The State of Income

Human welfare cannot be reduced to income or earnings alone. It is erroneous to say that greater human development invariably means striving for the highest income. *Opulence*, which is the goal of maximizing income, cannot be the essence of human development. However, income or earnings are still the most popular measure of levels of human existence. Comparisons across countries show that, among the components of human development, income is where the Philippines has lagged behind the most.

Where a market economy prevails, earned income becomes almost synonymous with the means to support, maintain, and uplift human life. Higher income means greater command over quantities and qualities of goods and services. Health, nutrition, and education, for example, are broadly related to income, both as causes and consequences. Therefore, while the importance of raising income may be disputed at higher levels of opulence, its significance in a situation of extreme poverty and deprivation cannot be denied. If the human development indices (HDI) for the Philippines and its various regions is any indication, the greater anomaly in the country's human development record is to be found not in incommensurate efforts to provide direct social services, but in the simple failure to secure higher income for the people.

What determines how much people earn? People earn income when the resources they own are used in production, either by themselves or by others. When labor is employed, or when equipment, land, or financial assets are used in productive work, their owners obtain claims to social output in the form of wages and salaries, rent, interest, and others. Generally, incomes improve over a broad front when total production in the economy increases. Thus, *growth* in production is the first determinant of income although in recent years, earnings by the growing number of overseas workers have augmented incomes from domestic production.

Incomes also depend on the amount and quality of *wealth* controlled by a household. A peasant household can live only from labor incomes earned by working family members. It will earn correspondingly less if its members lack skills, are malnourished, or illiterate. By contrast, families who own assets such as land, substantial bank deposits, shares in corporations, bonds, and others will be better off. In this country, political capital or influence sometimes substitutes for asset ownership, since it can provide access to the state's vast resources for one's own benefits.

In addition, however, the kind and the amount of income earned will depend on changing technologies and on the different strategies and priorities pursued by societies and governments. If much of the production required by the economy uses little labor, then owners of labor power are forced to sell their services for lower wages, must contend with unemployment, or create their own employment in the so-called *informal sector*.

Production growth, wealth distribution, political influence, technological changes, and economic policies, alone or combined, affect people's incomes in one way

Table 9
GROSS REGIONAL DOMESTIC PRODUCT (GRDP) PER CAPITA LEVELS AND GROWTH RATES

Region	GRDP per capita[a] (in 1985 pesos)		Annual Growth Rates of Real GRDP (in percent)				Annual Growth Rates of Real GRDP Per Capita (in percent)		
	1980	1991	1975-1980[b]	1980-1985	1985-1991	1980-1991	1980-1985	1985-1991	1980-1991
National Capital Region	30,655	27,082	6.1	-1.56	4.59	1.74	4.69	1.77	-1.12
I Ilocos	6,891	7,014	4.5	0.70	3.27	2.09	-1.23	1.33	0.16
II Cagayan Valley	7,821	5,944	7.3	-3.23	2.66	-0.06	-5.60	0.22	-2.46
III C. Luzon	10,968	10,945	5.9	0.08	4.38	2.40	-2.34	1.96	-0.02
IV S. Tagalog	14,117	12,397	5.7	-1.74	4.41	1.56	-4.49	1.67	-1.17
V Bicol	5,265	4,727	5.4	-0.09	2.49	1.31	-2.40	0.22	-0.98
VI W. Visayas	10,069	8,788	3.4	-1.37	2.99	0.98	-3.60	0.81	-1.23
VII C. Visayas	9,912	9,823	7.7	-1.07	4.40	1.88	-3.03	2.44	-0.08
VIII E. Visayas	5,416	5,286	3.5	1.32	1.82	1.59	-0.51	0.02	-0.22
IX W. Mindanao	7,626	6,488	11.0	-0.73	2.07	0.78	-3.03	-0.13	-1.46
X N. Mindanao	13,348	9,857	8.7	-2.69	2.07	-0.12	-5.30	-0.51	-2.76
XI S. Mindanao	14,413	11,539	4.9	-1.90	2.51	0.48	-4.42	0.06	-0.20
XII C. Mindanao	10,196	8,170	8.3	-1.10	1.91	0.53	-3.67	-0.58	-1.99
PHILIPPINES	**12,620**	**11,311**	**6.0**	**-1.27**	**3.70**	**1.41**	**-3.68**	**1.31**	**-0.99**

[a]Economic and Social Statistics Office, National Statistical Coordination Board.
[b]Philippine Institute for Development Studies, "Balanced Regional Development Study," Annex L, May 1990.
1975-1980 data are in 1972 constant prices.

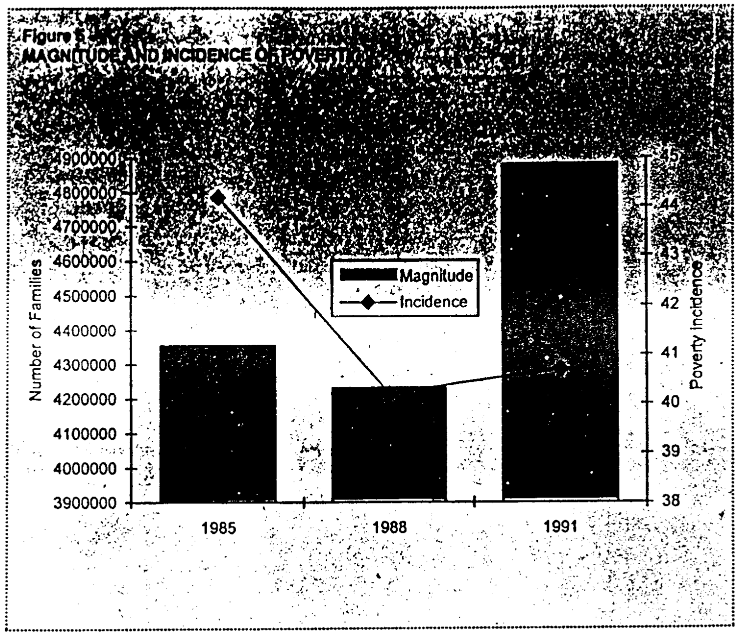
or another. At the level of the entire economy, incomes are measured by the *gross national product* (GNP), and average incomes are simply GNP divided by the population, or GNP per capita.

Incomes, Poverty, and Inequality

Viewed nationally, across regions or by sector, indicators of Philippine income over the last decade tell only one story: decline. Incomes per person fell drastically and still have to recover the level attained in the early 1980s (see also Figure 8). In addition, whatever income was created has been unequally distributed. Absolute poverty among the people has remained a serious problem.

The fall in per capita income is the direct outcome of stagnating output and a failure to recover. Complicating this is rapid population growth. Over the past two decades, real per capita incomes swang wildly, reflecting the "boom-bust" cycle of the economy. The longer trend has been one of decline. Filipinos have not regained the average level of incomes they earned a decade ago.

Income growth in the mid-1970s was moderately rapid. This was deceptive, however, since it was supported only by large amounts of foreign borrowings and could not long be sustained. As a result, the economy began to falter at the turn of the 1980s, then contracted precipitously during the mid-1980s in the worst reces-



sion the country ever experienced in forty years. During the latter part of the 1980s, average incomes recovered modestly but their recovery was fragile, and they soon declined in 1991 and 1992.

Clearly, the ups and downs of per capita income are primarily caused by the ups and downs of domestic production, or what is known as gross domestic product (GDP). In addition, incomes earned from abroad also dropped during the mid-1980s despite growing remittances from overseas workers due to heavy claims on the country by foreign creditors. The subsequent moderation of external debt service and rising remittances resulted in a slight increase in national incomes during 1991-1992, although domestic production continued to fall.

The picture at the national level is largely repeated in the regions, with some variations (Table 9). During the 1980-1985 period, Cagayan Valley, Northern and Southern Mindanao, Metro Manila and Southern Tagalog suffered the largest cuts in income, while regional incomes in Central Luzon and Bicol remained largely intact. During the tentative economic recovery between 1985 and 1991, Metro Manila, Southern Tagalog, Central Visayas and Central Luzon benefited most. The poor growth performance during the 1980s explains the continuing problem of poverty over the past decade.

Official measures of the *incidence of poverty*[1] increased between 1971 and 1985 (NSCB 1992), then improved somewhat in 1991 (Table 10). Nonetheless, since the population increased over the same period, the total number of poor families rose from 4.36 million in 1985 to 4.88 million in 1991 (Figure 5). Two out of every five Filipino households are poor. Since poorer families are also larger in general, the 40 percent poverty incidence in terms of families in 1991 translates into 46.5 percent poverty incidence in terms of population (NSCB 1992).

Subsistence poverty refers to the inability to earn enough income to meet the minimum food requirements of a normal person (i.e., 2,000 calories per day). This remains equally serious. There were 2.42 million families in subsistence poverty in 1991, or about one in every five Filipino households. This has hardly

[1]The number of poor families as a proportion of the total number of families.

Table 10
POVERTY INCIDENCE, SUBSISTENCE POVERTY AND REGIONAL SHARE OF THE TOTAL POOR FAMILIES
(by region; 1985, 1988 and 1991; in percent)

		Total Poverty Incidence			Subsistence Poverty Incidence			Share in Total Poor
	Region	1985	1988	1991	1985	1988	1991	1991
	NCR	23.0	21.6	14.9	6.0	5.0	2.5	5.7
	Non-NCR	47.5	43.1	44.9	27.2	22.7	23.1	94.3
	CAR	—	41.9	37.6	—	16.4	19.8	1.8
I	Ilocos	37.5	44.9	49.4	15.5	19.6	24.7	7.0
II	Cagayan Valley	37.8	40.4	43.1	19.1	18.4	20.6	4.0
III	C. Luzon	27.7	29.3	33.0	11.6	10.2	12.7	8.2
IV	S. Tagalog	40.3	41.1	38.0	20.3	21.7	17.8	12.4
V	Bicol	60.5	54.5	56.1	37.4	31.5	31.2	9.6
VI	W. Visayas	59.9	49.4	46.7	33.6	25.9	22.8	10.6
VII	C. Visayas	57.4	46.8	42.4	39.6	27.6	23.3	7.3
VIII	E .Visayas	59.0	48.9	40.7	42.4	31.2	24.8	5.4
IX	W. Mindanao	54.3	38.7	54.5	34.6	22.8	24.8	6.6
X	N. Mindanao	53.1	46.1	55.2	33.4	27.2	35.0	7.7
XI	S. Mindanao	43.9	43.1	47.5	23.3	24.0	27.2	8.0
XII	C. Mindanao	57.7	36.1	51.0	29.6	16.8	25.8	5.7
PHILIPPINES		**44.2**	**40.2**	**40.7**	**24.4**	**20.3**	**20.2**	**100.0**

Source: Technical Working Group on Poverty Determination, National Statistical Coordination Board.

changed from the 2.40 million households in 1985.[2]

Who are the poor? Where are they? With two out of five Filipino families living in poverty, it may be easy to generalize about the conditions and causes of poverty. Nonetheless, it is a fallacy to think that the poor are all alike, and that, therefore, their problems can be remedied by panaceas. In fact, there are many kinds of poor, to be found in different places in the country. The more they are delineated and the specific problems identified, the more focused and effective public intervention will be.

National averages hide many important differences across regions and between urban and rural areas. For example, poverty incidence may be disaggregated by region, and between urban and rural (Figure 6, and Tables 10 and 11). The following will be noted:

First, as may be expected, poverty incidence in Metro Manila is much lower than in the rest of the

[2]Estimates of total- and subsistence-poverty incidence are very sensitive to the measurement of the poverty threshold. The World Bank (1992) noted that Philippine poverty and subsistence poverty thresholds are substantially higher than Thailand or Indonesia, largely because the other countries assume a larger contribution of rice to calorie-intake and a larger share of food in total expenditures. Roughly adjusting for the "overestimation," the subsistence poverty rate in 1985 and 1988 would be 10.2 percent and 8.8 percent, respectively, instead of 24.2 and 20.8 percent, respectively, while the adjusted poverty incidence would be 31.9 percent in 1985 and 31.1 percent in 1988 (World Bank 1992: 324-26). Nevertheless, poverty thresholds are influenced by social norms; in principle, the official estimates reflect such norms. Thus, the discussion in the paper relies on the official estimates of poverty threshold income.

Figure 6
TOTAL AND SUBSISTENCE POVERTY ACROSS REGIONS, 1991

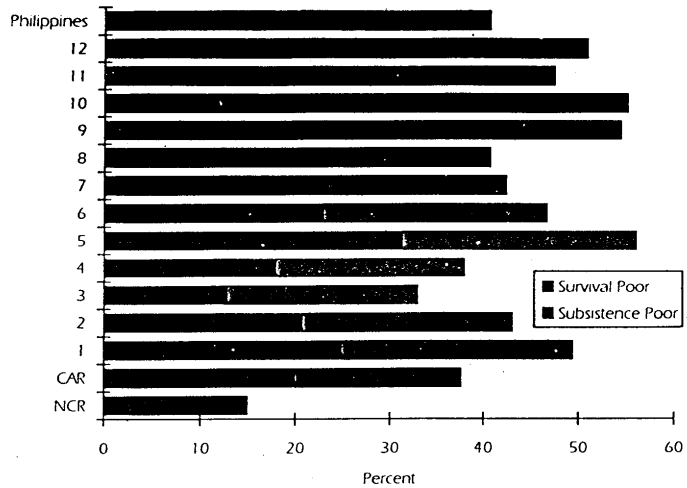


Table 11
RURAL AND URBAN POVERTY INCIDENCE BY REGION (as percent of all families)

	Rural			Urban		
Region	**1985**	**1988**	**1991**	**1985**	**1988**	**1991**
National Capital Region	—	—	—	23.0	21.6	14.9
Cordillera Autonomous Region	—	41.7	43.9	—	42.5	23.5
I Ilocos	37.1	46.0	49.4	39.0	41.0	49.5
II Cagayan Valley	38.1	40.1	43.1	36.2	42.3	43.2
III C. Luzon	29.7	30.9	35.4	24.9	27.0	31.3
IV S. Tagalog	44.5	46.1	46.4	33.2	31.5	30.1
V Bicol	65.3	55.9	53.5	42.1	49.3	62.0
VI W. Visayas	63.1	53.5	52.4	51.5	38.9	37.7
VII C. Visayas	61.8	54.2	52.7	47.7	31.1	29.3
VIII E. Visayas	60.7	51.2	41.6	52.5	41.1	38.7
IX W. Mindanao	55.6	39.6	57.5	47.5	34.5	47.7
X N. Mindanao	54.3	48.0	61.1	49.7	40.9	47.8
XI S. Mindanao	47.4	50.9	51.3	37.4	29.4	43.1
XII C. Mindanao	53.7	35.1	48.9	42.5	40.9	55.3
PHILIPPINES	50.7	46.3	49.1	33.6	30.1	32.2

Source: Technical Working Group on Poverty Determination, National Statistical Coordination Board.

country. But more important, poverty incidence in Metro Manila declined substantially during the period 1985-1991, while that outside the capital was reduced only marginally. As a result, Metro Manila's poverty incidence, which had been half that of the rest of the country in 1985, became only one-third of the poverty incidence everywhere else by 1991. The relative magnitude of changes in subsistence poverty incidence between the capital and the rest of the country during 1985-1991 is even more dramatic (Table 10). The implication is very clear: in terms of poverty alleviation, the economic recovery of the latter 1980s benefited largely the Metro Manila region.

Further breakdown in Table 10 shows regional variations in performance with respect to poverty alleviation. Apart from Metro Manila, the Visayas (Regions VI, VII and VIII) showed a similarly substantial reduction in poverty incidence during 1985-1991. In contrast, Regions I, II and III experienced significant deterioration in poverty incidence. The deterioration is particularly large for Region I, the so-called "Marcos country," which was somewhat neglected during the early post- Marcos years. Two other regions, Regions X and XI, also experienced some deterioration in poverty incidence. Region V (Bicol), which registered the highest poverty incidence in 1985, improved somewhat during 1985-1991; nevertheless, it still has the highest poverty incidence.

Through time, there have been marked shifts in the composition of poverty of urban and rural areas in some regions (Table 11). In Regions V and XII, urban poverty incidence rose substantially, while rural poverty incidence dropped significantly. In contrast, declines in urban poverty incidence were somewhat negated by increases in rural poverty incidence in Regions IV and IX. These compositional shifts may simply reflect changes in classification of areas according to National Statistics Office (NSO) criteria or more profound locational shifts in development and underdevelopment (Balisacan 1992).

Regions differ in population size; therefore regional figures on poverty incidence do not fully capture the magnitude of where the poor are in terms of absolute numbers. Table 11 decomposes the total number of poor families in 1991 by region and by rural or urban location. It shows that Region IV, especially its rural areas (most probably Mindoro, Palawan and Quezon), has the largest number of poor families in the country. Metro Manila has the lowest poverty incidence, accounting for 7.3 percent of the total number of poor families. The other regions with the largest concentration of poor families are Region VI (especially rural Western Visayas), Region V (especially rural Bicolandia), Region VII (especially rural Central Visayas), Region XI (especially rural Southern Mindanao) and Region III (roughly split between rural and urban Central Luzon). The top seven regions (including Metro Manila) account for nearly two-thirds of the poor families in the country.

Some 72 percent of all the poor families are in the rural areas. About 60 percent earned their income primarily from agriculture, either as farmers, agricultural workers, fishermen or forestry workers. The rest are primarily production, transportation and service workers, and unemployed. This suggests that in addressing poverty, it is important to disperse economic development to the regions outside Metro Manila, that agricultural productivity and growth is a priority, and that employment and better-paying jobs are central to the country's agro-industrial development strategy.

The larger the size of the family, the greater the poverty. In 1988, for example, only 25 percent of two-person families were poor, but 67 percent of families with more than seven members were poor. It suggests that poverty incidence would be lower if, among other things, average family size were smaller.

Whether and how an increase in overall incomes makes a dent on poverty will depend on two things: (1) *average income*, i.e., whether the region is rich or poor; and (2) *distribution of income*, i.e., whether it is distributed more or less equally.

Income inequality affects the extent of absolute poverty. Given two regions with almost similar average incomes, greater poverty will prevail in the region with the more unequal income distribution. This is especially true when the economy is stagnant or shrinking. The 1988 figures in Table 12, for example, shows that Central Luzon, where income distribution is more equal, tends to have a lower incidence of poverty than Region VI or VII.

On the other hand, it is also true that high average incomes can make up for the bad effects of unequal

Table 12
INCOME INEQUALITY, PER CAPITA INCOME AND POVERTY INCIDENCE BY REGION, 1985, 1988 and 1991

	Inequality (Gini Coefficient)			Poverty Incidence (percent of families)			Per Capita Income (pesos)		
Region	1985	1988	1991	1985	1988	1991	1985	1988	1991
National Capital Region	0.4146	0.4258	0.4397	23.0	21.6	14.9	24,372	26,975	27,082
Cordillera Autonomous Region*	n.a.	0.3741	0.4374	n.a.	41.9	37.6	n.a.	n.a.	n.a.
I Ilocos	0.4011	0.3743	0.4058	37.5	44.9	49.4	6,478	6,883	7,000
II Cagayan Valley	0.3856	0.3952	0.4209	37.8	40.4	43.1	5,864	6,192	5,944
III C. Luzon	0.3992	0.3861	0.4079	27.7	29.3	33.0	9,743	10,671	10,945
IV S. Tagalog	0.4058	0.4034	0.4278	40.3	41.1	38.0	11,222	12,159	12,397
V Bicol	0.3798	0.3876	0.3971	60.5	54.5	56.1	4,663	4,577	4,727
VI W. Visayas	0.4499	0.4080	0.4037	59.9	49.4	46.7	8,375	8,673	8,788
VII C. Visayas	0.4537	0.4602	0.4647	57.4	46.8	42.4	8,500	9,685	9,823
VIII E. Visayas	0.3904	0.4041	0.4417	59.0	48.9	40.7	5,280	5,345	5,286
IX W. Mindanao	0.3047	0.4087	0.4476	54.3	38.7	54.5	6,539	6,425	6,488
X N. Mindanao	0.4539	0.4424	0.4007	53.1	46.1	55.2	10,164	10,294	9,857
XI S. Mindanao	0.3932	0.4019	0.4452	43.9	43.1	47.5	11,497	11,871	11,539
XII C. Mindanao	0.3709	0.3583	0.3754	57.7	36.1	51.0	8,459	8,570	8,170
PHILIPPINES	**0.4466**	**0.4446**	**0.4735**	**44.2**	**40.2**	**40.7**	**10,461**	**11,243**	**11,311**

*For 1985, included in Regions II and III.

Sources: National Statistical Coordination Board. "Highlights of the 1991 Family Income and Expenditure Survey;" NEDA National Planning and Policy Staff and Development Planning and Research Project, "Income Distribution in the Philippines (1957-1988): An Application of the Dagum Model to the Family Income and Expenditure Survey (FIES) Data" by Ma. Cynthia S. Bantilan et al.

income distribution. Poverty in a much richer region is likely to be less than that in a comparatively poorer region even when the richer region has a less egalitarian income distribution. This is obvious in Table 12 when Metro Manila, for example, is compared with Bicol and Cagayan Valley. Similarly, when the distribution of income does not differ much, higher average incomes will be associated with lower poverty incidence. This is true for Central Luzon in comparison with Cagayan Valley or Eastern Visayas.

Changes in any one region's poverty incidence, income inequality, and average incomes through time are more difficult to explain (Table 12). Over the period 1985-1991, poverty incidence worsened in some regions even if average income increased slightly, simply because income inequality worsened. Examples are Regions II and XI. For the same reason, poverty incidence was reduced in Regions VI and XII because their average incomes increased while income distribution remained the same, or improved. In contrast, however, poverty incidence was reduced in Regions IV, V, VII, VIII and NCR despite the worsening of income inequality. A likely explanation for this is that a good number of the poor in these regions were only slightly below the poverty threshold in 1985; as a result, when average incomes increased marginally during 1985-1991, these

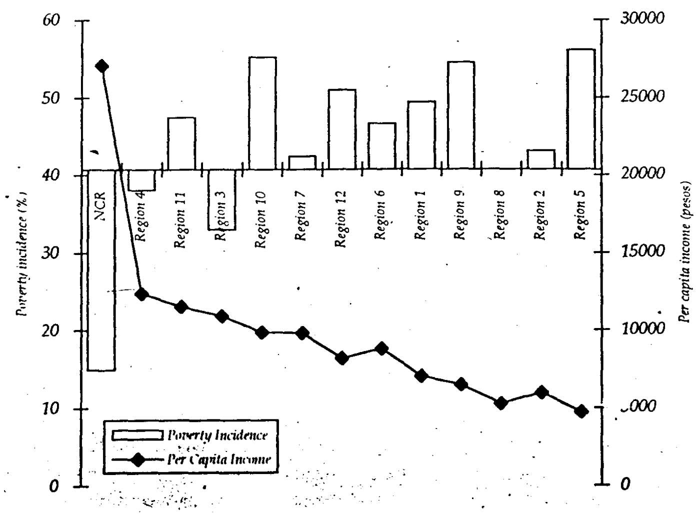
Box 2.1
AVERAGE INCOME AND POVERTY, 1991

The figure here classifies regions according to decreasing per capita income (actually, product), using the right hand scale. National Capital Region (NCR) has the highest average income, followed by Region IV, Region XI, and so on. The national per capita income in 1991 was P11,311.

The bars measured on the left hand axis show the incidence of poverty for each region, measured as a percent of the total population. NCR has a poverty incidence of 14.9 percent. The horizontal axis is drawn coinciding with the national poverty incidence of 40.7, so that if a region's bar is above the horizontal, that means its poverty incidence is above the national average. Region 8 happens to have a poverty incidence that is exactly equal to the national level. Only NCR, Region III, and Region IV have poverty incidence levels below the national level.

Does a higher regional per capita product imply lower poverty incidence? The picture is mixed. The observation is certainly true for NCR and Region IV, which have higher than average product and lower than average poverty levels. Likewise, Region V has the lowest per capita product and also the highest povery incidence. Region IX is also a classic case of low incomes and high poverty. These cases are "predictable".

But there are some unexpected results. Region XI has the third highest average product, yet its poverty incidence is much higher than that of Region VIII (third lowest in income); Region X has a higher product per capita than Region VII, yet its poverty incidence is also much higher. Clearly, other factors are at work, the most important of which is income distribution. Incomes in Regions X and XI happen to be unequally distributed because the profitable economic activities in these areas benefit a narrower group of people.



households graduated into the category of the non-poor.[3]

These observations provide straightforward lessons. When deprivation in some very poor regions are equally distributed, priority should be given to raising the level of growth and of incomes. Where there is a good degree of inequality, it is important to distinguish whether high or increasing income inequality signifies the presence or absence of growing opportunities. Generally, where average incomes are rising, poverty will be reduced, although inequality may increase. In poorer regions, where no new economic opportunities are pre-

[3] It is also possible that there are some measurement or estimation errors in the establishment of the region-specific threshold incomes by NSCB

sent, both poverty and inequality will be high; indeed, the inequality itself will be a cause of poverty. Again, in this case, growth in incomes is of primary importance.

Reducing the incidence of poverty, therefore, largely entails a sustained high growth rate of the economy, accompanied by a more equal distribution of the fruits of economic growth.

Unfortunately, Philippine society has always been characterized by increasing inequality in incomes, in good times and in bad. Figure 7 shows the shares in income of the poorest 40 percent and richest 20 percent of the population over the period 1985-1991.

Poverty and Rural Underdevelopment

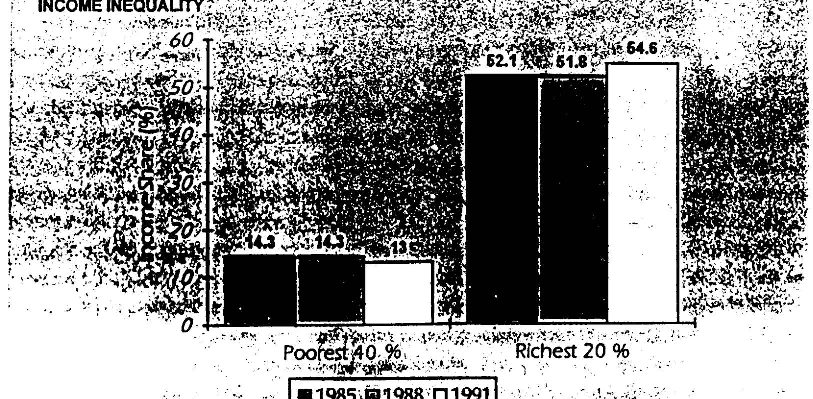
The poor in the Philippines are still primarily rural people. They are poor because they lack access to good lands or natural resources and must work with inferior resources. This condition applies to farmers in the uplands, indigenous peoples, small-farm cultivators in rainfed lowland areas, artisanal fishermen, and landless agricultural workers.

Among urban households, the poor are those with little skills, the unemployed, and the underemployed, e.g., scavengers, peddlers and unskilled laborers. Typically, whether in town or country, the poor must take on multiple jobs since the incomes from their "primary occupations" are too meager to sustain them. Therefore, additional, part-time, or seasonal work is always sought. More members of poor households are in the labor market seeking work, primarily in the informal sector, to help meet the household's daily needs (Imperial et al. 1993).

Studies of poor rural households in Northern Mindanao vividly picture the effects of poverty. Almost 9 percent of all families eat less than three meals a day, and a considerable percentage of children are malnourished (Madigan 1988). Spending on health is extremely low, and the rate of getting sick (morbidity) among rural households is high. Such households have been excluded from the modern health care system. Housing, water supply, and sanitation facilities are equally wanting. Poor families have high fertility and infant mortality rates. Another study of Northern Mindanao (Costello 1989) finds the poorest municipalities in the region's inaccessible areas: remote uplands and offshore islands with little transportation contact with the region's economic growth points. This shows clearly that *infrastructure* — i.e., access through highways or coasts to the region's economic growth points — is indispensable for economic development. In short, an important condition of the poor is their exclusion from the mainstream of economic life.

The relationship between rural development and household welfare is somewhat involved, but must be

Figure 7
INCOME INEQUALITY



understood nonetheless.[4] Obviously rural households will always respond to their economic, physical and social surroundings as best as they can. But how well they can do so depends on the means available to them, namely, their labor, skills, access to land and natural resources, and the quality of these means. The incomes they earn simply reflect how good or how poor are these resources over which they dispose. For example, landless rural households can rely only on earnings from unskilled labor, and this determines why they are way down on the ladder of rural poverty. Owner-cultivators and farm renters, on the other hand, may earn from tilling the land and from occasional forays into the rural labor market and will be somewhat better off. But even this depends on whether they have good access to markets for outputs and inputs. Farmers in the uplands may have land to till, but the quality of land is poor and the markets are more difficult to reach and they earn less as a result. Similarly, small fisherfolk have access only to degraded and overfished municipal fishery grounds and this is reflected in their incomes.

When there is a great need for labor in either urban and rural areas, wages and incomes of rural households (especially the landless) will tend to increase. Differences in the quality and economic value of lands tilled and natural resources managed is a major determinant of the variation in incomes among the owner-cultivators, farm renters, and fisherfolk.

The basic aspects of human development — nutrition, health, and education — cannot be considered in isolation from each other; instead, they are the outcomes of a household's choices, given the constraints it faces. Age and sex, sociocultural beliefs, and *current incomes* will determine how much of a priority a household is willing to place on health and education as against, for example, savings or investment. Higher incomes will generally lead to a higher desire for better nutrition, health, and education, as well as a greater ability to obtain these.

Apart from income, however, nutrition also depends on the physical availability and price of food, whether imported or produced domestically. Similarly, it is not only income that determines health and education status but also the physical presence of personnel and facilities in the rural areas. The concentration of facilities in the urban centers means that, even for the same level of income, a rural family must spend more than an urban family to obtain the same quality of health care or education. For this reason, direct government provision is often needed in remote areas. In turn, rising levels of health and education are needed for a household to improve its prospects of earning income over time. This is discussed in more detail in the chapter on the State of Human Capital.

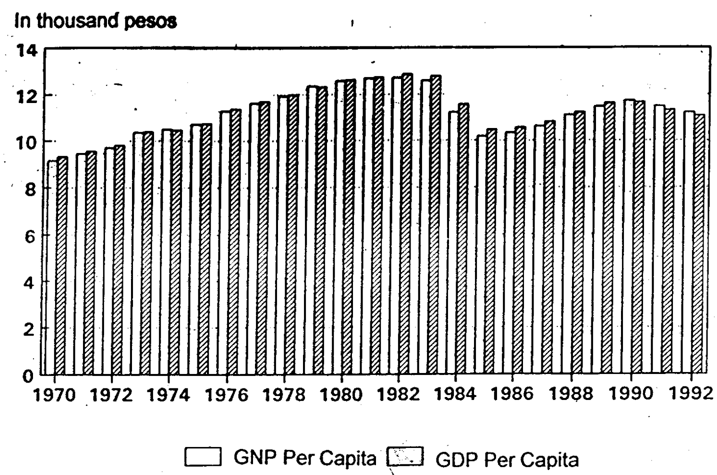
In all this, the direction of government policies and the magnitude of its spending have a critical and pervasive influence on the economy and on the human development condition of the households. The government's development strategy shapes the extent of domestic and foreign investments, the allocation of capital between industry and agriculture, and the employment effect of investments and economic growth. Government expenditure policies determine the allocation between current and capital expenditures and among the competing budgetary claims from the social sector, defense, general administration, and economic support services. Agrarian and natural resource policies determine the extent of access to agricultural land and other natural resources in the rural sector. Finally, government macroeconomic policies influence the availability and pricing of food imports/exports, the incentives to household and corporate savings and investments, and the labor force participation rates of household members. In sum, the quality of governance shapes the character of development and the welfare status of the rural (and urban) households.

The disturbing prospect is the emergence of a vicious cycle. Rural unemployment and underemployment cause poverty; poverty leads to poor nutrition, health and education, poor quality and low productivity of labor force, and high fertility, morbidity and mortality rates. Low household savings and investments tighten the noose of economic stagnation and poverty.

At the household level, breaking this vicious cycle means "voting with the feet," i.e., migrating to urban areas or leaving the country in search of a job. At the national level, breaking the cycle requires a shift in government development strategy toward greater commitment to employment creation, substantially improved rural infrastructure, increased government pro-

[4]The rest of the section draws from Intal (1989).

Figure 8
GNP AND GDP PER CAPITA (1985 prices)



vision of basic health and education services, increased focus on food security, and improved access to land and natural resources by many of the rural poor. Above all else, there is a need for a continuously high economic growth, well above the population growth rate, and an end to the boom-bust cycles of past decades.

Why is Philippine Economic Performance So Poor?

If the "stop-go" pattern of economic growth is to be broken, its causes must be understood. In the 1980s, the economy ran true to the form of the previous two decades. The only difference was that the period between boom and bust was now compressed into a shorter time (Figure 8). The "high-flying" 1970s ended with the big crash of 1984-1985; the brief economic recovery of 1987-1989 ultimately ended in a recession and economic stagnation during 1991-1992. The "stop-go" pattern pervades all sectors, with manufacturing and industry being the most volatile and agriculture registering the least growth fluctuation. The year 1994 is now being touted as the first year of recovery for the economy. But whether this recovery represents something new or shall simply repeat the pattern will depend on whether lessons have indeed been learned.

The 1980s must be given up as a lost decade for the Philippines. The economy staggered from one crisis to the next, while the economy of rest of the Western Pacific region surged (Table 13). In that period, the country's income, industrial output, and exports grew even more slowly than the average of the 20 severely indebted countries.

The reasons for the economy's failure during the 1980s are as follows: (1) the need to implement stabilization measures as a consequence of the debt crisis; (2) loss of international competitiveness in the light of dynamic changes that occurred in the Asia-Pacific region during the decade; and (3) uncertainty in politics and in the policy regime, especially as perceived by foreign investors.

Debt and Stabilization

Under the prevailing system of international finance and politics, highly indebted countries are compelled to undergo wrenching economic adjustments before they recover. The process of adjustment invariably takes several years and involves declines in per capita incomes. The Philippines is the only Asian country in the

Table 13
PHILIPPINE ECONOMIC PERFORMANCE IN INTERNATIONAL PERSPECTIVES, 1965-1989
(average annual growth in percent)

Philippines	GDP Growth	Industrial Growth	Inflation Rate	Gross Domestic Investment	Export Growth (in US$)
1965-1980	5.9	8.0	11.7	8.5	4.6
1980-1989	0.7	-0.8	14.8	-7.8	1.3
Severely indebted countries					
1965-1980	6.1	6.9	29.1	8.3	-0.2
1980-1989	1.9	1.5	140.5	-2.0	3.9
Other ASEAN[a]					
1965-1980	8.0	11.1[a]	12.9	12.0	6.9
1980-1989	5.8	6.2	3.6	4.2	8.3
East Asia[b]					
1965-1980	7.3	10.9	9.3	11.1	10.0
1980-1989	7.9	10.4	6.0	9.9	10.0

[a]Simple average.
[b]Includes ASEAN and China.
[c]Excludes Malaysia.
Source of basic data: *World Development Report 1991.*

"club" of 20 severely indebted middle income countries, and its wrenching experience in economic adjustment since the 1983-1985 economic crisis sharply contrasts to the ebullience of the rest of East and Southeast Asia. Filipinos themselves have tagged their country as the "sick man of Asia," an indication of their eroded self-confidence.

Because the Philippines could no longer borrow from commercial banks and had to restructure its external debt, it was compelled to subsist on severely limited foreign exchange reserves. For most of the 1980s, the management of the macroeconomy was placed under the tight control of the International Monetary Fund, and macroeconomic stabilization inevitably took primacy over economic growth. The country made net payments to foreign creditors of some $12 billion during 1983-1991. Given the country's low international reserves, export earnings or foreign investment would have had to rise substantially in order for the economy to grow sustainably. Failing that, pump priming the economy through domestic financing of the concomitant fiscal deficit could not be sustained for long and the growth of the economy had to be sacrificed ultimately through stringent monetary and fiscal policies. By the second half of 1989, the domestic financing of the budget deficit (using primarily short-term debt), together with the "mopping up" operations of the Central Bank led to rising domestic interest rates which significantly pushed up government expenditures on domestic debt service. To address the worsening internal debt service problem and the rising trade deficit, the government implemented stringent fiscal policy beginning in late 1990, thus, starting the economic stagnation during 1991-1992.

It is instructive to contrast the experience of the Philippines in macroeconomic management to that of other similarly indebted countries, for example, Indonesia, during the 1980s. In contrast to the Philippines, Indonesia received positive net resource transfers during its critical macroeconomic adjustment period

Table 14
MACROECONOMIC INDICATORS: THE PHILIPPINES AND INDONESIA COMPARED

	1978-1982		1983-1987		[illegible]	
	PHI	IND	PHI	IND	PHI	IND
Net resource transfer (in billion US$)	1.9	0.6	-1.1	2.7	-1.8	-3.3
Foreign borrowing (as share of government deficit*)	233.8	100.2	30.0	100.1	54.6	100
Government deficit* (as a percent of GNP)	2.2	3.7	1.9	4.6	2.5	6.4
Broad money (M2) (as percent of GNP)	21.9	8.0	22.6	24.2	24.7	34.1
Claims on private sector	28.0	11.7	26.8	9.3	16.7	34.2
Real GNP growth rate (% p.a.)	4.6	6.7	-3.3	5.0	5.3	7.2

*Government deficit refers only to central government

(1983-1987), implemented a less stringent fiscal policy with its budget deficit financed from foreign borrowing, vigorously pursued an expansionary credit policy (as indicated by the sharp rise in the share of broad money M_2 to GNP and in the share of domestic credits going to the private sector) within the framework of an overall prudent monetary policy (indicated by the stable ratio of narrow money-M_1-to GNP). Given a financially healthy Central Bank, it succeeded in effecting a relatively non- inflationary depreciation of the Indonesian rupiah, such that there was a significant real depreciation of the rupiah. It posted positive deposit interest rates that helped encourage the rising domestic savings rate. On the other hand, as Table 14 shows, the Philippines was hobbled by substantial negative net resource transfers to its creditors and by a financially precarious Central Bank. As a result, fiscal policy was tighter, with the ratio of national government deficits to GNP being lower than in Indonesia. Credit policy was decidedly stringent *vis-a- vis* the private sector, so that the share of credits going to the private sector dramatically declined during the late 1980s. In addition, because the currency devaluations were undertaken only as a last resort and not as part of a competitive strategy, the devaluations proved far more inflationary and much less effective than those in Indonesia (Intal 1991a).

The dilemma of the Philippine macroeconomic adjustment process is that the large negative net resource transfers weakened the government's credibility and dampened the prospects for national consensus on the structural reforms needed to ensure a sustainable growth path. At the same time, because there was no strong structural reform program to improve the efficiency and competitiveness of the economy and its exports, the balance-of-payments crisis eventually recurred after the slump in initial demand. Attempts to pump-prime the economy and achieve economic recovery put renewed pressure on the country's meager international reserves (Intal 1991b).

Erosion of Competitiveness

After the initial burst of reforms in its early months, the Aquino administration failed to forge a national consensus on the needed structural reforms. As a result, it largely muddled through in its economic management during much of the first four and a half years. During its last 18 months, it resolved to push through with the needed structural reforms toward more open trade, especially with the implementation of the tariff reform program under Executive Order 470, financial and foreign exchange liberalization, privatization, and a more liberal investment regime exemplified by the Foreign Investments Act of 1991. It may be argued that had there been a more decisive resolution of the policy dilemma of the Philippine macroeconomic adjustment process, the structural reform package would have been more credible and more vigorously implemented, the policy rules of the game would have been firmly set in place, thereby giving clear policy signals to the private sector earlier, and the positive impact on the economy of such reforms would have been greater (Intal 1991b).

The current administration has continued the push for greater economic openness, investment-friendliness, privatization, deregulation and liberalization. It has adopted the attainment of international competitiveness and the enhancement of human resource development as critical pillars of the country's development strategy toward higher economic growth during the 1990s.

Nevertheless, the challenge of substantially improving the country's international competitiveness remains great (Tables 15 and 16 and Figure 9). As Table 15 indicates, Philippine labor productivity growth, especially in manufacturing and even in agriculture, has significantly lagged behind that of China, Indonesia, Malaysia and Thailand during 1975-1990. Table 16 also indicates the deterioration in the quality of infrastructure in the Philippines compared to its ASEAN neighbors. Moreover, Figure 9 shows the substantial loss in price competitiveness of the Philippines *vis-a-vis* China and Indonesia as a result of the successful real depreciations of China's yuan and of Indonesia's rupiah during the 1980s. Finally, the substantial decline in the domestic savings rate (Figure 10) limits the leeway for non-inflationary government pump-priming and implies much greater reliance on foreign investments for the needed hike in investment in the country.

From what has just been said, it is obvious that the peso will have to depreciate further in real terms, in order to regain somewhat the loss in price competitiveness *vis-a-vis* China and Indonesia and, at the same time, gain some price competitiveness *vis-a-vis* Thailand and Malaysia. In addition, labor productivity growth needs to be significantly increased. Among other things, this calls for improvements in the quality of infrastructure, the allocation of scarce capital resources, the entrepreneurial responses to competition, and the robustness of the country's economic expansion. The Philippines needs to have a coherent, clear and realistic plan to substantially raise agricultural productivity (rooted in substantial improvement of resources in farm infrastructure, including irrigation, varietal research and more effective and focused agricultural support services toward improved productivity and crop diversification) to be able to compete internationally, especially in view of the much better land/labor endowment of the other ASEAN countries (Thailand, Malaysia, Indonesia). Similarly, the domestic savings rate (Figure 10) especially that of the private sector and the government's tax effort must be raised substantially.

Table 15
AVERAGE LABOR PRODUCTIVITY INDICES: ASEAN-4 AND CHINA (1975=100)

	1975	1980	1985	1990
China				
Overall	100	122	166	203[b]
Indonesia				
Overall	100[a]	126	131	140b
Manufacturing	100[a]	156	195	227[b]
Malaysia				
Overall	100	125	138	163
Manufacturing	100	106	117	161
Philippines				
Overall	100	120	96	104
Manufacturing	100	122	107	119
Thailand				
Overall	100	118	136	167[b]
Manufacturing	100	121	131	165[b]

[a]1976; [b]1989

Note: Average labor productivity is measured as the ratio of the gross value added at constant prices to total employment.

Institutional Capacity

Finally, there is a growing need to significantly improve institutional support and the capability of those sectors and agents that will play a key role in the global competition for goods, services and investments. These include government's pro-active support for exports and small and medium enterprises through aggressive technology, investment, and market search and match-ups, simpler and faster processing of investments and exports applications and papers, more effective and facilitative management of official development assistance (ODA) resources, greater funding of and improved institutional programs on technology-based skills training; the redirection of the industrial relations environment toward a more cooperative, rather than adversarial, labor-management-government relations,

Figure 9
PRICE COMPETITIVENESS INDEX OF THE PHILIPPINES VS. SELECTED ASIAN COL

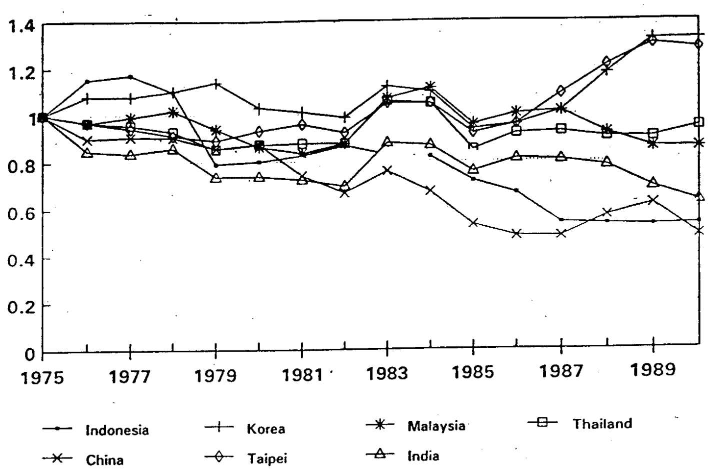


Figure 10
DECLINE IN DOMESTIC SAVINGS, 1970-1991

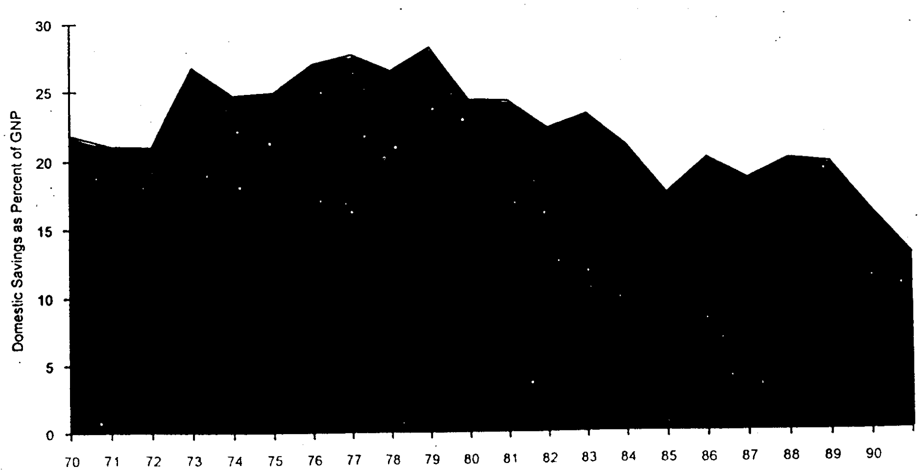


Table 16
SELECTED INDICATORS FOR ASEAN- 4

		1970	1975	1980	1985	1990
Investment Rate (GDCF/GNP) ratio						
	Philippines	21.6	27.6	20.0	12.6	16.5
	Indonesia	15.7[a]	22.8	27.8	32.3	31.7
	Thailand	20.5[b]	24.7	24.0	22.5	29.0
	Malaysia	23.1[c]	21.7	31.7	31.5	33.1
INDUSTRIAL RELATIONS No. of Strikes and Lockouts						
	Philippines	104.0	62.0	371.0	187.0	—
	Indonesia	1.0[a]	13.0	498.0	78.0	37.0[f]
	Thailand	22.0	241.0	18.0	4.0	10.0[f]
	Malaysia	26.0	73.0	30.0	25.0	17.0
Number of Workdays not Worked ('000)						
	Philippines	994.7	105.3	2457.7	955.2	.
	Indonesia	9.1	3.0	33.8	557.0	48.6[f]
	Thailand	7.7	722.9	6.4	13.1	89.3[f]
	Malaysia	2.3	46.7	24.5	36.0	24.9
INFRASTRUCTURE Length of Paved Roads ('000)						
	Philippines	13.5	10.5	27.7	21.3	23.4
	Indonesia	20.4	33.1	56.5	83.6	89.5[f]
	Thailand	10.1	15.2	22.4	31.3	38.8[h]
	Malaysia	16.0	18.5	20.0	25.9	35.9[h]
No. of Commercial Vehicles ('000)						
	Philippines	179.4	273.2	392.9	514.4	764.9
	Indonesia	125.9	231.5	560.1	1072.6	1257.1[f]
	Thailand	162.8	246.2	140.8	684.7	689.9[f]
	Malaysia	72.6	157.7	204.8	311.1	407.1
Power Production Index (1970=100)						
	Philippines	100.0	157.8	206.4	264.4	299.3[h]
	Indonesia	100.0	183.9	618.9	1303.4	1817.8[h]
	Thailand	100.0	195.1	332.5	532.0	860.4[h]
	Malaysia	100.0	163.4	287.5	426.2	611.9[h]

Merchant Shipping ('000) Gross Reg. tons		1970	1975	1980	1985	1990
	Philippines	946.0	879.0	894.5[d]	4334.2	4342.9
	Indonesia	643.0	859.0	1412.0	1936.0	2035.0[h]
	Thailand	82.0	183.0	391.0	586.0	539.0[h]
	Malaysia	48.0	359.0	702.0	1773.0	1668.0
Telephone Density (Per 100 persons)						
	Philippines	0.8	1.2	1.1	1.2[d]	1.5
	Indonesia	0.2	0.2	0.3	0.4	0.5[g]
	Thailand	0.4	0.8	1.1	1.5	1.9[e]
	Malaysia	1.6	2.4	4.4	8.2	11.4

[a]1971; [b]1972; [c]1973; [d]1982; [e]1986; [f]1987; [g]1988; [h]1989.

Sources: Yearbook of Labor Statistics, ILO (1977, 1989-1990); Statistical Yearbook of Asia and the Pacific, UN (1991, 1980); Key Indicators of Developing Asian Pacific Countries, ADB (1985, 1991); Philippine Statistical Yearbook, 1991.

and the inculcation of an export culture where on-time performance and product quality consistency are given emphasis.

Employment, Economic Dualism, and Regional Development

For most poor Filipino households, labor is the major economic resource over which they dispose. Clearly, income from labor depends on whether and how badly labor is required. As the experience of rapidly growing economies has shown, where employment is full, wages and salaries will be rising across a broad front. Reducing poverty, therefore, implies generating a large number of jobs and means of livelihood, especially in the better-paying formal sector, to employ hitherto abundant labor.

But how big is the unemployment problem? Table 17 presents the labor force participation rates and the unemployment and underemployment rates during the 1980s. The situation is straightforward: labor force participation rates have been rising, the unemployment rate remains high, and the underemployment rate is very high.[5]

Viewed together with Figure 8, Table 17 clearly shows that a reduction in the unemployment and underemployment results in a faster pace of economic growth. From this, it may be inferred that high and sustained economic growth is central to employment and poverty alleviation.

An ever-growing number of people join the labor force annually, while a considerable number remain unemployed or underemployed. As a result, real wages have not increased but have declined or remained constant. Real agricultural wages barely changed during the 1980s (Table 18). They stagnated in most regions, except for Central Luzon and Southern Tagalog which are closest to Metro Manila and, thus, are strongly influenced by its industrial wages and cost of living.

Real wages in agriculture have been relatively constant and substantially lower than the formally legislated minimum wage applied to large industrial firms. This suggests that agricultural labor is highly mobile, creating a large national pool of "surplus" labor. In

[5]The *labor force* refers to people of working age (15 years and above), who are either employed or unemployed. The labor force participation rate are these same people, taken as a proportion of the working age population.

People who have not worked at all during the week the survey was taken are regarded as unemployed. The underemployed, on the other hand, are people who worked less than the normal number of hours in a week, or who worked the normal number of hours but are still looking for work. The unemployment and underemployment rates, respectively, are the number of unemployed and underemployed people, as a proportion of the labor force.

Table 17
LABOR FORCE PARTICIPATION, UNEMPLOYMENT AND UNDEREMPLOYMENT RATES, 1981-1992

	Labor Force Participation Rate	Unemployment Rate	Underemployment Rate	
			A	B
1981	61.7	23.9	14.5	—
1982	60.1	9.4	25.5	13.9
1983	63.6	7.9	29.8	17.2
1984	63.5	10.6	36.4	22.5
1985	63.4	11.1	22.2	15.3
1986	63.8	11.1	28.4	17.8
1987	65.7	9.1	23.9	11.1
1988	65.4	8.3	23.6	11.4
1989	64.4	8.4	22.7	10.9
1990	64.5	8.1	22.6	13.9
1991	64.5	9.0	22.1	N.A.
1992	65.0	8.6		

Notes: Series A refers to those who worked for the reference quarter, but still wanted additional work, expressed as a proportion of the employed; Series B refers to those who worked less than 65 days in the quarter but still wanted additional work, expressed as proportion of the employed.

Source: National Statistics Office;
Balisacan, Arsenio M., "Urban Poverty in the Philippines: Incidence, Determinants and Policies."

contrast, real wages in industry have risen in the latter 1980s because of legislated or mandated increases, and because of more serious implementation by the government of the mandated minimum wages in recent years (Reyes and Sanchez 1990; World Bank 1992). Real wage increases in the industrial sector outstripped the small increases in labor productivity during the latter 1980s (Table 19 and Figure 11).

The government-mandated increases in real wages in the industrial sector, together with a significantly lower and relatively constant real wage rate in agriculture means the labor market is dualistic. This has led to greater reliance of industrial firms on temporary, casual, contractual and other flexible labor arrangements in the face of economic shocks. Coupled with poor infrastructure facilities and an overvalued peso, the higher real wages have reduced the country's international competitiveness in unskilled labor-intensive manufactures, slowed commodity diversification of exports, discouraged employment generation in the formal sector, and, thereby, delayed the increase in the market-determined real wage (i.e., elimination of the "surplus labor").

In view of this, government intervention in the labor market must be redirected away from minimum wage fixing and toward indicative wages based on productivity and differentiated according to industry and region (Intal and Sanchez 1993). There is an urgent need — even if temporary — for greater flexibility in labor arrangements, especially in the export sector. An option worth exploring is the temporary suspension of legal impediments to subcontracting arrangements.

In the current situation, it is easier for laborers to move across regions than to change sectors, especially from agriculture to industry. This has some implications on the country's development policy for the regions. With funds being scarce and with the urgency of the need to provide infrastructure facilities to attract investments, it is preferable *in the short run* to develop a few selected sites as "investment and export platforms" rather than to spread the resources thinly. The problem with such a course, however, is that it could exacerbate the already large disparities in average incomes among the regions described earlier. The current favorite investment sites will typically be those with higher incomes and better infrastructure (e.g., Calabar, Cebu, Subic, Cagayan de Oro-Iligan corridor, Davao City to General Santos City corridor, and Central Luzon). There are large differences in physical and social infrastructure among the various regions. As expected, Metro Manila is pre-eminent in almost all respects, road density, households with electricity, literacy rate and households with level III water supply. Other better-endowed regions are Central Luzon, Calabar, Ilocos, and, to a lesser extent, Central Visayas, Western Visayas, Northern Mindanao and Southern Mindanao.

A good strategy would be for government to further relax regulations and aggressively facilitate private sector participation in infrastructure investment in the selected investment and export areas. By promoting and

Table 18
WAGE RATES IN AGRICULTURE BY REGION, 1980-1991

Region		In Pesos at 1980 Prices				Index	
		1980	1985	1988	1991	1980	1991
I	Ilocos	11.05	11.05	11.06	11.05	100.4	100.3
II	Cagayan Valley	10.41	10.40	10.40	10.42	94.6	94.6
III	C. Luzon	12.13	12.12	12.14	12.12	110.2	110.0
IV	S. Tagalog	12.32	12.33	12.32	12.32	111.9	111.8
V	Bicol	10.92	10.93	10.93	10.92	99.2	99.1
VI	W. Visayas	10.42	10.41	10.42	10.42	94.6	94.6
VII	C. Visayas	10.21	10.19	10.21	10.20	92.7	92.6
VIII	E. Visayas	11.60	11.59	11.59	11.60	105.4	105.3
IX	W. Mindanao	10.23	10.23	10.23	10.22	92.9	92.8
X	N. Mindanao	10.87	10.85	10.86	10.88	98.7	98.7
XI	S. Mindanao	10.73	10.75	10.73	10.74	97.5	97.5
XII	C. Mindanao	10.80	10.79	10.81	10.79	98.1	98.0
PHILIPPINES		**11.01**	**10.99**	**11.00**	**11.02**	**100.0**	**100.0**

Figure 11
NON-AGRICULTURAL PRODUCTIVITY AND REAL WAGES

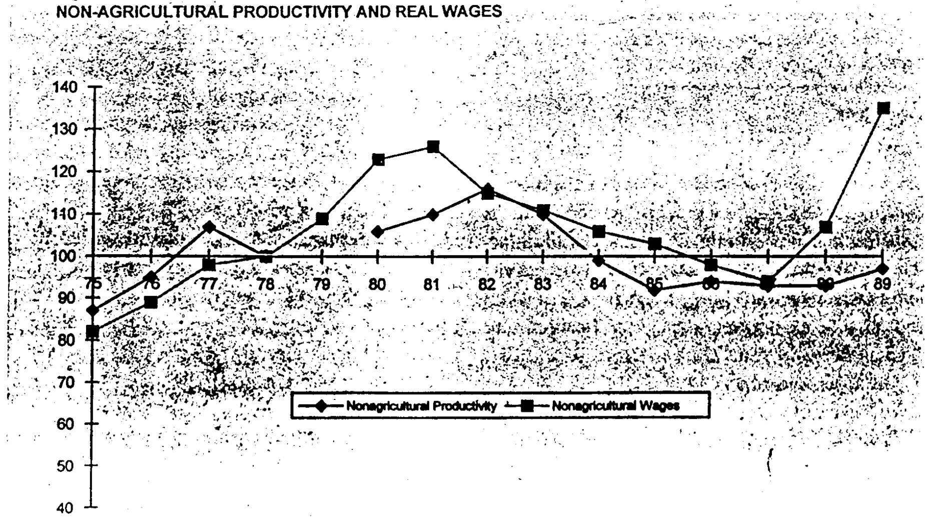


Table 19
INDEX OF AVERAGE LABOR PRODUCTIVITY
AND REAL LEGISLATED WAGES, 1975-1989; 1978=100

	Non-agriculture		Agriculture	
	Labor productivity[a]	Real wage[b]	Labor productivity[c]	Real wages[d]
1975	87	82	92	75
1976	95	89	101	n.a.
1977	107	98	108	96
1978	100	100	100	100
1979	n.a.	109	114	114
1980	106	123	109	132
1981	110	126	107	132
1982	116	115	111	122
1983	110	111	98	118
1984	99	106	102	111
1985	92	103	106	106
1986	94	98	103	106
1987	93	94	105	105
1988	93	107	109	125
1989	97	135	115	n.a.

[a]Average labor productivity in manufacturing, indexed at 1978=100.
[b]Legislated wages in real terms indexed at 1978=100. Wage includes cost of living allowances and 13th month pay.
[c]Average labor productivity in agriculture.
[d]Legislated wage in the plantation sector.

facilitating private sector involvement in these areas, the government may use a larger proportion of its resources to improve the physical and social infrastructure and significantly improve agricultural productivity in the more depressed regions (Regions V, VIII, IX, II and XII). Subcontracting arrangements may also be supported between firms in key selected investment and export zones and firms and households in the more depressed regions.

With the other measures discussed earlier, employment generation would be accelerated, interregional economic linkages strengthened, the country's international competitiveness enhanced, economic growth rate increased, and poverty incidence reduced.

Generating Income Growth and Combating Poverty

The policy insights from the previous discussion can be pulled together into a coherent package for generating income growth and combating poverty. The anti-poverty package can be decomposed into three major thrusts, namely:

Reviving the economy

This is an issue of stimulating the economy through fiscal and monetary policy. More than two years of macroeconomic stabilization program led to a virtual stagnation of domestic output and to declining per capita incomes. But now, the macroeconomic environment is finally conducive to moderate pump-priming by the government to help push economic recovery forward.

Currently favorable conditions include lower interest rates, single digit inflation, and a high level of international reserves. The energy crisis that plagued the country during the second half of 1992 and first half of 1993 had eased up significantly because of the aggressive pursuit since late 1992 of private investments in power generation. As more fast-track projects come on stream and the maintenance of existing power plants improves, power outages should become only intermittent throughout 1994, in contrast to the six to eight-hour power outages during the first half of 1993. The improved power outlook should give a one-time productivity boost toward increasing the capacity utilization in the industrial sector. A carefully calculated pump-priming of the economy should, therefore, have only minimal effects on inflation.

The economy should not be overstimulated, however. The present situation is no license to expand the public deficit indiscriminately. There is a need to control the total budget deficit,[6] lest economic stability is once more endangered by deteriorating government finances and frenzied borrowing. The debt service prob-

[6]This is the consolidated public sector deficit, which includes that of the national and local governments, public corporations, the Social Security System (SSS), Government Service Insurance System (GSIS), the Oil Price Stabilization Fund (OPSF), and the Central Bank, among others.

lem of the government remains critical; if a large deficit is financed from domestic borrowing, domestic interest rates could shoot up once more and create an unsustainable debt service spiral where the government needs to borrow more funds simply to pay off debt.

The national government should seek to finance any necessary increase in its deficit through long-term foreign loans, which are cheaper. In this respect, the Philippines' regained access to international commercial lending, hard-earned and costly as it was, should be fully utilized. Once more, a cautionary note: the government should resort to foreign borrowing to the extent that borrowing is *necessary at all*. Clearly, this does not rationalize indiscriminate foreign borrowing, nor foreign borrowing for the wrong purpose, such as that by the *Bangko Sentral* to prop up the exchange rate.

The aim of stimulating the economy is to nudge the private sector toward taking greater risks and putting in more investments, not to replace private with government initiative. Specifically, the appropriate pump priming program for the Philippines is as follows:

(a) *Aggressive promotion of both foreign and returning Filipino capital from abroad.* The country needs a big boost in the amount devoted to investment because many of its current industries, including agriculture, lag behind technologically. A rapid catch-up is needed if high growth and better global competitiveness are to be achieved.

Further, the expected large current account deficits in 1994 and succeeding years cannot be financed without substantial investments from abroad. Therefore, aggressive investment promotion and facilitation are *central* to economic recovery and sustained growth.

The remarkable surge in the stock exchanges in 1993 and the spate of foreign investment missions to the country are encouraging signs of stronger foreign investor interest in the country. But these positive points need to be consolidated by credible policies and tangible performances, lest they become no more than speculative bubbles.

(b) *Moderate relaxation of monetary targets in the short run.* Monetary policy under the various stabilization programs has up to now been restrictive. This is inappropriate if the aim is to shift over to a mode of growth. More relaxed monetary targets will allow a reduction in the reserve requirements and a lowering of interest rates to boost investments, and a depreciation of the peso to push exports. They will also allow the national government, if necessary, to draw down some of its deposits with the central bank to help finance the incremental budget deficit.

(c) *Easier budgets to finance focused and targeted social expenditures.* Budgetary support is required for health, nutrition, food, housing, and education for the most vulnerable poverty groups. A targeted poverty alleviation program strengthens the political support for needed structural reforms.

(d) *Improvements in tax administration and tax enhancements.* Improved tax administration is long overdue and should be the preferred means of closing the fiscal gap. At the same time, a larger take in the right taxes should help dampen expectations, lest prices start increasing rapidly with an easier monetary policy.

(e) *Facilitation of private investments and official development assistance (ODA) expenditures in infrastructure and utilities development.* Greater flexibility is needed in the use of ODA to strengthen match-ups between private investments and ODA funds for the government's infrastructure program. This involves greater reliance on more realistic utility pricing, user charges for infrastructure projects, and probably some degree of liberalization (at least for a given period) on foreign equity participation and rates of return restrictions in the utilities industry.

(f) *Active and reliable communication on the state of power and infrastructure development and the state of peace and order.* The aim should be to reduce uncertainty among investors and encourage private investments both in industry and agriculture.

The time is ripe for the government to prod the economy toward economic recovery. In contrast to classical pump-priming programs of make-work infrastructure projects, it may be more appropriate is focus on prudent easing up of monetary and fiscal ceilings, targeted poverty alleviation, aggressive investment facilitation and promotion, pro-active communication, and improved tax administration. The prudent easing up of fiscal and monetary policies in the short run would not induce a debt service spiral if the incremental budget deficit is financed from abroad.

Sustaining high growth

Growth will be sustained and will become equitable only if structural and sectoral policy reforms push through. Philippine economic growth in the past could not be sustained because government policies did not encourage a drive for productivity, efficiency and international competitiveness. This was fatal in the light of large-scale restructuring and relocation of industries in Japan and other countries in East Asia. Industrial advantages were rapidly lost, gained, or redistributed in the 1970s and the 1980s, but the Philippines was largely left out in the process owing to instability and the long-term decline in productivity.

In addition, the path of growth the country took did not encourage greater equity in the distribution of income; instead it heightened inequity. This was because past strategies failed to emphasize enough use of labor and land, the country's relatively more abundant resources. Instead, they encouraged the use of capital and non-renewable resources. By contrast, a strategy based on using labor and land would be more efficient, productive, and equitable, with a greater dispersal over the countryside. If the relative scarcities of factors of production are reflected in their prices (wages, rents, interest rates, and others.) then domestic and foreign investments would, of themselves, flow in areas with the highest impact on employment and output.

Since 1986, the Philippine government has pursued a program of structural and sectoral reforms toward a more open and competitive economy and a stronger and more stable macroeconomic environment. Fits, starts, and occasional uncertainty notwithstanding, a significant amount has been accomplished. Thus, for example, the the financial sector was substantially deregulated, the tariff and nontariff systems rendered more uniform and less protectionist, the foreign investment regulatory regime substantially liberalized, and foreign exchange market virtually freed. The Philippines now compares favorably with a number of developing countries in terms of economic openness, outwardness, and extent of deregulation of the economy (World Bank 1992).

Nevertheless, while semi-skilled and professional Filipino labor is inexpensive compared to the rest of East Asia, the wages of unskilled production labor — which is important for the export of unskilled-labor intensive goods which seems to be at the heart of the initial take off toward industrialization — have become comparatively higher than those of China, Vietnam, Indonesia, Sri Lanka and a few other countries. This worrisome trend is helped along by the continuing strength of the peso, which also makes domestic wages look high in comparison with those of competing countries.

As a result, the Philippines is slowly being squeezed out of the unskilled labor-intensive exports by lower cost, labor abundant countries like China and Indonesia. The Philippines may, therefore, have to focus instead on semi-skilled labor intensive industries (e.g., high-end garments; metal-based and engineering-based industries; and electronics). However, to compete in these areas *vis-a-vis* Thailand, Malaysia, Singapore and others, the country needs a vastly improved infrastructure including telecommunications, a vibrant domestic economy for economies scale and for cushioning the fluctuations in the export market, and more efficient and stable government procedures, rules, and regulations. Without such efficient complementary factors, not much will change from the present where the country instead *exports* its semi-skilled labor to the rest of the world rather than uses it at home.

The Philippines needs to push its structural and sectoral reform program further to maintain economic growth at a rate much higher than population growth. The following are the key components of this reform program:

(a) *Peso depreciation.* Changes in the exchange rate have been extremely contentious in the past because of their effects on prices and real incomes. But there can be no getting around the fact that the country's price competitiveness has deteriorated seriously *vis-a-vis* China and Indonesia (Figure 9).

A depreciation can help remedy this, as well as improve the country's competitiveness *vis-a-vis* Thailand and Malaysia.

A depreciation can be accomplished primarily through astute and pro-active monetary management.

(b) *Attracting domestic and foreign private investments in infrastructure and utilities.* This means acceleration of the current policy direction toward investment liberalization and competition measures in utilities (including inter-island shipping). Perhaps, restrictions on foreign equity participation in utilities can be liberalized for a certain period of time (i.e., with a sunset clause). There may also be a need for greater flexibility and streamlined procedures for project evaluation and approval, as well as deregulation in utility pricing.

(c) *Further refinements of the tariff structure.* The purpose is to ensure that Philippine industries with export potential are not unnecessarily taxed (jewelry is an example) compared with the competing industries in other countries. There is a need to determine how the Philippine tariff structure can be harmonized with those of relevant countries in the region, such as Thailand and Indonesia.

d) *Stronger cooperation between labor, management, and government.* As the economy becomes more open and competes with the rest of the world economies, especially of East Asia, it will become increasingly evident that in many respects the Philippine management and labor groups compete with the management and labor groups of the rest of the world (especially East Asia).

Fostering industrial peace and enhancing labor-management cooperation toward greater agro-industrial productivity and competitiveness would necessitate some redefinition of government intervention in industrial relations (Intal and Sanchez 1993). Specifically, this would mean a deemphasis on mandatory wage fixing and a greater emphasis on (i) private sector collective bargaining as the mechanism for wage adjustments and (ii) human resource development role of the workplace. There may be a need for a "social compact" in which the key roles of the government, employers and workers are indicated and agreed upon. The role of the government includes responsible fiscal and monetary policies, strong focus on employment creation, more efficient bureaucracy, market friendly regulations, effective intermediation between employers and workers, and tapping unions as agents of government poverty alleviation programs. The role of firms includes (i) investment in upgrading labor skills and better technology to raise labor productivity and (ii) investment in improved work environment. The role of labor unions is responsible unionism with an economy-wide view of labor's basic interests.

(e) *Focus on agricultural productivity and countryside development.* The deterioration in international competitiveness of the Philippines during the 1980s was not only in industry but also in agriculture. Improved agricultural productivity would help stabilize food prices, dampen increases in wage costs, and reduce overall inflationary pressures in the economy. Since most of the poor are in the rural areas and are involved in agriculture, addressing poverty and raising income growth necessitate improving agricultural productivity and farm incomes. Given the limited budgetary resources, there is a need to redirect the agricultural budget away from subsidies in grain purchases and sales through the National Food Authority and toward increased expenditures in irrigation and agricultural research. Improvements in agricultural service administration and in the organization of the agricultural research and extension system are also needed. (David, Ponce and Intal, 1993.)

Countryside development involves not only improving rural infrastructure but also pro-active government technical assistance to small- and medium-scale firms in the regions and in the countryside. A more aggressive pursuit of job subcontracting to the regions will help strengthen the market base for the small- and medium-scale firms in the countryside. The development of these firms in the countryside, which is the essence of rural industrialization, increases the nonfarm incomes of rural households. Thus, with higher farm and nonfarm incomes of the rural households, rural poverty can be substantially reduced.

(f) *Further streamlining of the government bureaucracy.* In addition to improvements in tax effort through tax enhancements and better tax administration (including more effective measures against tax evasion), it is important to streamline further the government bureaucracy. Given the budget constraint, the present size of the bureaucracy has resulted in the stagnation of real incomes of public sector employees at a very low level compared with those of the organized private sector. As a result, it is difficult to attract and maintain good and well-trained persons in the government. Poor governance has many side-effects, a poorly performing and poorly paid bureaucracy exacts substantial transactions costs from private business, and this contributes to the poor international competitiveness of the country. Thus, it may be better to have fewer but better paid government personnel. This calls for government reorganization, streamlining, and redefinition of the nature of governance toward greater reliance on private initiative, decentralization, market- based regulation, greater accountability, and cost effectiveness. In this regard, the more specific recommendations of the Department of Budget and Management-Philippine Institute for Development Studies (DBM-PIDS research project (Taguiwalo, forthcoming) are worth considering.

(g) *Continuing reform of property rights, including agrarian reform, and investments in resource regeneration.* The policy direction toward community resource management and social forestry helps encourage more responsible utilization of natural resources. When the benefits of improved resource management are more directly felt and (as under social forestry) largely privatized, then the so-called "tragedy of the commons" is negated and the incentive to resource conservation, regeneration or improvement is strengthened. Nevertheless, given the magnitude of resource degradation in the country, a substantial portion of the investment for resource regeneration would have to be shouldered by the government. Investment in resource regeneration has good side effects (e.g., slower erosion rate), hence, taxation to finance public investments in resource regeneration is meritorious. In addition, to strengthen further the incentive structure toward resource conservation and regeneration, it is important to implement more appropriate pricing of resource extraction to account for externalities.

Targeting poverty alleviation measures for the most vulnerable poverty groups

This primarily involves social expenditures, food subsidies and livelihood programs. Because poverty is pervasive in the Philippines, the broad-based measures of reviving and restructuring the economy to make economic growth more sustainable are central to the anti-poverty program. Nevertheless, poor households have varying capabilities and opportunities to benefit from economic growth. Indeed, many of them may even be adversely affected during the process of structural reform. Thus, hand in hand with efforts at improving overall economic growth and structure, there should be a well-thought out targeted poverty alleviation program aimed primarily at the poorest of the poor (core poor). The program would include food subsidies to the core poor to eliminate serious malnutrition, basic maternal and child health care, education subsidies (e.g., tuition, books, and others) to very poor children to prevent forced dropouts in the primary and elementary schools, basic water and sanitation facilities, especially in congested urban slums, and small livelihood grants to cooperative groupings of the more entrepreneurially inclined very poor households.

Lessons from poverty alleviation projects (PAP) undertaken by nongovernment organizations show that successful PAPs necessitate long term, highly focused, participatory and flexible interventions (with a heavy dose of capability building measure) given the heterogeneity of poor households (Imperial et al. 1993). Government poverty alleviation programs may have to be drastically redesigned, from a focus on sectoral programs undertaken by the various departments toward a focus on specific groups of poor households. The poverty alleviation program has to be area-based and its implementation highly decentralized. Thus, the logical implementors of the poverty alleviation program are the local government units (LGUs) rather than the central government departments. The challenge for the LGUs and the national government is how to pull together national and local government programs and resources into a coherent, focused and integrated program of intervention to the area-defined targeted poor households.

The defining characteristic of the program is that it is limited and targeted. Given the magnitude of the poverty problem in the Philippines, a very ambitious and broad-based poverty alleviation program requires enormous budgetary resources, which could endanger the objectives of prudent fiscal policy and macroeconomic stability. The significant adverse effect of large public sector Philippine Assistance Program (PAP) subsidies on the budget and on the macroeconomy has already been demonstrated in some countries (e.g., Egypt). Thus, the poverty alleviation program should largely be a supplement to, rather than substitute for, the macroeconomic recovery and reform program.

Appendix 2.1
MONITORING THE STATE OF INCOME

There is a fairly elaborate and extensive system of monitoring and gathering information on the state of income in the country at present, given the centrality of income as measure of economic development and indicator of poverty. However, this system is geared for national and regional data only. There is as yet no systematic mechanism to monitor the state of income and welfare of selected poverty groups. Thus, the challenges are how to refine and decentralize further the monitoring of the state of income and its determinants and how to institutionalize a mechanism of monitoring the state of income and welfare of selected poverty groups that are of policy interest to the government.

Monitoring National and Regional Income

The three most important tools for measuring the state of income are the national and regional income accounts, the family income and expenditures survey, and the household labor force and employment surveys. The national and regional income accounts provide the summary measures of national and regional production, income, and expenditures. The national income accounts are estimated annually and (with greater errors) quarterly. The regional income accounts are estimated only annually and with a much greater lag than the national income accounts because of the greater difficulty of generating relevant regional data.

The family income and expenditures survey offers rich information on the level and sources of household incomes and the level and distribution of household expenditures. This is currently the primary source of data for the official estimates of poverty incidence and income distribution. However, the survey is undertaken every three years only; as such, it cannot be used to monitor the state of income of households more frequently. Ideally, the survey should be undertaken annually; however, the national statistics office faces severe funding constraints. The third most important survey, the labor force survey, is undertaken much more frequently, i.e., every quarter. The survey sample is much more limited than that of the family income and expenditure survey. Nevertheless, in principle, the labor force survey can be tapped to provide interim indicators of the state of household incomes at the national level.

Refinements of the three measurement tools described above may center on strengthening the measures of productivity and on improving the sampling frames to make the estimates more internally consistent. To have more readily available measures of productivity, estimates of the value of capital stock and employment can be included as an adjunct to the national income accounts.

Monitoring Income and Welfare of Poverty Groups

This is where the major challenge lies. While there are ad hoc and recurrent surveys of poor groups by nongovernment organizations (NGOs) and by the Department of Social Welfare and Development, there is no systematic mechanism to monitor, on a regular basis and in a statistically sound way, the state of income and welfare of the poor, especially the very poor. Funding constraints, lack of effective demand for such data from the government agencies, and probably even difficulties in establishing sampling frames are the most important reasons for the failure to institutionalize a monitoring mechanism on the state of income and welfare of the very poor.

There may be three approaches to gathering systematic information on the very poor on a regular basis, namely: panel data, area-based survey, and community-based census. A panel data of a limited sample of households nationwide can provide important insights on the process of social transformation or degeneration of the very poor. It may not be easy, however, to establish sampling frames for representativeness because the very poor tend to be more mobile and hold several "jobs." The area- based survey is useful for the preparation of the area-based poverty alleviation program of the LGUs. The community-based, community-managed census requires a much simpler questionnaire and may focus solely on indicators (not estimates of level) of income and welfare in order to minimize response errors. The census will be useful for poverty alleviation program design at the local level (i.e., provincial down to the barangay level). The experience on basic minimum indicators (BMI) of Thailand and of the United Nations Children's Fund (UNICEF) (CPAP/UPCA 1992) indicate that a community-based, community-managed census and an area-based survey are workable and useful.

The Presidential Commission to Fight Poverty (1993) has put forward a set of minimum basic needs (MBN) indicators to measure the level of welfare of poor households. These indicators have been recommended for adoption and implementation by the 1993 National Workshop on Poverty Alleviation and Countryside Development. The indicators measure the state of poverty, nutrition, health, food consumption, housing, water and sanitation, basic maternal and child care, basic education and people's participation.

Aside from monitoring MBN indicators, it is useful to monitor changes in the determinants of the level of income and welfare of the very poor in order to have a deeper understanding of the coping mechanisms and the social transformation process of the poor. Is there a definable poverty ladder? How transitory or permanent is the poverty condition of the very poor households? How are their resource endowments changing? These are possible questions that may be addressed by a longitudinal study of panel data, which can be more detailed than the area-based survey and the community census in order to help probe household behavior and environmental constraints to poverty alleviation.

In sum, it is recommended that a system of monitoring the MBNs and state of income and welfare of the poor households be institutionalized at the national and local levels through panel data, area-based surveys and community-based, community-managed census, in addition to the family income and expenditure survey.