential leadership. The outcome of the last elections illustrates this proposition: the strong economic growth of recent years failed to translate into votes for the outgoing administration's candidate. Obviously for a considerable segment of the population the benefits of recent progress did not go deep enough to significantly improve their lives. What will the Duterte administration do differently to ensure that growth is in fact not only sustained but also truly inclusive?

Thus far the Duterte administration's economic policy pronouncements have been less controversial in nature. Through Executive Order No 5, series of 2016 (EO No. 5, s. 2016), it has accepted the work embodied in the previous administration's long-term development vision, as outlined in *AmBisyon Natin 2040*, as a guide for the latest Philippine Development Plan, 2017–22 (PDP). According to EO No. 5, moreover, *AmBisyon Natin 2040* shall provide the direction for succeeding PDPs through 2040, to ensure continuity.

Released in February 2017, the current PDP lays out the socio-economic programme and priorities of the administration until 2022.[33] It targets real GDP to grow annually by 7–8 per cent over the next five years, at which time the country is expected to reach upper-middle-income status with a per capita income of at least US$5,000 (in PPP), from US$3,550 in 2015. Poverty incidence is targeted to decline to 14 per cent by the end of the plan period; this is equivalent to six million Filipinos exiting poverty.

The plan also aims to cut unemployment to 5 per cent or less by 2022, particularly by bringing down youth unemployment from its current double-digit level; in areas outside the National Capital Region, reducing underemployment is the priority. The plan contains explicit targets for reducing inequalities in human development outcomes through interventions in health and nutrition, education, social protection, and disaster risk management.

The PDP 2017–22 is the programmatic translation of the administration's "0-10-point socio-economic agenda". Specific objectives include reforming taxation to achieve greater progressivity; accelerating infrastructure spending (towards "a golden age of infrastructure"); increasing competitiveness (including relaxing some of the more restrictive economic provisions of the Constitution); encouraging innovation (through enhanced support for science, technology and the creative arts); promoting rural development (through secure property rights, raising productivity and facilitating value chain linkages, among others); strengthening health and education systems, including social protection programmes; putting more teeth into the reproductive health policy; and pursuing the peace process. The last one is of particular significance under this, the country's first "Mindanao Presidency".

Looking forward, what are some of the key markers and parameters that are likely to shape economic progress in the medium term? At least four stand out.

First, early economic indicators: Indicators thus far suggest that the strong economic momentum is being maintained. For the first four quarters of the Duterte administration, real GDP growth averaged 6.7 per cent, albeit still reflecting investment decisions taken during the previous administration. However, with growth in the first half of 2017 at 6.5 per cent, the economy seems poised to attain its 6.5–7.5 per cent growth target for 2017, with expectations of more robust domestic spending and a resurgence of external demand. On the supply side, this depends on the absence of any major disruption in agricultural production, the diversification of the country's manufactured exports' destinations, and the steady growth of services supported by rising incomes, stable prices and the growth of external trade.

Since the beginning of 2017, the peso has continued to weaken, reaching a low not previously seen in the last decade. Higher outflows due to the strengthening of the dollar and prepayment of some of the country's foreign debt partly explain the recent depreciation. The government largely attributes this development to the economy's higher growth trajectory and the concomitantly greater demand for imports.[34] In this view the weak peso is a sign of better things to come, in addition to its immediate salutary effects on OFW remittances and exports. A less sanguine view points to a build-up of negative investor sentiment over the conduct of the war on drugs, the IS presence and martial law in Mindanao, and the lack of any palpable sign thus far that the "golden age of infrastructure" has finally dawned.[35] Investor confidence swings in any case, and can be turned around for better or worse depending upon what the incumbent administration chooses to do within the remaining years of its term. Meanwhile, the monetary authority assures that it has sufficient elbow room to deal with any adverse effect caused by sudden movements in the exchange rate.

The inflation rate bears watching, given its intimate association with poverty and the PDP's target of bringing poverty incidence down from 21.6 per cent in 2015 to 14 per cent by 2022. Early in 2017, headline inflation exceeded 3 per cent, from less than 2 per cent in the last two years, and peaked at 3.4 per cent in April. Not by coincidence, self-rated poverty rose to 50 per cent in the first quarter, from 44 per cent in the last quarter of 2016, before returning to the same level in the second quarter after inflation dropped back to below 3 per cent in June.[36] This calls attention to the careful management of inflation, especially as the peso depreciation, the proposed increases in consumption taxes (see below), and the additional demand spurred by income tax cuts (see below) and higher government spending are bound to create inflationary pressures going forward. A key variable, food price inflation, critically depends on whether the quantitative restriction on rice imports will finally be lifted and for good. But this requires legislative action.

Second, the cabinet team and other key presidential appointments: Philippine cabinets are appointed by the president and, although mediated by the need to balance a range of competing constituencies, they give an indication of presidential priorities and preferences. The Duterte cabinet is no exception, as it covers the spectrum of personal confidantes, individuals with conservative and leftist political orientation, regional power brokers, retired military and police officers, and technocrats. A reassuring feature of the three key economics appointments — in Finance, Budget and Management, and the National Economic and Development Authority (NEDA) — is their technical expertise. Two of the three appointees are economists. Two of the three have also held cabinet positions in previous administrations. The recent appointment of a career central banker to the post of BSP governor further provides reason for optimism on the matter of the country's macroeconomic management.

The president has so far deferred to the economic team on most matters of economic policy. It remains to be seen how long this situation will last, given the president's almost singular focus on law and order and his predilection for quick fixes. For now at least, it is safe to say that, with few exceptions, the economic team has been successful in moderating populist tendencies in the Duterte cabinet and containing their potentially adverse unintended results.[37]

Third, relations with the legislature: Philippine presidents need to secure congressional cooperation to get their bills passed, and even presidents whose parties have a majority in congress, such as Duterte, cannot take their party discipline and support for granted. When relations between the executive and legislative branches of government break down, key budget and other pieces of legislation can be blocked.

The first major economic policy challenge will be the financing of the administration's ambitious spending programme.[38] Congress has been debating a comprehensive tax reform proposal developed by the Department of Finance that would reduce the overall tax burden on the poor and middle classes and, at the same time, increase the government's fiscal space by raising additional revenue equivalent to about 1 per cent of GDP. Specific measures contained in the initial package[39] include: lowering personal income taxes as well as estate and donor taxes; increasing the excises on petroleum products, automobiles and sugar-sweetened beverages; broadening the value-added tax base;[40] and improving tax administration.[41] Compensating measures to protect the poor and vulnerable through highly targeted transfers are also envisaged.

At the time of writing, these proposals have passed the Lower House and are due for deliberation by the Senate. There is no telling what the final form of the tax law is going to be after it has gone through the legislative process. To be sure, it will be a product of much lobbying and negotiation. It is not unusual for lawmakers — especially those eyeing re-election — to support components of the bill that have a revenue-eroding effect while opposing those that would compensate for any lost revenue. This has prompted the secretary of finance to earlier recommend to the president that he veto any version of the tax reform bill that does not include the necessary revenue enhancing measures.

A second policy issue is the proposal to introduce a federal political system. Although a key platform in President Duterte's election campaign, the details have yet to be spelled out, and they would in any case require constitutional change. The Philippines has been a unitary state ever since independence. However, a major decentralization reform was introduced in 1992, and local governments have considerable expenditure responsibilities, funded mainly through automatic transfers from the national government under the Internal Revenue Allotment. Thus in some respects the system operates as a de facto federation. There is a strong case for revisiting and reforming the current arrangements, particularly given the very large vertical fiscal imbalances and the variable quality of local governance. Whether the adoption of a formal federal model is the solution is far from obvious, however. At this stage there are no proposals before Congress; neither has the Department of Finance undertaken any substantial preparatory work. The tax reform bill still pending in Congress assumes the status quo regarding the Philippine political system.

A third issue is developing a sustainable base and policy model for infrastructure financing, including the mix of sources — national and local government budgets, public–private partnerships (PPPs), private borrowing, and official development assistance (ODA) — and the accompanying regulatory arrangements. The objective of elevating infrastructure expenditure to 7 per cent of GDP from its previous level of less than 5 per cent is an ambitious one. The challenge is how to accelerate the approval and implementation processes without disregarding the due diligence requirements — complete staff work, in the lexicon of career-planning personnel — that are so critical to maintaining the integrity of government projects. A range of accompanying measures will need to be introduced, including improved bureaucratic capacity, especially for project preparation and development, more efficient procurement laws, and streamlined and transparent governmental procedures, not to mention major adjustments in traffic regulations. On the supply-side, the shortage of contractors will need to be addressed, in turn requiring a relaxation of foreign investment restrictions.

Failure to remove the institutional and administrative bottlenecks hindering infrastructure development could set back the public investment programme and reinforce private investors' uncertainties about the seriousness of government's efforts. This could also undermine future initiatives on tax reform, as higher revenues would only serve to magnify government underspending. At the same time, the expanded fiscal space offers fertile ground for more programmes promising quick relief to the marginalized and low-income segments of the population (e.g., free college education at state universities and colleges, free irrigation, free housing, among others) with little consideration for their distortive and longer-run effects.

Fourth, relations with the international community: Philippines foreign policy has tended to be ASEAN-centred, moderate and broadly U.S.-aligned. Will President Duterte's strident nationalist rhetoric change these settings? Among his first overseas trips were visits to the hemisphere's two dominant powers, China and Japan. He has sought to rejuvenate the critical Beijing relationship that was ruptured over the decision of the Permanent Court of Arbitration in The Hague in July 2016 to uphold the Philippines' exclusive sovereign rights over the West Philippine Sea and invalidate China's claim to resources in the area. This is a necessary step forward in order to ensure continuing access to Chinese investment and infrastructure financing. It remains unclear, however, what compromises the Philippines will have to make on its sea boundaries.

Meanwhile, while there is no evidence to date that the president's anti-American remarks have affected bilateral relations, President Trump's attacks on U.S. businesses that offshore their activities, and his proposed changes to the taxation of international income, may threaten the Philippine BPO industry. The United States is both the dominant market and foreign investor in this industry, accounting for at least 70 per cent of the total, and so any market disruption would have serious consequences. According to the Philippine Economic Zone Authority, the agency that administers the fiscal incentives and tariff-exemptions-granted BPO, approved investments declined in 2016. Foreign investment commitments in the information technology and transport and storage sectors similarly declined in the first quarter of 2017. The heightened nationalist rhetoric in both countries may have been a factor, but it is too early to be sure.

In summary, it remains to be seen whether the economic momentum thus far achieved in the last six years can carry forward to at least the next six and start delivering on the promise of a comfortable and secure life for the citizenry. While the prospects for attaining the growth targets seem favourable, as shown by recent economic performance, the risk of squandering opportunities is also very real. The hostility expressed towards long-standing development partners early on is a case in point. So is the preoccupation with congressional investigations of doubtful value in terms of legislation. In the meantime, attention is diverted from more urgent matters.[42]

How the economy has been able to keep the growth momentum despite the "noise" emanating from various quarters, including from the government itself, perhaps attests to its resilience and newfound dynamism. But then again, it may be asked if the negative international press the government received in the past year in connection with the country's human rights situation was not largely self-inflicted, and whether the nation could in fact be much further along the road to inclusive development without the controvesies.

As we have seen, the Philippines has generally underperformed in capital formation and equalizing opportunities, owing to regulatory impediments, poor infrastructure and perceived political instability. It would be a sad irony if the current administration is able to overcome the first two bottlenecks only to be undermined by the third by its own doing.

Notes

1. The most comprehensive recent treatise on Philippine economic history is that of Sicat (2014). Although ostensibly a biography (of one of the most

important economic policymakers in the modern Philippines), it is in fact a broad and nuanced analysis of the country's post-independence economic history.

2. The mid-1980s economic crisis has been dissected in detail in several excellent analyses by Philippine economists, especially those associated with the University of the Philippines School of Economics (UPSE). See, for example, de Dios et al. (1984) and Remolona, Mangahas, and Pante (1986) for analyses of the crisis and its aftermath.
3. Although the Philippine record resembled much of that in the rest of the developing world, as this was the decade of debt and stagnation in many developing countries.
4. A term that incidentally gained wide international currency from the Philippines during the Marcos era.
5. In path-breaking historical analysis, de Dios and Williamson (2013) investigate the record of Philippine industrialization, drawing attention both to its early start as the third Asian nation to record significant industrial growth (following Japan and China) and its "deviant behavior" from the 1980s as industrial growth slowed. They refer to a "perfect deindustrializing storm" and conjecture that the likely explanations included the 1980s political instability, a failure to exploit the Japanese industrial relocation to the region, institutional weaknesses, elements of the liberalizing policy package, a loss of skills from the large-scale outmigration, and Dutch Disease effects of the subsequent remittances.
6. As a recent illustration of the uneasy relationship, in February 2017 the country's environment secretary ordered the closure of the majority of the country's mines on grounds of alleged environmental violations. The secretary was subsequently removed from the cabinet.
7. This feature of Philippine development has been termed "development progeria" in a widely cited paper (Daway and Fabella 2015).
8. The remittance and BPO statistics are approximate, especially the remittances, which are a likely underestimate owing to unrecorded inflows.
9. One attempt to measure the openness of the services sector was the World Bank's 2011 Services Trade Restrictiveness Index that was developed on the basis of surveys of 103 economies for the period 2008–10. Among the eight developing East Asian economies surveyed (six from ASEAN), the Philippines was the most restrictive, more so even than Indonesia.
10. Although as Llanto notes in chapter 8, with reform, a bond market that taps into remittance flows could begin to play this role.
11. Scholars at the University of the Philippines School of Economics have investigated the country's poverty and inequality in great analytical detail. Mangahas and Barros (1979) analysed the record through to the mid-1980s,

while Balisacan (2003, 2015 and references cited therein) has written several seminal papers on the subject since the late 1980s.

12. The CARP continues to be a subject of continuing and spirited debate. See, for example, the recent exchanges between leading economists at the University of the Philippines (Fabella 2014; Monsod and Piza 2014).
13. Quimbo et al. (2015) provide an early and cautiously optimistic evaluation of the programme.
14. Detailed analyses of regional development are provided by Balisacan and Hill (2007) and Pernia et al. (1983). The most complex subnational development challenges are in Mindanao. These are extensively examined in the literature, most recently by Hutchcroft (2016).
15. The Philippines was a relative late starter in the establishment of a competition regulatory agency, with the Philippine Competition Commission being established in 2015 and commencing operations only in 2016. See the foreword to this volume.
16. The internal quotes are from Bennett (2014).
17. Nevertheless, the cornerstone of a free media, protection for journalists, remains problematic. The Philippines has one of the highest murder rates for journalists among non-conflict countries, according to statistics compiled by the international Committee to Protect Journalists (www.cpj.org).
18. In addition to chapter 9, see also De Dios (2009) and Fabella (2006) as leading political economy analyses of Philippine institutions.
19. In fact, Philippine defence expenditure is minuscule, at little more than 1 per cent of GDP, and the country's military has little modern hardware.
20. See Coxhead and Jayasuriya (2003) for an earlier stocktake and assessment.
21. We are grateful to Jan Carlo (JC) Punongbayan, a doctoral student at the University of the Philippines, for preparing the statistics on which this section is based.
22. Note that the growth data refer to GDP, not GDP per capita. Since around 1960, annual population growth has approximately halved, from just over 3 per cent to a little under 2 per cent per annum.
23. Note that "industry" here is defined in the national accounts sense to include the manufacturing, mining, construction, and utilities sectors.
24. Note also that, while overseas employment might be regarded as a "service export", for balance of payments purposes it is not recorded as such.
25. As noted above, Mangahas and Barros (1979) provide a comprehensive survey of the earlier period.
26. This trend is also confirmed in the more frequently reported self-rated poverty statistics. See Social Weather Stations (2017).
27. Economic historians would of course be quick to point out that "initial conditions" have much deeper and more complex origins than those

portrayed here. We recognize this point, but this deeper analysis is beyond the scope of this chapter. For a flavour of the literature, see Booth (2015) and Williamson (2015), companion chapters in the same volume. Note also that Indonesia and Malaysia have had international boundary changes since 1960, significantly so in the case of Malaysia.

28. Extending this comparison of the Philippine crisis in 1984–86 and Indonesia 1997–98, although the political transitions and the economic contractions were very similar, Indonesia took just seven years to return to its pre-crisis PCI, whereas the Philippines took almost twenty.
29. As mayor of Davao City in Mindanao for twenty-two years, Duterte built a reputation for quick and decisive action.
30. He has appointed a number of personalities associated with the militant Left to his cabinet.
31. At least 7,080 killings by the police or by unidentified assailants have been reported from 1 July 2016 to 31 January 2017 in connection with the government's campaign against illegal drugs, raising concerns about possible human rights violations from both domestic and international human rights groups. Independent groups have estimated the death toll to be around 13,000. Since January 2017, the police have also stopped reporting deaths from vigilante-style or unexplained killings; as of 26 July 2017, police data cite a figure of only 3,451 for people who have died in anti-drug operations.
32. This is reflected in the net satisfaction ratings reported by both the Social Weather Stations (www.sws.org.ph) and Pulse Asia Research, Inc. (www.pulseasia.ph) as of the first semester of 2017.
33. See www.pdp.neda.gov.ph.
34. After fifteen years of surplus, the current account sustained a deficit in the first quarter of 2017 and the BSP expects this to increase.
35. "Philippine Peso Slumps with no Sign of Infrastructure Push", *Financial Times,* 21 August 2017.
36. "Second Quarter 2016 Social Weather Survey: Families Self-Rated as Poor Decline to 44%; Food-Poor Families Decline to 32%", Social Weather Stations, 21 July 2017.
37. "Populism-proof", *The Economist*, 19–25 August 2017.
38. Early estimates from the Department of Finance put the figure at P366 billion a year until 2022 for incremental investments in infrastructure, education and training, health, and social protection, welfare and employment.
39. The proposed tax reforms are being introduced in phases, with other measures to reform corporate taxes and rationalize fiscal incentives, among others, to subsequently follow.

40. VAT exemptions are to be limited to only raw food and other items that can be justified by a strong economic rationale.
41. Measures here include fuel-marking, e-receipt, mandatory point-of-sale (POS) connection to the BIR, and relaxation of bank secrecy for criminal cases.
42. The peace process is one with serious implications on investor confidence. Another is the proposed amendment of the Public Service Act to liberalize rules on foreign investment in public utilities.

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