From a Sick Man to a Rising Tiger: The Philippines' Challenges in Keeping the Economy Healthy

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Abstract

In the 1950s and 1960s, the Philippines was relatively more developed than other Asian countries. However, things then turned out unfavorable for the Philippines, which failed to be an Asian tiger and won a nickname of the "sick man of Asia." Pressure from special interest groups and the country's trade policy toward import substitution made the Philippines an unattractive location for the industrial sector in Asia. Political instability that prevailed until the 1990s had an effect in discouraging foreign investors' intention to invest in the Philippines.

The Philippines may not have been sick, but compared with Asian tigers, the economic growth and management, FDI (foreign direct investment) inflows, and TFP (total factor productivity) growth certainly looked much less dynamic. Through the administration of Arroyo (2001-2010) and Aquino (2010-2016), the Philippines has managed to become one of the highest growing countries in the world. During this period effective economic policies contributed to favorable overall macroeconomic outcomes. Increasing remittances helped strengthen the country's external sector.

The new government needs to keep and strengthen existing effective policies while starting missing initiatives. The tasks include continuing with more infrastructure spending and improving the investment climate through deregulation, restructuring, and more competition in key sectors. With strong domestic demand and services sector, the economy will be stimulated by a more dynamic manufacturing sector if the bottlenecks for growth are removed in the future.

Key words: The Philippines, economic management, inclusive growth, investment climate

1 Introduction

In the early 1950s, the Philippines with its modern production structure had the higher GDP per capita than the so-called Asian tiger economies. Hong Kong, Singapore, South Korea, and Taiwan are the first generation

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of Asian tigers, while Indonesia, Malaysia, and Thailand are the second generation of Asian tigers. Even in the 1960s, the Philippines was still relatively more developed than other Asian countries, which explains why Manila was chosen over Tokyo as the location to host the headquarters of the Asian Development Bank (ADB) established in 1966. [2] However, in terms of subsequent economic growth, things did not turn out favorable for the Philippines, which failed to be an Asian tiger. Left behind the Asian tigers in growth and FDI inflows, the Philippines instead won a rather negative nickname of the "sick man of Asia." Kind (2000) attributes the prolonged poor performance of the Philippine economy to pressure from special interest groups and the country's trade policy toward import substitution that made the Philippines an unattractive location for the industrial sector in Asia.

The purpose of this paper is to reflect on the Philippine economy's past trend and policies to clarify the remaining challenges for the new government to sustain the recent growth trend and overcome deficiencies. Section 2 will highlight past struggles that led to the "sick man" nickname. Section 3 will explain how the Philippines came to strengthen its economic management toward a higher and more stable growth path. Section 4 will summarize the remaining challenges that need to be addressed by the new government. Section 5 will offer concluding remarks.

2 Was the Philippines sick?

Kind (2000) argues that the Philippines was relatively successful in attracting FDI inflows in the late 1960s, since the foreign investors were provided with access to protected domestic market. However, the Philippines' low income growth posed a limit to import substituting FDI. Inefficient and corrupt bureaucracy, as well as high tariff barriers, discouraged firms in the Philippines to engage in international trade. As such, the Philippines could not attract FDI as other Asian tigers did in the 1970s and the mid-1980s. While China enjoyed massive FDI inflows in the 1990s, the Philippines lacked locational advantages and suffered from poor infrastructure and bureaucracy.

According to Kind (2000), the Philippines systematically had negative TFP growth from 1960 to 1994, while Thailand, Indonesia, and Malaysia fared much better. The Philippines was also slower in the process

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[2] Since the ADB was created out of Japan's active initiative, Tokyo was the logical and anticipated location for the headquarters especially for the Japanese side. The close voting outcome in favor of Manila disappointed Japan, as explained by Watanabe (1977). Given the subsequent growth of the ADB during the past 50 years, however, Manila seems a more practical choice than Tokyo after all in view of the overall maintenance cost, availability of English-speaking employees, housing options for international staff, access to other Asian countries, etc.

of industrialization. The growth rate was lower in all sectors of the economy, especially industry, in the Philippines than in the other three countries. During the period 1975-1995, labor productivity did not change much in the Philippines, while it rose substantially in the other three countries. The trend was the same for agriculture and manufacturing. The Philippines' stagnant labor productivity was related to low and inefficient investments reflecting the ongoing industrial and trade policy.

World Bank (2013) reports a decomposition of growth in output per worker over the period 1961-2000, which stood at only 1.0 percent, far lower than that in Asian tigers and China (Table 1). The contribution of physical capital to growth is only 0.9 percentage point, again much lower. The contribution of human capital is 0.4 percentage point, while that of TFP turns out negative (-0.3 percentage point) unlike other countries in the region. This is explained by the country's inward-looking strategy from the 1950s to the 1970s and the shortage of FDI in the subsequent decades, which could have stimulated innovation.

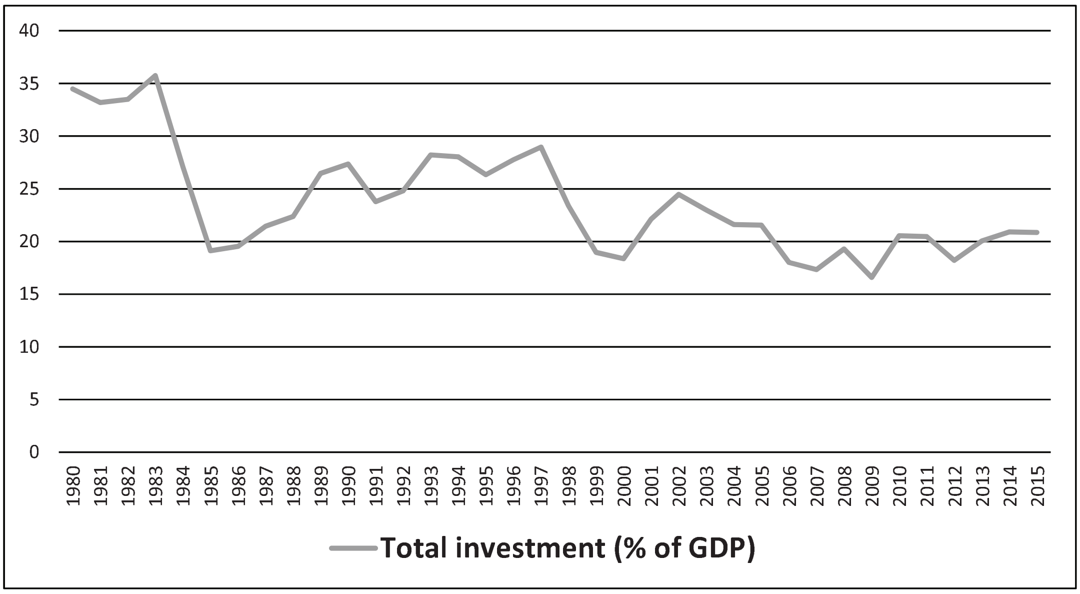
The Philippines experienced some favorable economic development under Marcos' presidency from 1965. The share of investment in GDP rose during the 1970s. However, the large income inequalities persisted during the Marcos administration, creating social unrest. A Martial Law was declared in 1972, lasting until 1981. Real wages in the Philippines suffered a sharp decline. The political instability led to a sharp decrease in the investment ratio and higher inflation in 1984 and 1985 (Figures 1 and 2). In February 1986 the People Power Revolution occurred, and later Corazon Aquino was elected president.

Table 1 Total factor productivity (TFP) of East Asian countries

	Growth in output per worker	Contribution to growth of		
		Physical Capital	Human Capital	TFP
Philippines	1	0.9	0.4	-0.3
East Asia	4.4	2.4	0.5	1.4
China	4.8	1.7	0.4	2.6
Indonesia	3	1.8	0.5	0.6
Korea	4.8	2.8	0.7	1.2
Malaysia	3.6	2.2	0.6	0.8
Singapore	5	3	0.5	1.5
Taiwan	5.8	3	0.6	2.1
Thailand	4.1	2.5	0.4	1.2

Source: WB staff estimates using data from 1961 to 2000
Source: World Bank (2013)

Figure 1 Investments as share of GDP



Data source: International Monetary Fund, World Economic Outlook Database, April 2016

The Philippines' development did not turn out impressive even after the Marcos regime. In the fight against poverty, Indonesia and China fared much better than the Philippines from 1985 to 1995. Even after the 1986 revolution, the Philippines could not attract FDI as other Asian tigers did. FDI inflows declined between 1988 and 1992 due to political instability and inconsistent trade policies. [3]

The political situation stabilized with the election of Fidel Ramos in 1992, contributing to increased confidence in the political system. The financial sector was reformed and deregulated under the Ramos administration, making it easier for foreign banks to participate in the market. The supervision of the banking sector was strengthened, which could be the reason why the Philippines was hit relatively less severely by the Asian financial crisis of 1997. Joseph Ejercito Estrada was elected president in 1998 but resigned in January 2001.

[3] Kind (2000).

3 Toward a better economic management

3.1 Arroyo regime

Gloria Macapagal Arroyo, who served as president from 2001 to 2010, adopted budgetary and fiscal reforms that later gradually led to steady growth. Arroyo administration introduced a value-added tax, cut administrative costs, and initiated a conditional cash transfer program providing poor households with subsidy if they send their children to school and vaccinate them.[4] The Arroyo administration thus deserves part of the credit for the Philippines’ improvement in economic management including strengthened fiscal stance. As in Figure 3, there was still a budget deficit in 2010 when the Arroyo regime was over.

3.2 Aquino regime

Building on Arroyo’s social programs and fiscal reforms, former President Benigno Aquino III has succeeded in keeping the economy healthy in spite of tough external conditions, making him a very popular president. The Aquino regime, deserving much credit for boosting Philippines economic growth, was instrumental in carrying out some key economic reforms for six years. Impressive economic performance under Aquino administration includes stronger economic growth backed by domestic demand, sustained current account surplus since 2003 helped by steady remittances mainly from Overseas Filipino Workers (OFWs), higher foreign direct investment inflows, low and stable inflation, as well as improved fiscal position (Figures 2, 3, and 4). Such a strong macroeconomic performance has been supported by effective policy reforms, reliable inflation targeting policy[5], as well as solid fiscal stance and banking system.[6] Aquino made efforts to invite FDI through PEZA (Philippines Economic Zone Authority) Special Economic Zone. The government also initiated support for the automobile industry through subsidy in the form of tax returns, aiming for expanded employment.

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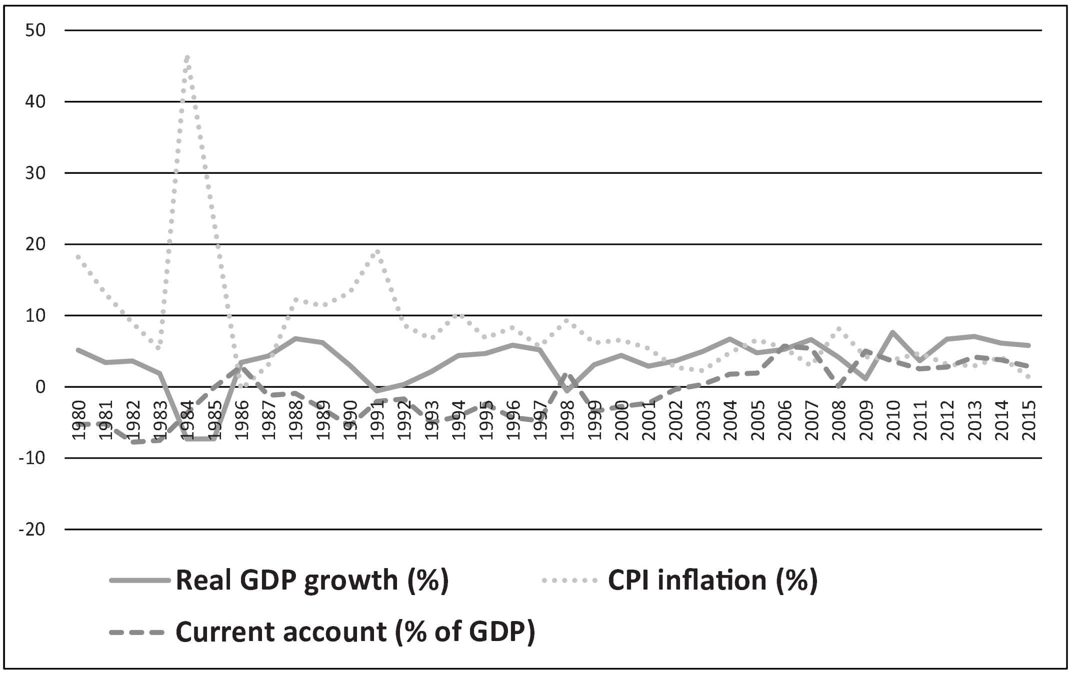
4 “First of iron,” The Economist, May 14th-20th 2016, 17-20.

5 The current official target range is 2%-4%.

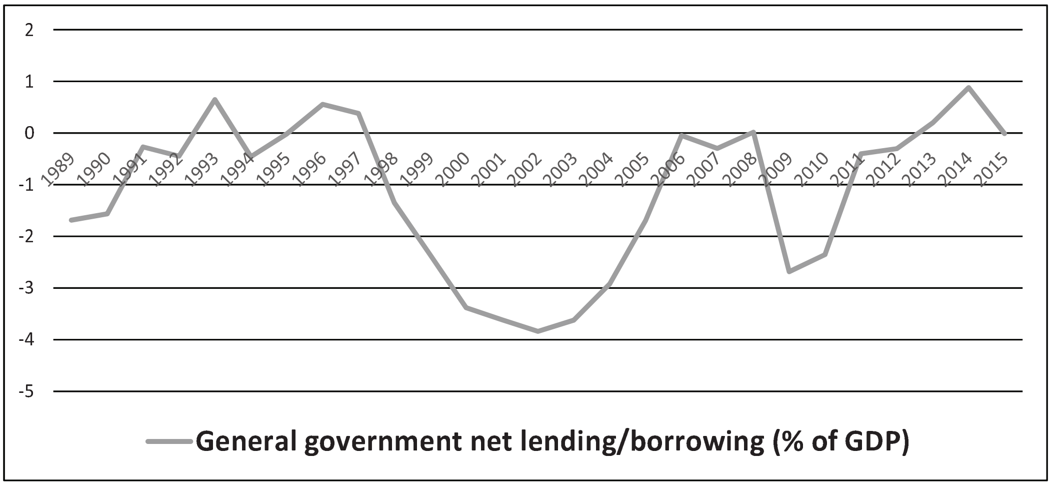
6 See Deorukhkar and Xia (2016).

Figure 2 Growth, Inflation, and the Current Account



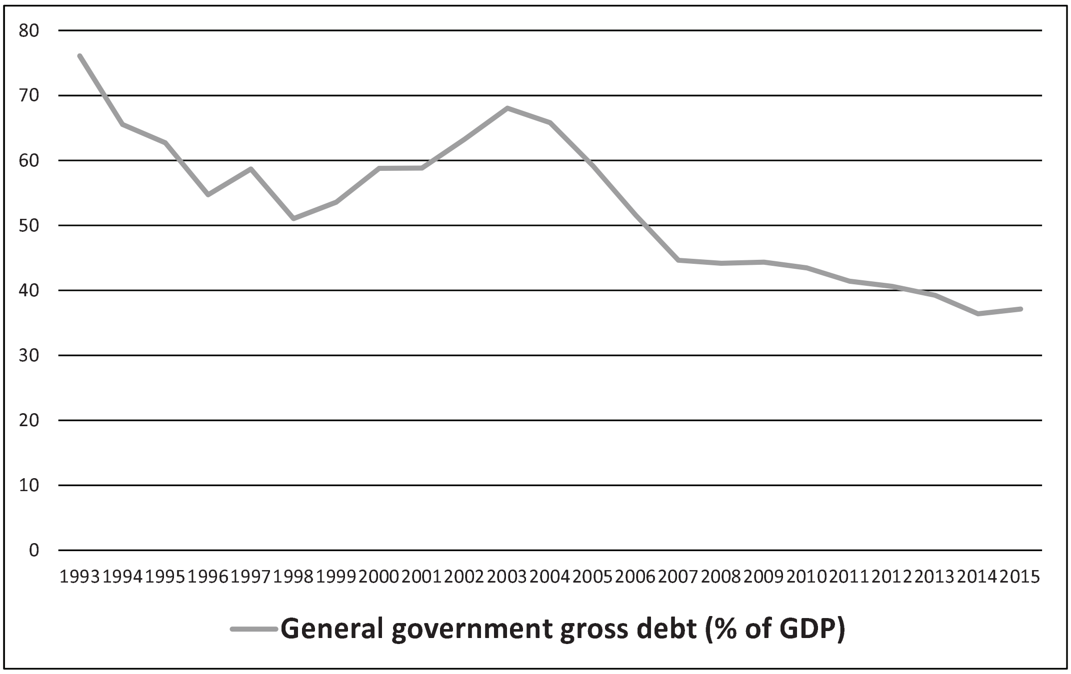
Data source: International Monetary Fund, World Economic Outlook Database, April 2016

Figure 3 Fiscal Stance



Data source: International Monetary Fund, World Economic Outlook Database, April 2016

Figure 4 Public Debt



Data source: International Monetary Fund, World Economic Outlook Database, April 2016

The Aquino regime came up with several successful economic reforms such as increasing infrastructure spending through public-private partnership (PPP), solidifying fiscal space with new revenue sources, an anti-corruption initiative, conditional cash transfers to the poor, and expanding education. Private investments were crowded in by the government's efforts to expedite PPP projects and improvements in public infrastructure.[7] Asian Development Bank (2016a) holds the view that the healthy economy will be sustained if the policy continuity is achieved. In the first half of 2016, domestic demand expanded rapidly, assisted by election-related spending.[8] In the same period, foreign direct investment almost doubled, improving fixed investment as a ratio to GDP to 23.7%, according to Asian Development Bank (2016c).

4 Challenges for the new government

4.1 Inclusive growth

Rodrigo Duterte took office on June 30, 2016. Prior to assuming presidency, Duterte had announced a

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[7] Deorukhkar and Xia (2016).

[8] Asian Development Bank (2016c).

10-point socioeconomic agenda and a pledge to continue economic reforms set by the Aquino administration. The Duterte administration's announced agenda was as follows:[9] (1) Maintain current macroeconomic policies, including fiscal, monetary, and trade policies; (2) Institute progressive tax reform and more effective tax collection, indexing taxes to inflation; (3) Increase competitiveness and the ease of doing business; (4) Accelerate annual infrastructure spending to account for 5% of GDP, with public-private partnerships playing a key role; (5) Promote rural and value chain development toward increasing agricultural and rural enterprise productivity and rural tourism; (6) Ensure security of land tenure to encourage investments, and address bottlenecks in land management and titling agencies; (7) Invest in human capital development, including health and education systems, and match skills and training; (8) Promote science, technology, and the creative arts to enhance innovation and creative capacity. (9) Improve social protection programs, including the government's conditional cash transfer program; (10) Strengthen implementation of the Responsible Parenthood and Reproductive Health Law.

Given the stellar economic performance under Aquino administration, it is a logical strategy for the new government to stick to the policies that have worked effectively.

While Aquino administration has managed the economy fairly well, a number of development challenges remain. As studied in depth by World Bank (2013), a crucial policy challenge is to accelerate inclusive growth that creates more and better jobs and reduces poverty. In spite of the Philippines' stellar economic performance, the pace of poverty reduction slowed in the past decade. National poverty rate was estimated at 25.2% in 2014 according to Asian Development Bank (2016b).

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9 Word Bank (2016b).

Figure 5 Unemployment

Data source: International Monetary Fund, World Economic Outlook Database, April 2016

The Philippines has experienced some years of "jobless growth" as pointed out by Asian Development Bank (2016a). Job creation improved with a rise in economic growth to 6.2% on average since 2010. The unemployment rate has been declining gradually as seen in Figure 5. However, the rates of unemployment and underemployment of young people remain higher.[10] Asian Development Bank (2016c) reports the unemployment rate of 5.4% and the underemployment rate of 17.3% in July 2016, indicating that roughly a quarter of the workforce is inadequately employed. The lack of good jobs inhibits the pace of poverty reduction. The Philippines has a relatively young population, so it is important for young people to be engaged in productive jobs instead of inadequate informal work. The Philippines needs further growth in manufacturing industry, which is significantly more productive than services, to bring about more and better jobs as the Asian tigers could.[11] The other remaining challenge is to improve productivity in the agricultural sector, whose employment accounts for about a third of total employment.

As can be seen in Figure 6, the population has been increasing rapidly. According to Asian Development

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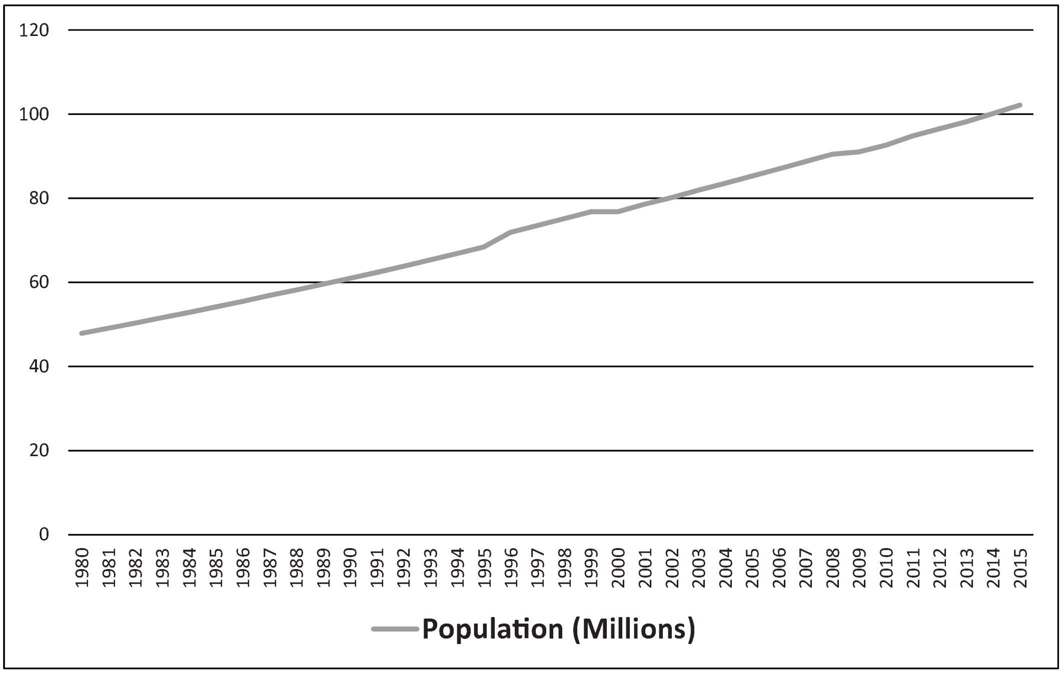
[10] According to World Bank (2016a), intense drought brought by El Niño increased underemployment in the agricultural sector in 2015.

[11] Asian Development Bank (2016c) reports that most of the new jobs generated in 2015 were in services.

Bank (2016b), the population reached 101.57 million in 2015, compared with 72 million in 1996. The average annual growth rate of population was 1.9% in 2010-2015. The population growth generates negative outcomes as well. Manila and other cities are highly congested, incurring immense economic cost daily.

Figure 6 Population



Data source: International Monetary Fund, World Economic Outlook Database, April 2016

The government could make efforts to avoid concentration in Metro Manila by encouraging alternative development around Clark by modernizing the Clark International Airport. The same logic applies to the needed expansion of the Port of Batangas to ease the congestion in the Port of Manila.

In a bigger picture, the new government could assist development of areas outside of Luzon, traditional center of production. Doing so may help the Philippines strengthen its development potential going forward. Unlike other past presidents, the fact that Duterte is from Mindanao could work as an advantage to the country in this respect. As shown in the 10-point socioeconomic agenda, the new government is committing to enhanced efforts to develop rural and regional areas.

4.2 External sector

The Philippine economy has mainly been domestic demand driven. Its export to China are lower than other Asian economies such as Taiwan, Korea, and Malaysia that are more vulnerable to China's economic slowdown. This can also work to the Philippines' advantage in creating weaker pressure or needs to yield to China's positions regarding ongoing territorial disputes. The Philippines is not over-reliant on commodities, either.

With the external sector contributing negatively to GDP growth, the weakness in external demand has an effect in discouraging Philippine growth outlook.[12] As the global demand recovers, policy efforts to increase exports growth will be needed. The fact that Japan is currently the Philippines' most important export destination reflects partly the success of the Japan-Philippines Economic Partnership Agreement signed in 2006.

Thanks to the population growth, an expanding domestic market is making the Philippines more attractive for foreign investors. This is a change from the past when the limited size of the domestic market had an effect in discouraging FDI inflows.

4.3 Investment climate

In addition to the weakness in external demand, domestic infrastructure shortage in quantity and quality, especially in the transportation and energy sector, generates a negative impact on growth outlook.[13] As seen in Figure 1, investment to GDP ratio has fluctuated around 20% in 2010-2015, lower than that of other ASEAN countries such as Indonesia, Thailand, Malaysia, and Vietnam.[14]

As recognized as part of his policy agenda, Duterte needs to increase infrastructure spending that enhances the transport capacity by improving roads and ports. Metro Manila appears to be overly congested.[15] It is necessary for the new government to keep investing in the improvement of transport system, in coordination with such development partners the ADB, World Bank, and JICA (Japan International Cooperation Agency),

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[12] It is worth noting that the Philippines' current account surplus is sustained by a significant amount of remittances.
[13] Deorukhkar and Xia (2016).
[14] See also Asian Development Bank (2016a).
[15] A feasibility study on building a subway system is under way. It is being built in Hanoi, Vietnam.

among others.

The Philippines continues to suffer from weakness in governance and institution that makes policy less effective. According to the World Bank, the Philippines is still behind many countries in bureaucratic delays in getting new business and construction permits, as well as weak contract enforcement. Very high electricity cost poses another critical challenge in doing business in the Philippines. The Philippines' ease of doing business ranking stands at 103 (out of 189 economies) in 2016, having worsened from 97 in 2015 following an improvement since 2010. It is not surprising, then, that the Philippines is still behind its Asian competitors in the amount of FDI inflows. Further reforms to strengthen competition, improve regulatory efficiency, and cut down the administrative costs of doing business are necessary for stimulating investment.

5 Concluding remarks

The Philippines had the higher GDP per capita than the Asian tiger economies in the early 1950s. Even in the 1960s, the Philippines was still relatively more developed than other Asian countries. However, in terms of economic growth, things did not turn out favorable for the Philippines, which failed to be an Asian tiger and instead won a nickname of the "sick man of Asia."

Pressure from special interest groups and the country's trade policy made the Philippines an unattractive location for the industrial sector in Asia. It is possible that ineffective policies such as import substitution prevented the Philippines from growing as other Asian tigers did typically through the development of a thriving manufacturing sector. Political instability that prevailed until the 1990s had an effect in discouraging foreign investors' intention to invest in the Philippines. As noted by Kind (2000), the overall economic performance of the Philippines was not so inferior compared with other developing countries. Looking back, the Philippines may not have been sick. However, compared with Asian tigers, the economic growth and management, FDI inflows, and TFP growth certainly looked much less dynamic, allowing Asian tigers to surpass the Philippines' economic status over time. Since the agriculture and services sectors are behind in terms of productivity, the Philippines did not enjoy high TFP growth as Asian tigers did thanks to the manufacturing sector.

Through the administration of Arroyo (2001-2010) and Aquino (2010-2016), the Philippines has managed to become one of the highest growing countries in the world. It is fair to say that during this period effective economic policies contributed to quite favorable overall macroeconomic outcomes. Increasing remittances from a growing number of OFWs helped strengthen the country's external sector. With all the remaining tasks including addressing income inequality, insufficient employment, and persistent poverty, the ongoing tide is favorable for the Philippines as long as a balanced economic policy is maintained. The new government needs to keep and strengthen existing effective policies while starting missing initiatives that are necessary to overcome the development challenges. The tasks include continuing with more infrastructure spending and improving the investment climate through deregulation, restructuring, and more competition in key sectors. The country needs more investments if it wants to sustain growth and expand employment.

As the middle class grows in number gradually going forward, the Philippines may become a genuine tiger in the near future as a steadily growing middle income country. The English-speaking labor force will remain abundant and become more efficient through education. With strong domestic demand and services sector, the economy will be stimulated by a more dynamic manufacturing sector if the bottlenecks for growth are removed in the future.

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