



Philippines

The Philippine economy is moving to a higher growth path, having recovered from the recession of the early 1990s. The recovery strengthened in 1995 with GDP growing strongly for the second successive year. Helped by the restoration of political stability and recent economic reforms, exports grew at a healthy pace, and the current account deficit in the balance of payments declined. The macroeconomic picture would have been better had the inflation rate not risen to double-digit levels in September 1995; however, the average inflation rate for the year was lower than in 1994.

In the past, the Philippines has experienced a series of volatile “boom-bust” economic cycles. The current recovery, however, is qualitatively different and has the potential to lead the economy onto a self-sustained growth path. A decade of structural reforms has significantly reduced macroeconomic distortions and liberalized a once highly protected economy. Manufactured goods now constitute the bulk of exports, reducing the country’s traditional reliance on volatile commodity earnings. External debt and debt-service payments are now significantly lower in real terms than they were in the late 1980s. Moreover, international investors’ confidence in the economy is now stronger than perhaps at any time in the recent past.

Recent Trends and Prospects

Growth, Investment, and Employment. The economic recovery which began in 1994 strengthened in 1995, with GDP growing by

4.8 percent. Although this growth rate is lower than the Government’s target, it was achieved in a year in which the agriculture sector slowed down considerably, due initially to less than normal rain in the planting season and, subsequently, to excessive rain and floods in the harvesting season. Agricultural production increased by only 0.9 percent in 1995 compared with 2.6 percent in the previous year.

Growth in the industry and services sectors more than compensated for the slowdown in agriculture. With improved electric power supply and the easing of supply-side constraints, the industry sector is responding positively to the reform measures initiated by the Government. Industrial production grew by 7.3 percent in 1995, surpassing the growth rate of 5.8 percent achieved in the previous year. With the exception of agro-industries, the acceleration in industrial growth has been broadly based. Manufacturing, which accounts for about 70 percent of industrial output, grew by 6.9 percent, a marked improvement on the growth rate of 5 percent achieved in 1994. Construction and utilities maintained their double-digit growth rates for the second consecutive year in 1995. Within manufacturing, industries such as machinery and transport equipment, minerals and metals, paper and paper products, petroleum products, and chemicals grew most impressively, whereas growth of industries such as beverages and food processing slowed down. The services sector, which accounts for about 43 percent of GDP, expanded by 4.9 percent in 1995 compared with growth of 4.3 percent in 1994.

Gross domestic investment contracted in 1995 to 22.3 percent of GDP compared with 24 percent in 1994. Slackening power sector investment demand after a two-year rehabilitation program contributed to the decline in the investment rate. At about 15 percent of GDP, gross domestic saving remained much the same as in the previous year, with the result that the resource gap narrowed by 1.5 percent of GDP.

It is somewhat premature to assess the impact of the current recovery on employment and poverty. The conventional unemployment rate, which measures the percentage of the labor force who did not work for lack of opportunities, has remained stable at about 9.5 percent since 1993. However, the underemployment rate, which measures the percentage of those employed who wanted more work, has declined from 21.4 percent in 1994 to 19.8 percent in 1995. These rates indicate that the current recovery has achieved a modest improvement in the employment situation although output growth has been driven more by gains in labor productivity than by increased

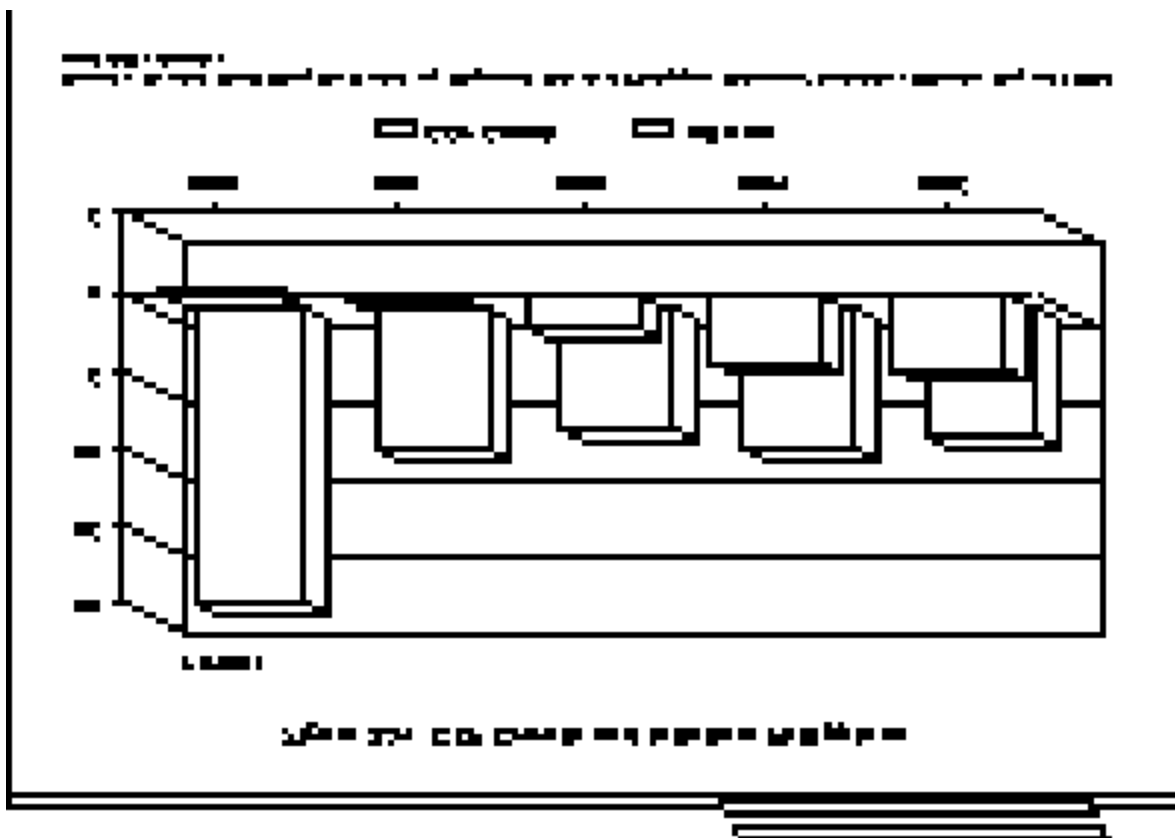
employment. This is normal in the initial stages of an economic recovery. Preliminary evidence suggests that, with the resumption of growth, the percentage of families living below the official poverty line has declined from 39 percent in 1991 to 36 percent in 1994.

The growth prospects over the medium term appear reasonably bright. GDP is expected to grow at an annual rate of about 5.5 percent in 1996 and 5.7 percent in 1997. The industry sector will spearhead growth, with industrial output expected to increase at about 8 percent in both years. Services output is forecast to increase by about 5 percent in 1996 and 5.2 percent in 1997. Assuming normal weather conditions, agricultural output should improve at about 2.5 percent annually in the next two years. Growth of the economy generally will be driven largely by investment and exports. Led mainly by private investment, gross investment as a ratio of GDP is expected to increase to 23.7 percent in 1996 and by a further percentage point in 1997. Since the increase in investment will be matched only partially by increased private savings, the

Table 2.11 Major Economic Indicators: Philippines

		1993	1994	1995	1996	1997
Gross Domestic Product	% change	2.1	4.4	4.8	5.5	5.7
Agriculture	% change	2.1	2.6	0.9	2.5	2.5
Industry	% change	1.6	5.8	7.3	8.0	8.0
Services	% change	2.5	4.3	4.9	5.0	5.2
Gross Domestic Investment	% of GDP	24.0	24.0	22.3	23.7	24.7
Gross Domestic Saving	% of GDP	13.8	14.9	14.7	16.1	16.9
Inflation Rate	% change in CPI	7.6	9.1	8.1	9.0	7.5
Money Supply Growth	% change	24.6	26.5	28.0	22.0	18.0
Merchandise Exports	\$ billion	11.4	13.4	17.3	21.7	27.1
	% change	15.8	18.1	28.9	25.0	25.0
Merchandise Imports	\$ billion	17.6	21.2	26.4	31.7	37.4
	% change	21.2	20.7	24.4	20.0	18.0
Current Account Balance	\$ billion	-3.3	-2.8	-2.1	-2.5	-3.0
	% of GDP	-6.0	-4.4	-2.8	-3.1	-3.2
External Debt Outstanding	\$ billion	35.9	39.3	41.0	43.5	46.0
Debt-Service Ratio	% of exports	25.5	18.5	15.1	15.0	14.0

Sources: Government of the Philippines, National Statistical Coordination Board, "The National Accounts of the Philippines, CY1993 to CY1995" (mimeo, January 1996); International Monetary Fund, *International Financial Statistics* (Washington, DC, February 1996); World Bank, *World Debt Tables 1996*, Vol. 2 (Washington, DC, 1996); and staff estimates.



resource gap is expected to worsen somewhat over the period.

Despite the good growth prospects, progress in reducing the unemployment rate is likely to be modest over the next two years. Even if employment opportunities grow somewhat faster than does the labor force, the underemployed are likely to benefit the most as firms start making better use of their existing but underemployed workers.

Budget, Money, and Prices. For the second consecutive year, the Central Government achieved a fiscal surplus in 1995, equivalent to about 0.5 percent of GDP. The consolidated public sector deficit, which was about 2 percent of GDP in 1993, had already been reduced to nearly 1 percent by 1994. In 1995, it was virtually eliminated. Most of the reduction in the public sector deficit was brought about by increased privatization receipts and a turnaround in the position of the Central Bank. Receipts from privatization constituted about 1.5 percent of GDP in 1994 and 1995. Similarly, in contrast to losses of about 1.5 percent of GDP in 1992, the Central Bank achieved a modest surplus in 1994, following financial restructuring in

late 1993. Adjusting for these temporary increases in revenues, the reduction in the public sector deficit has, however, been of a much smaller magnitude.

There has not been much progress in reducing government expenditure in the last two years. Central government expenditure, which was about 20 percent of GDP in 1990, was reduced to around 18 percent by 1994. The fact that there has not been any significant reduction in these expenditures is partly because of their inflexible structure. Over 70 percent of Central Government spending consists of salaries and wages, interest payments on government debt, and mandatory allotments to local governments.

During the first half of 1994, necessitated by the need to check rising inflation, the Government followed a tight monetary policy through sterilization of a significant portion of foreign capital inflows. This strategy, however, pushed up interest rates, attracted further capital inflows, and strengthened the peso, thereby threatening export competitiveness.

In response, beginning in the second half of 1994, the Government switched to an expansionary monetary policy aimed at

stemming the appreciation of the peso. Coinciding with the Mexican crisis in early 1995, this policy stance checked the nominal appreciation of the peso. However, monetary aggregates continued to grow briskly with broad money supply increasing by 26.5 percent in 1994 and at the slightly higher rate of 28 percent in 1995. Recognizing the dangers of accelerating growth in money supply, the Government began to tighten monetary policy toward the end of 1995.

The average inflation rate in 1995, although slightly lower than in 1994, remained relatively high at 8.1 percent. Inflation increased in the second half of the year to double-digit levels, partly because of the weather-induced failure of the rice crop, and partly because of the sustained growth in money supply. The Central Government's budget for 1996 aims at a fiscal surplus of Philippine peso (₱) 17.5 billion, equivalent to about 0.8 percent of GDP. The revenue/GDP ratio is projected to remain at its 1995 level of about 19 percent. On the expenditure side, the budget aims at a mild restructuring away from current operating expenditure and toward capital expenditure. The former is programmed to decline by about 0.5 percent of GDP and the latter to increase by about the same magnitude. The consolidated public sector deficit is projected to be close to zero in 1996. To achieve these fiscal targets, the Government has already introduced the much-delayed expanded value-added tax (EVAT) effective January 1996, which is expected to yield additional revenue of about ₱15 billion a year. The Government has also raised the administered price of petroleum products in an attempt to arrest the growing deficit in the oil price stabilization fund, which had reached ₱7.6 billion in December 1995. Money supply growth is expected to be lower at about 22 percent in 1996 and about 18 percent in 1997.

There will be two sets of factors working in opposite directions to affect prices in 1996 and 1997. On the one hand, if the tight monetary stance is maintained during 1996, there should be a gradual downtrend in the inflation rate. On the other hand, the increase in the administered prices of petroleum products in early February 1996 could put upward pressure on prices. Taking these factors into account, the inflation rate is expected to decline only gradually to about 7.5 percent by the

end of 1996, averaging 9 percent for the year as a whole. For 1997, inflation is expected to decline to 7.5 percent.

External Trade and Payments Merchandise exports grew by an impressive 29 percent in 1995, following 18.1 percent growth in 1994. To some extent, this reflects improvements in the power supply in the recent past; however, it also indicates that the removal of quantitative restrictions on trade and the rationalization of tariffs is beginning to have a favorable effect on exports.

The composition of Philippine exports has changed in the last decade. Manufactured products now account for about 80 percent of exports compared to less than 50 percent nearly a decade ago. In 1995, manufactured exports increased by about 30 percent and were fairly broad based. Exports of machinery and transport equipment, non-metallic mineral manufactures, chemicals, textile yarn and fabrics, footwear, electronics, and travel goods all increased faster than did total exports. Import growth was also strong at about 24 percent in 1995. Consistent with its stage of development, two thirds of Philippine imports consisted of raw materials and intermediate and capital goods. In 1995, the value of raw materials and intermediate imports grew by about 26 percent and that of capital goods imports by some 10 percent.

The trade deficit in 1995 was higher than in the previous year at about \$9 billion. Because of the large net inflow from services, the current account deficit declined from 4.4 percent of GDP in 1994 to 2.8 percent in 1995. Continued capital inflows, both official and private, have not only enabled the country to finance the current account deficit but also allowed the Central Bank to build up its foreign exchange reserves by about \$600 million. External debt increased to \$41 billion in 1995; however, the debt-service ratio declined to about 15 percent of exports from 18.5 percent in 1994.

The prospects for the continued growth of manufactured exports appear good over the medium term. The recent agreements to liberalize trade through the World Trade Organization and the ASEAN Free Trade Area should be beneficial to exports from the Philippines. Increasing foreign direct investment should also continue to improve domestic access to foreign technology and

Box 2.3 The Challenges of Managing Infrastructure in the Philippines

Given the past underinvestment and the prospect of continued rapid urbanization, the capital requirements of the infrastructure sectors such as power, transportation, water supply, and telecommunications are indeed large at an estimated \$5 billion annually or about 6.5 percent of GDP. Because of the resource constraints facing the public sector, the Government's strategy is to rely increasingly on the private sector for such infrastructure investment.

With the deregulation of telecommunications since 1993, the sector has already attracted private investment and further significant investment is expected. The Government will need, through its regulatory body, the National Communications Commission, to be vigilant about unfair trade practices and predatory behavior on the part of any dominant firm. It will need to develop appropriate policies for the maintenance of competition in an industry where economies of scale are an important determinant of the viability of investment.

Private investors have so far committed about \$3 billion to power projects; however, achieving the Government's goal of meeting all future power requirements from private investment will require attention to a number of issues. These include the development of clear and transparent government policies for private power producers; independent pricing of transmission; restructuring of the National Power Corporation, the largest power supplier in the country; and promotion of greater competition among power producers.

Attracting private investment for the provision of water supplies is not likely to make much progress until some technical and organizational problems are remedied. These include poor levels of maintenance of existing facilities; substantial losses of revenue through leakage, as in Metro Manila; inappropriate tariff structures that encourage wasteful use; and the small size of administrative authorities which prevents the achievement of economies of scale. An appropriate regulatory

framework is also required if, for technical reasons, competitive supply is not feasible.

In the case of ports, private sector contractors under franchise or lease agreements with the Philippine Ports Authorities (PPA) provide most of the port services to shipping operators. Investment in private port facilities is discouraged by the PPA. The PPA, which owns major public ports, serves as the regulator of its competitors in the service, bringing about an obvious conflict of interest. To encourage the flow of private resources into port development and operations, the regulatory framework has to be reformed and port activities have to be deregulated.

Even as the private sector increasingly participates in the provision of infrastructure, however, the public sector will continue to play an important role. Certainly, in recent years the private sector has invested in sectors once considered unsuited for private investment. Despite this trend, the private sector still invests primarily where returns are high and the pay-back period short. In the transport sector, for example, ports and airports may offer financially viable projects for the private sector, but the public sector is likely to have an important role in the financing of road construction and maintenance. Similarly, in the provision of water supply and sanitation, the public sector will have to be a key investor.

As the private sector increasingly participates in infrastructure provision and as the number of infrastructure providers increases, the Government's policy-making and regulatory roles will assume greater importance and require strengthening.

Overall, the public sector's role will have to change, from that of a predominant, and often monopolistic investor, to one of a partner in investment and a fair enforcer of the regulatory requirements for effective and efficient supply of infrastructure services. A key challenge for the Government is to forge such a public-private partnership.

help to raise productivity. Coupled with normal agricultural growth in the next two years and the pickup in agricultural exports, all these factors should enable exports to grow at an annual rate of about 25 percent in 1996 and 1997. As the economy's production structure diversifies and becomes better integrated with the export sector, the import

intensity of exports should gradually decline, leading to somewhat slower growth in imports. Imports are, therefore, expected to grow by about 20 percent in 1996 and by around 18 percent in 1997. The resultant trade deficit will be about \$10 billion in each year. Continued buoyancy in the remittances of overseas workers should, however, help to

contain the current account deficit to about \$2.5 billion in 1996 and \$3 billion in 1997. External debt is projected to rise to \$43.5 billion in 1996 and further to \$46 billion in 1997. The rapid increase in exports over these years will result in a fall in the debt-service ratio to 14 percent of exports in 1997.

Policy and Development Issues

The recent stabilization and structural adjustment measures have laid the foundations for sustaining strong growth. However, concerted efforts are needed to maintain the growth momentum while controlling inflation. Besides the maintenance of firm monetary policies, continued growth would require the provision of adequate infrastructure, increased agricultural investment, further fiscal consolidation, and measures to enhance the economy's international competitiveness.

Economic growth in the Philippines in the past has often been hampered by infrastructural constraints. The recovery of 1987-1990, for instance, was cut short by severe power shortages. It is important that steps are taken to guard against the reemergence of such constraints, whether they be in power, transportation, or water supply, especially by encouraging private sector infrastructure investment (Box 2.3).

In recent years, overall agricultural production has barely kept pace with population growth. Slow agricultural growth has limited the capacity of the rural economy to absorb labor and reduce poverty, thus increasing migration to the cities and further straining urban infrastructure. It is, therefore, important that the Government takes steps to achieve faster growth of agricultural production, which in the past has come from increased yields, especially of food crops. The growth in yields has, however, leveled off in recent years. Given the inescapable time lags in the application of some of the technological breakthroughs currently being achieved in the area of high-yielding rice for the Philippines, increases in agricultural production in the medium term will have to come largely from increased irrigation. Increased public

investment in irrigation is, therefore, crucial for achieving faster growth of agricultural output over the medium term.

Continued fiscal adjustment will be another key requirement for maintaining macroeconomic stability and the current growth momentum. Given the need for large public investments in irrigation and infrastructure, fiscal adjustment from now on will have to concentrate on stepping up public investment while, at the same time, keeping a tight hold on the public sector deficit. This would require a significant increase in government savings, which, in turn, would require controlling the growth of current expenditure, on the one hand, and raising additional revenues, on the other. Measures such as civil service reforms and abolition of fiscal subsidies and tax expenditure would be crucial for containing current expenditure. On the revenue side, privatization receipts are likely to dry up soon; in any case, these are more properly used for debt reduction or new capital expenditure. The Government's tariff reduction program may also involve some decline in revenues. Replacing these revenue losses, let alone increasing the revenue/GDP ratio, will be a challenging task, requiring a comprehensive tax reform program involving fewer but more broadly based taxes, reasonable tax rates, and strictly enforced tax collection. The Government has drawn up a tax reform program which addresses some of these issues and the implementation of the program is high on the policy agenda.

Although the Philippines has made significant progress in the liberalization of the economy, there is scope for further efforts in this direction. The priorities include deregulation of the energy sector; further reduction and rationalization of tariffs; phasing out of the remaining quantitative restrictions on imports; removing restrictions on foreign investment in retail trade; restructuring the National Power Corporation and privatizing its generation facilities; extending the privatization program to areas such as water management, ports, and railways; and adapting the legal, regulatory, and administrative capacity to manage rising private sector participation in the economy.