Chapter VIII

Philippines: Reforms Reveal Results

1. Economic Reforms under the Aquino Administration

(1) The Inherited "Minus-Assets"

The Philippine economy is now back on track toward sustainable growth, following years of recession in the first half of the 1980s. This turnaround owes to the success of reforms promoted under the administration of Corazon Aquino, who came into power in February 1986, and to that of Fidel Ramos, who took over as her successor in June 1992.

Aquino stepped into office with the burden of rebuilding the economically devastated and socially chaotic nation left behind by Ferdinand Marcos. Political stability and economic reconstruction were immediately set in place as policy objectives. In short, Aquino started from behind with the task of settling the political and economic debts the Philippines had inherited. This task also involved an examination of the failures of Marcos' government-led development policy.

This government-led development policy in the Philippines as in other developing countries of Asia in the 1970s, was carried out under martial law as proclaimed in 1972. A positive open-door policy was adopted with an eye on overseas markets, while foreign direct investment was encouraged to promote export-oriented industrialization. This was also a policy shift toward strengthened economic relations with Japan as post-World War II free-trade relations with the United States came to an end. At the same time, the Philippines openly received foreign assistance to establish a social infrastructure, as symbolized by its "rice and roads" program.

When martial law was first proclaimed, Marcos called for "reforms from the center" and "the end of oligarchy," and indicated ambitious policy guidelines that proclaimed, among others, the Decree of Land Reform. Under his long-running dictatorship, however, everything eventually came under the control of Marcos and his cronies. They monopolized the markets for products, eg. sugar, coconuts and other produce, while raising the number of inefficient government corporations in the financial market, both through intervention. With the high global interest rates at the beginning of the 1980s, this brought to the surface the accumulated debt problem in the Philippines. The government-led business development policy ended in failure.

The assassination of Senator Ninoy Aquino in August 1983 threw the nation into political chaos and triggered capital flight. By October, the central bank had declared a moratorium on the repayment of principal on external debt, leading to a foreign currency crisis. The economic world lost confidence amid the political chaos. The spiraling political and economic confusion under the Marcos administration brought the Philippine economy to its knees in the first half of the 1980s. The burden, in the end, had to be shouldered by the Philippine people: layoff soared. Anti-government sentiment reached its peak and, in February 1986, the "people power" movement toppled the Marcos administration and put Aquino into office.

(2) Introduction of Deregulation Policy

As noted earlier in this section, the tasks of the Aquino administration were to promote political stability and economic reconstruction. As for the former, the administration first enacted a new constitution to eliminate the possibility of any administration seizing a long-term grip on power. For a national reconciliation among its people, the administration temporarily made peace with anti-government forces both inside and outside of congress. This, however, met with resistance from supporters of the former government, so the results were limited and the same problems remained when the Ramos administration took over.

In the area of economic reconstruction, the Philippines sought relief from its foreign currency crisis with support from the United States, Japan, and other foreign governments, as well as from international financial institutions in the form of softer terms for debt restructuring and new loans. As part of the plan, an economic development policy based on deregulation, liberalization and decentralization was introduced. This policy, taking into account the failure of the government-led economic policy under the Marcos administration, called for (1) strong free markets, (2) private-sector-led economic development, (3) creation of work opportunities in rural areas, and (4) strengthening of labor-intensive export industries.

Economic reconstruction, envisioned along these lines, was embodied in the Medium-Term Development Plan (1987-1991).

These economic reforms by the Aquino administration, were actually carried out under a structural adjustment policy. The economic recovery loan (ERL) from the World Bank in 1987 were structural adjustment loans (SAL). In extending the US$310 million SAL, the World Bank stipulated that one of the conditions for policy dialogue would be for the liberalization policy to serve as the basis for macroeconomic management in the Philippines. The policies carried out under ERL promoted (a) trade liberalization, e.g., import liberalization and lower tariffs; (b) tax reform, e.g. introduction of a value-added tax to replace the sales tax; (c) industrial policy, e.g. streamlining of the investment promotion policy; (d) public investment plans, e.g. a revised Medium-Term Public Investment Program (MTPIP) with a shift in emphasis toward agricultural/rural development, education and health; and (e) reform of government financial institutions whose lending operations were crippled by non-performing loans that amounted to 80% of all assets (including the Philippine National Bank (PNB), the Development Bank of the Philippines (DBP) and six commercial banks with government dealings).

The structural adjustment policy under the Aquino administration was supported not only by SAL, but also by sector adjustment loans (SECAL). A privatization policy, an important part of structural adjustment, was facilitated by a US$200 million SECAL from the World Bank in 1988, aimed at promoting the reform of government corporations. Thus, a number of privatization plans were drafted and enforced under the Aquino administration, including plans for the privatization of government-owned and/or -controlled corporations (GOCC) by the Committee on Privatization (COP); transfer of the non-performing assets of PNB and DBP into an Assets Privatization Trust (APT); and the establishment of the Presidential Commission on Good Government (PCGG) to recover the assets illegally acquired by Marcos' family and his cronies. These policies have been continued under the current Ramos administration.

The greatest achievement related to trade and investment liberalization was the enactment of the Foreign Investment Act in 1991, which led in principle to the liberalization of foreign direct investment.

(3) Economic Stagnation Returns under the Stabilization Policy

If the achievements of economic reform under the Aquino administration are judged by the economic conditions in the latter half of the 1980s (1986-1990), one can see a return to sustained growth of 4.7% per annum in GDP terms. By sector, manufacturing held strong at 5.0%, supported by growth of 2.7% in agriculture, forestry and fisheries. In terms of expenditure, capital formation recovered all the way to 16.1%. Exports, however, got off to a late start, registering 9.7% growth.

Neighboring Asian countries began expanding their exports with the appreciation of the yen after the Plaza Accord of 1985, but Philippine exports were lackluster as a result of sluggish direct investment in earlier years under the Marcos administration. The strong yen, however, had an impact on the increase in foreign investment thereafter. In 1988, the net direct investments reached US$986 million, triple that of 1987. This increase was driven by a sense of hope under the new Aquino administration and by direct investment of US$806 million through debt-equity conversions. The years from 1989 were also marked by an increase in the influx of portfolio investment, which amounted to US$386 million in 1989.

Economic indicators during this period changed. First of all, external debt as a share of GNP, which reached its peak of 96.6% in 1986, declined steadily thereafter. Short-term debt as a share of external debt also dropped, down from the 40-50% range in the first half of the 1980s to the 10-15% range from 1989.

This easing of the debt burden with support from international financial institutions was a positive trend. Improvements in other economic indicators, however, were slow to occur. In terms of reducing the fiscal deficit, priority on alleviating poverty and other areas left the fiscal situation unimproved. The Consolidated Public Sector Deficit (CPSD), a measure not only of the fiscal balance of the national government, but also of the balance of 14 government-supervised corporations, the Oil Price Stabilization Fund, government financial institutions and the central bank, increased to 51 billion pesos, or 4.7% of GNP, in 1990. The current balance deficit also increased, shooting upward to 5.5% of GNP in 1989. This exposed a structural weakness in the Philippine economy, i.e. that the trade deficit would expand with an increase in imports accompanying economic recovery. The increase in interest rate on treasury bills, a reflection of inflation-driven high interest rates, brought an increase in interest payments as a share of expenditure from the national government budget. This had the negative effect as reducing the budget for economic activities. Furthermore, while the external debt problem had been resolved, domestic debt became an issue. As a result, construction of infrastructure closely linked to production, e.g. power generation plant renovation and irrigation construction and rehabilitation, was postponed. This turned out to be an underlying cause of the power crisis that resulted in frequent brownouts for three consecutive years from 1990.

The economy, while bouncing back in the latter half of the 1980s, was troubled in 1990 by resistance from supporters of the former government and by seven failed coup attempts under the Aquino administration, which lacked political leadership. The increase in new investments came to a halt. Then during the Gulf War in 1991, an economic stabilization policy was introduced, placing more priority on stability than on growth, but the belt was tightened too much and the economy worsened again.[1] The Philippine people became frustrated and closed the curtain on the Aquino administration.

2. Economic Reforms under the Ramos Administration

(1) The "Philippines 2000" Initiative

Ramos succeeded Aquino in June 1992 and continued to promote economic reforms in line

Table 8-1 Targets under the Medium-Term Philippine Development Plan (1993-1998) of the Ramos Administration

(GDP Growth Rate by Industrial Origin) (Unit: %)

	1993	1994	1995	1996	1997	1998	1993-98 Annual Average
Agriculture, Forestry, Fisheries	2.0	2.2~2.7	2.4~3.0	2.8~3.5	3.0~3.8	3.2~4.2	2.7~3.4
Industry	1.8	4.7~5.7	5.2~7.9	6.1~9.1	8.0~9.7	8.9~11.4	6.6~8.8
Manufacturing	0.7	4.6~5.5	5.0~8.2	6.0~9.5	8.0~10.0	8.9~11.8	6.5~9.0
Mining and Quarrying	0.7	5.0~5.5	5.2~6.5	5.5~7.0	6.5~7.5	7.5~8.5	5.9~7.0
Construction	6.7	5.0~6.8	6.0~8.0	7.0~9.0	9.0~9.8	9.5~11.3	7.3~9.0
Electricity, Gas, and Water	2.9	5.1~6.0	5.5~6.1	6.0~6.8	7.5~7.8	8.5~9.0	6.5~7.1
Service	2.1	3.0~4.3	4.1~6.4	5.3~7.5	9.0~9.8	9.8~10.0	6.2~7.8
Gross Domestic Product (GDP)	2.0	3.4~4.4	4.1~6.2	5.0~7.2	7.4~8.5	8.1~9.8	5.6~7.2
Gross National Product (GNP)	2.4	3.5~4.5	4.0~6.5	5.0~7.5	7.5~8.5	8.5~10.0	5.7~7.4
Per Capita GNP (US$)	838	904~913	936~967	986~1,044	1,066~1,139	1,165~1,262	1,011~1,065
Inflation Rate	7.6	9.0~10.0	6.5~6.5	5.0~5.0	5.0~5.0	4.0~4.0	5.9~6.1

(GDP Growth Rate by Expenditure Share) (Unit: %)

	1993	1994	1995	1996	1997	1998	1993-98 Annual Average
Personal Consumption	3.0	3.0~3.8	3.3~4.0	3.5~4.5	4.5~4.8	4.7~5.0	3.8~4.4
Government Consumption	-7.0	8.3~8.5	5.5~6.1	6.0~7.0	6.3~7.3	6.5~7.5	6.5~7.3
Investments	10.1	8.3~9.3	9.9~10.7	10.8~11.7	12.8~13.8	13.5~15.0	11.0~12.1
Exports	6.2	13.2~14.0	14.5~16.0	15.7~16.5	17.7~18.3	18.5~19.3	15.9~16.8
Imports	13.0	8.5~9.5	11.5~9.5	13.4~10.5	14.3~13.8	15.5~14.0	12.5~11.5
Gross National Product (GNP)	2.4	3.5~4.5	4.0~6.5	5.0~7.5	7.5~8.5	8.5~10.0	5.7~7.4

Note: 1985 Prices
Source: Medium-Term Philippine Development Plan, 1993-1998.

with the reconstruction plans of the previous administration. The above-mentioned deregulation and decentralization were economic policies common to both the Aquino and Ramos administrations. Recognizing political stability to be an essential precondition of both these policies, the Ramos administration worked to build public consensus toward priority on development by holding an economic summit in 1993 and drafting a Social Reform Agenda in 1994. This likewise reflects an awareness that improving economic standards would lead to greater political stability.

At the heart of this public consensus-building effort is the "Philippines 2000" initiative, a national campaign to raise economic standards in the Philippines to the level of its newly industrializing neighbors in Asia by the year 2000. This initiative is built on the Medium-Term Philippine Development Plan (1993-1998), which calls for average GDP growth of 5.6-7.2% (GNP growth of 5.7-7.4%) per annum, to be led by exports which are projected to increase at 15.9-16.8% per annum (Table 8-1). In short, the economic development strategy under the Ramos administration aims to achieve a positive cycle of increased exports → increased imports → increased direct investment → improved productivity → strengthened export competitiveness → increased exports. Toward this end, it became urgent to lower tariffs to encourage imports and to establish an attractive business environment for direct investment, especially for foreign investment. The major economic laws and executive orders enacted under the Ramos administration (Table 8-2) show that these goals are clearly being pursued. As under the Aquino administration, these economic reforms were carried out within the framework of a structural adjustment policy through dialogue with international financial institutions. Specifically, assistance came in the form of an Expanded Fund Facility (EFF) from IMF and financial structural adjustment loans (FSAL) from the World Bank, among others. When the new central bank law was enacted in 1994, a US$300 million FSAL was received from the World Bank. The liberalization of foreign banks in 1994, to be mentioned later, was facilitated by a US$475 million EFF.

(2) Promotion of an Attractive Business Environment

The reforms carried out when Ramos took office were designed to address the power crisis. They included An Act Creating the Department of

Table 8-2 Major Economic Laws and Executive Orders Enacted under the Ramos Administration

RA: Republic Act ( ): Date of enactment EO: Executive Order

Economic laws	Economic executive orders, etc.
· Electric Power Crisis Act of 1993 (RA No. 7648, 5 April 1993) · The Investor's Lease Act (RA No. 7652, 4 June 1993) · The New Central Bank Act (RA No. 7653, 14 June 1993) · An Act Extending the Life of the Committee on Privatization (COP) and Asset Privatization Trust (APT) (RA No. 7661, 23 December 1993) · The Expanded Value-added Act (EVAT) Law (RA No. 7716, 5 May 1994) · Build-Operate-Transfer (BOT) Act (RA No. 7718, 5 May 1994) · The Foreign Banks Liberalization Act (RA No. 7721, 18 May 1994) · The Special Economic Zone Act of 1995 (RA No. 7916, 24 February 1995) · The Agricultural Tariffication Act (RA No. 8178, 28 March 1996) · The Official Development Assistance (ODA) Act of 1996 (RA No. 8182, 11 June 1996) · An Act Amending the Internal Revenue Code (RA No. 8240, 22 November 1996)	· Foreign Exchange Liberalization (The Central Bank's Circular No. 1353, 24 August 1992) · Tariff Reductions on Capital Goods (EO No. 189, 18 July 1994) · Tariff Reductions on Apparel, Garment, Chemical Products (EO No. 204, 30 August 1994) · Tariff Reductions on Manufactured Goods (EO No. 264, 22 July 1995) · Modifying the Rate of Duty on Certain Imported Goods to Implement the Philippine Schedule of Tariff Reduction under the CEPT·AFTA Scheme (EO No. 287, 12 December 1995)

Table 8-3 Major Economic Indicators of the Philippines (1991-1996)

	Unit	1991	1992	1993	1994	1995	91-95 (Annual average)	1996
Real GDP Growth Rate	%	-0.6	0.3	2.0	4.4	4.8	2.2	5.5
Sector								
Agricultural, Forestry, Fisheries	%	1.4	0.4	2.1	2.6	0.8	1.5	3.1
Industry	%	-2.7	-0.5	1.6	5.8	7.0	2.2	6.3
(of which Manufacturing)	%	-0.4	-1.7	0.7	5.0	6.8	2.0	5.5
Service	%	0.2	1.0	2.5	4.2	5.0	2.6	6.0
Expenditure								
Personal Consumption	%	2.2	3.3	3.0	3.7	3.8	3.2	4.6
Government Consumption	%	-2.1	-2.1	6.2	6.1	5.3	2.9	2.9
Capital Formation	%	-17.3	7.8	7.9	8.7	3.0	1.5	18.4
Exports	%	6.3	4.3	6.2	19.8	12.0	9.6	23.9
Imports	%	-1.1	8.7	11.5	14.5	16.0	9.7	21.2
Current Balance	$1 million	-869	-868	3,016	-2,950	-3,297		N.A.
versus GNP	%	-1.9	-1.6	-5.5	-4.5	-4.3		N.A.
Consolidated Public Sector Deficit(1)	10 billion pesos	-26.0	-25.9	-30.1	-18.3	N.A.		N.A
versus GNP	%	-2.1	-1.9	-2.0	-1.0	N.A.		N.A.
International Reserves (yearend)	$1 million	4,470	5,218	5,801	6,995	7,632		11,620
External Debt (yearend)	$1 million	29,956	30,934	34,282	37,079	37,778		N.A.
versus GNP	%	65.0	56.9	62.0	56.4	49.6		N.A.
Of which Short-Term Debt	$1 million	4,827	5,256	5,035	5,197	5,279		N.A.
Short-Term Debt Share	%	16.0	17.0	14.7	14.0	14.0		N.A.
Debt Service Ratio(2) (DSR)	%	19.5	17.0	17.1	17.1	16.0		N.A.
Treasury Bill Interest Rates(3) (annual average)	%	21.478	16.018	12.448	12.714	11.761		N.A.
Inflation Rate (annual average) (Consumer Price Index)	%	18.7	8.9	7.6	9.0	8.1		8.4
Foreign Exchange Rate (annual average)	Peso/dollar	27.479	25.515	27.120	26.417	25.714		26.216

Note 1: Total balance for the public sector, including national government, government financial institutions, central bank, local government, and Oil Price Stabilization Fund
Note 2: Serviced debt as a share of exported goods and services
Note 3: Average interest for 91 days, 182 days and 364 days
Source: Bangko Sentral ng Pilipinas, "Selected Philippine Economic Indicators, February 1997," etc.

Energy in 1992 and the Electric Power Crisis Act of 1993. As priority was also placed on ensuring public peace, the Presidential Anti-Crime Commission (PACC) was established. Major advances were also made in peace negotiations with anti-government forces. In October 1995, participants in past coup attempts were eventually granted amnesty. In September 1996, a peace agreement was signed with the Moro National Liberation Front (MNLF), an Islamic anti-government armed group based in Mindanao.

To set up an attractive business environment that would induce foreign direct investment, Ramos took various measures to follow up on the Foreign Investment Act enacted by Aquino in 1991 to liberalize foreign direct investment. These measures included the liberalization of foreign exchange in 1992, which allowed foreign currency holdings by exporters, and the liberalization of market entry by foreign banks in 1994, under which 10 new foreign banks were allowed to set up branches providing full banking service.

The opening of these branches came nearly half a century after the enactment of the General Banking Act in 1948. Two Japanese banks were among those that set up new branches in Manila.

This triggered competition among the new branches as well as the domestic banks toward lower interest rates, while promising to entice foreign businesses to the country. Under the Foreign Banks Liberalization Act, trade and investment increased with the countries where these banks had their headquarters. According to a survey by the central bank, direct investment related to these 10 foreign banks amounted to 57.3 billion pesos from 1995 to June 1996. Furthermore, the loan balance to local businesses was 3.8 billion pesos.[2)] The bureau in charge at the central bank expects it will take three years for the results of the Foreign Banks Liberalization Act to appear fully. It is hoped that market information will be provided not only to investors from the countries where the banks have their headquarters, but also to locally based traders.

In terms of tariff reductions, which aim to boost productivity through strengthened national competitiveness, the full implementation of a tariff reform program was announced in 1994. A series of executive orders and laws were established to reduce tariffs, first of all, on capital goods, second, on apparel, garment and chemical products, and third, on manufactured products. After 2004, there will be a uniform tariff of 5.0% on all manufactured goods. These measures were declared unilaterally and apply to all WTO members. As a member of the Association of South East Asian Nations (ASEAN), the Philippines has drafted a schedule for other additional tariff reductions through the Common Effective Preferential Tariff (CEPT) scheme aimed at establishing an ASEAN Free Trade Area (AFTA) by the year 2003.

3. Reforms Reveal Results

(1) Back on Track toward Sustainable Growth

The Philippine economy in the first half of the 1990s (1991-1995) has got back on track to recovery under the Ramos administration. Over this period, the GDP growth rate has averaged 2.2% per annum, increasing in each of these years. Compared with the previous year, the rate was 4.4% in 1994, 4.8% in 1995, and 5.5% in 1996, showing sustained growth (Table 8-3). This economic recovery is the result of economic reforms carried out under both the Aquino and Ramos administrations.

A sectoral examination of the factors behind

Table 8-4 Share of Exports by Product (1990-1995)

(Unit: %)

	1990	1991	1992	1993	1994	1995	90-95 Change in share
Manufactured Goods of which	69.7	72.4	74.3	76.7	78.7	79.5	+9.8
Electrical/Electronic Equipment/Parts and Telecom.	24.0	25.9	28.0	31.2	37.0	42.5	+18.5
Garments	21.7	21.0	21.8	20.0	17.6	14.7	-7.0
Chemical Products	3.2	3.4	2.7	2.3	2.3	2.0	-1.2
Machinery/Transport Equipment	1.8	2.0	2.9	3.2	3.5	4.2	+2.4
Processed Foods and Beverages	2.5	2.6	2.2	2.4	2.2	1.7	-0.8
Agricultural Produce (processed)	18.2	17.6	16.4	14.3	12.6	12.2	-6.0
Coconuts	6.1	5.1	6.5	4.7	4.7	5.7	-0.4
Sugar	1.6	1.5	0.1	0.1	0.6	0.4	-1.2
Fruits/Vegetables/Commercial Produce	9.2	10.1	8.2	8.0	7.1	5.9	-3.3
Minerals	8.8	6.9	6.5	6.1	5.9	5.1	-3.7
Petroleum Products	1.9	2.0	1.5	1.1	1.0	1.0	-0.9
Special Transactions	0.3	0.2	0.3	0.3	0.5	0.6	+0.3
Re-exports	0.1	0.9	1.0	1.5	1.3	1.6	+1.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	0.0
Total Exports Amount ($1 million)	8,186	8,840	9,824	11,375	13,483	17,447	
Change over previous year (%)	4.7	8.0	11.1	15.8	18.5	29.4	

Source: Same as that for Table 8-3.

this growth shows that manufacturing recovered from 1994, while agriculture recovered in 1996 after a serious rice shortage in 1995. By expenditure, exports recovered from 1994 as export-led growth took hold. This is in line with the development strategy mentioned earlier.

The increase of amount of exports in the first half of the 1990s became milder in 1995 (29.4% compared with the previous year) and 1996 (17.7%). Amid the sluggish growth of its neighboring developing countries in Asia, this was appropriate. In manufacturing, electrical and electronic equipment and parts underwent dramatic increases, moving up 18.5 points over five years to 42.5% (Table 8-4). This is thought to have been due to an increase in exports by latecomers into the Philippine market. By contrast, the export of machinery and transport equipment increased only 2.4%, showing less vitality than in other ASEAN countries. In terms of indigenous businesses, the competitiveness of the Philippines for car parts manufacturing dropped when General Motors decided to set up its production base in Bangkok, Thailand instead of in the Philippines and when the ASEAN Industrial Cooperation (AICO) plan was introduced. The export share of garments also decreased, falling to 14.7% in 1995, resulting in a cumulative drop of 7.0 points for the period, due to the increased competitiveness of China and other late-comer developing countries in this area. The export share of agricultural and fishery products also plunged dramatically.

As for export destinations, there has been a 5.7 point increase in exports to ASEAN countries, a considerable increase indicating a trend toward expansion of trade within ASEAN countries. From 1994, the share of exports to ASEAN countries reached the 10% range, suggesting the impact of AFTA's inauguration (Table 8-5). The share to Japan has gradually decreased, but this is being replaced, it is believed, by exports to the Asian newly industrializing economies (NIEs).

A look at foreign direct investment in the first half of the 1990s shows a rapid increase from 1993 in terms of equity approved by the Board of Investments (Table 8-6).[3)] This increase appears to have stopped in 1995, but can be explained as a temporary trend in investment related to power generation.[4)] Net direct investment, according to a release

Table 8-5 Share of Exports by Destination (1990-1995)

(Unit: %)

	1990	1991	1992	1993	1994	1995	1990-95 Change in Share (of which)
United States	37.8	35.6	39.0	38.4	38.1	35.3	-2.5
Japan	19.7	20.0	17.7	16.0	15.0	15.7	-4.0
China	0.8	1.4	1.2	1.5	1.2	1.2	+0.4
NIEs	9.4	9.4	9.4	9.8	10.8	10.5	+1.1
Hong Kong	4.0	4.4	4.7	4.8	4.8	4.7	+0.4
ROK	2.8	2.6	1.8	1.9	2.2	2.5	-0.7
Taiwan	2.6	2.4	2.9	3.0	3.4	3.3	+0.7
ASEAN	7.1	7.0	5.3	6.6	10.2	12.8	+5.7
Indonesia	0.7	0.5	0.4	0.4	0.6	0.7	0.0
Thailand	1.9	2.5	1.0	1.4	2.7	4.6	+2.7
Malaysia	1.6	1.4	1.3	1.5	1.6	1.8	+0.2
Brunei	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Singapore	2.9	2.6	2.6	3.3	5.3	5.7	+2.8
Australia	1.2	1.2	1.1	1.0	1.0	0.8	-0.4
United Kingdom	4.3	4.2	4.8	4.8	4.7	5.3	+1.0
Germany	4.8	5.7	5.3	5.2	4.9	4.0	-0.8
Netherlands	4.4	3.8	4.1	3.2	3.8	4.6	+0.2
Other	10.5	11.7	12.0	13.5	10.7	9.8	-0.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	0.0

Source: National Statistical Coordination Board; "1996 Philippine Statistical Yearbook"

Table 8-6 Share of Direct Investments in Philippines by Country (Investments approved by Board of Investments, Equity Base)

(unit: %)

	1990	1991	1992	1993	1994	1995	1990-95 Change in Share
United States	6.2	10.7	21.7	16.6	28.6	33.6	+27.4
Japan	31.8	27.0	25.5	21.1	4.5	5.4	-26.4
China	1.9	2.6	0.8	1.0	0.7	0.0	-1.9
NIEs	38.5	38.3	22.6	10.2	24.0	2.9	-35.6
Hong Kong	21.7	1.1	4.5	1.5	12.1	2.0	-19.7
ROK	2.2	5.7	15.0	7.7	0.6	0.1	-2.1
Taiwan	14.6	1.5	3.2	1.0	11.3	0.7	-13.9
ASEAN	2.4	0.7	2.0	8.8	12.7	20.7	+18.3
Indonesia	0.4	0.1	0.0	0.0	0.0	0.0	-0.4
Thailand	0.0	0.1	0.4	0.0	2.4	20.1	+20.1
Malaysia	0.6	0.1	0.0	1.4	7.8	0.3	-0.3
Singapore	1.4	0.4	1.6	7.3	2.5	0.2	-1.2
Australia	1.2	0.7	0.2	0.0	0.4	0.8	-0.4
United Kingdom	2.0	36.5	10.2	0.4	1.6	6.7	+4.7
Germany	0.5	1.2	1.0	3.1	0.8	0.0	-0.5
Netherlands	0.8	2.3	4.0	15.0	2.0	0.3	-0.5
Other	14.7	10.0	12.0	23.8	24.7	29.6	+14.9
Foreign Investments Total	100.0	100.0	100.0	100.0	100.0	100.0	0.0
Amount (1 million pesos)	23,370	21,389	7,250	14,415	62,725	48,112	
Change over Previous Year Ratio (%)	-8.5	-66.6	98.8	335.1	-23.3		
Domestic Investments (1 million pesos)	24,664	22,171	20,502	19,527	99,566	73,602	
Total (1 million pesos)	48,034	43,561	27,753	33,941	162,290	121,715	

Source: Board of Investments

by the central bank, climbed up a digit from US$864 million in 1993 to US$1,289 million in 1994. Behind this was a rapid influx of new direct investment amounting to US$547 million in 1993 and US$930 million in 1994 (Table 8-7).

Recent foreign direct investment is characterized by the entry of ASEAN businesses, most notably from Thailand and Malaysia. The share of investment from ASEAN countries has increased 18.3 points to 20.7% over the last five years. Of this, 20.1% is investment from Thailand (Table 8-6). Under the Foreign Banks Liberalization Act, the Bangkok Bank opened up a branch in Manila. In addition, Italian-Thai entered the construction industry, Siam Cement joined the cement and paper industry, and Thai Petrochemical Industries (TPI) has initiated the plan for petrochemical production. Thai enterprises are thought to have chosen the Philippines as part of an international strategy in the process of Thailand's economic growth. According to local business circles in Thailand, other Asian countries were slow to enter the Philippines, so Thai enterprises were able to take advantage of the opportunities and potential ahead of the rest. Entry from Malaysia includes the opening of a hotel by the Kuok Group. This and other Malaysian ventures are also attracting attention in Manila business circles.

(2) Economic Fundamentals Improve

One characteristic of the Philippine economy in recent years is that growth and stability are being achieved at the same time. This is fundamentally different from the situation under the Aquino administration, when growth and stability became a trade-off; that is, as already mentioned, economic growth increased the financial deficit while stabilization policy slowed the pace of growth.

Economic indicators show that the macroeconomic imbalance is being reduced. The current account deficit relative to GNP stopped rising at 4.3% in 1995 and has gradually been shrinking since. CPSD is also shrinking. This reflects a turnaround in the fiscal balance of national government from a deficit to a surplus in 1994, after the government had liquidated its holdings in government corporations during privatization (Table 8-3). In 1996, CPSD registered its first surplus (2.1 billion pesos) since the indicator was put into use in 1981.[5] From June 1996, foreign currency reserves reached a historical high when the international reserves hit US$10 billion, due to the increase in remittances from Filipino overseas contract workers and the influx of foreign investment mentioned later. The external debt balance relative to GNP slid to under 50% in 1995, while the short-term debt ratio and debt servicing ratio were also low and stable (Table 8-3). The positive turnaround in the foreign currency position strengthened the peso on foreign exchange markets and kept inflation at the single-digit level. As a result, interest rates for treasury bills are in a downward trend. This turnaround in the Philippine economy, as already mentioned, is finally happening now as a result of economic reforms carried out under both the Aquino and Ramos administrations.

4. Tasks for Further Development

(1) Threat of a Mini-bubble

As shown here, the Philippine economy has clearly entered a positive cycle. Nevertheless, concerns remain. One of these is the increased foreign investment in securities, as the positive turnaround

Table 8-7 Foreign Investments to the Phillipine (1986-1996) (unit: $1 million)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996(1)
Foreign Investments, Net	140	326	986	843	480	654	737	812	1,558	1,609	983
(Direct Investments, Net)	127	307	936	471	528	529	675	864	1,289	1,361	1,161
Inflow	173	418	1,026	575	550	556	776	1,238	1,591	1,459	1,332
New Foreign Investments in the Philippines	17	34	81	93	171	130	234	547	930	1,300	931
Reinvested Earnings	20	22	17	56	28	34	42	43	29	23	43
Technology Fees and Others Converted to Equity	32	17	8	38	22	50	41	5	36	22	0
Debt Conversions	14	287	806	306	226	273	269	193	2	0	0
Bond Conversion	-	-	-	-	0	0	0	0	45	46	246
Imports Converted into Investments	-	-	-	-	2	6	5	0	1	6	0
Bank Inter-Branch Operations	68	41	82	74	101	63	185	313	481	0	0
Others	22	17	32	8	0	0	0	137	67	62	112
Outflow	46	111	90	104	22	27	101	374	302	98	171
Residents' Investments Abroad	2	1	2	-	4	2	24	323	112	98	171
Capital Withdrawn from the Philippines (2)	35	58	74	95	-	-	-	-	-	-	-
Bank Inter-Branch Operations	-	-	-	-	18	25	77	51	190	0	0
Others	9	52	14	9	-	-	-	-	-	-	-
(Portfolio Investments, Net)	13	19	50	372	-48	125	62	-52	269	248	-178
Inflow	13	21	51	386	6	242	588	2,369	3,685	4,448	6,521
Residents' withdrawal of Foreign Investments Abroad	-	-	-	-	4	15	22	112	706	627	1,107
Non-Residents	-	-	-	-	152	227	566	2,257	2,979	3,861	5,414
Outflow	0	2	1	14	204	117	526	2,421	3,416	4,240	6,699
Residents	-	-	-	-	0	15	115	1,061	1,338	1,864	2,885
Non-Residents	-	-	-	-	204	102	411	1,360	2,078	2,376	3,814

Note 1: For the period from January to October
Note 2: Included in Outflow of Portfolio Investments (Non-Resident) after 1990 in the original data.
Source: Same as that for Table 8-3 .

of the Philippine economy has drawn attention to Asia's new booming market in Manila. Inflow of portfolio investment by non-residents reached US$2,979 million in 1994, US$3,861 million in 1995, and US$5,414 million in the period from January to October of 1996, an increase of 25.5% over the same period in the previous year (Table 8-7). This was due to the increase in listed corporations as the Philippine Stock Exchange (PSE) has modernized and to the fact that the low price-earnings ratio (PER) of securities listed on PSE indicates that the stocks are low priced and will rise, in contrast to the sluggish prices of stocks on the Bangkok Stock exchange.

At the same time, the price of real estate in the Manila and Cebu metropolitan areas is rising in anticipation of a shortage of land for industrial use in the future. This shift toward real estate speculation has been accelerated by the Special Economic Zone Act of 1995. Under this law, the first "ecozones" have been identified in each of the country's 36 provinces. In Iloilo and Albay provinces, for example, local land owners are applying to have farmland classified as ecozones, indicating the start of a real estate boom.[6] Investment is also going into the construction of hotels in and around Manila in anticipation of the APEC conference of 1996 in the Philippines. Under such conditions, financial authorities are debating whether or not to set guidelines (ceilings) on the lending activities of commercial banks in order to avoid a bubble.

There are warnings that real estate investment by financial institutions, especially by commercial banks, could trigger a miniature bubble economy.[7] In Makati, the financial center in metropolitan Manila, land prices in the first half of 1995 reached 265 thousand pesos per square meter, nearly double the price of the previous year. The same trend can be found in the booming business town of Ortigas, where prices reached 95 thousand pesos per square meter, up 33% compared with the previous year. While this indicates an increase in demand, it also points to rising real estate speculation by commercial banks.

According to a survey by the central bank, real estate loans as a share of commercial bank loans rose from 16% in 1990 to 21% in May 1995. This share is only an average; there is considerable variation depending on the individual financial institution. The real estate loans of the Aboitiz Group's Union Bank of the Philippines, for example, accounted for 30% of all their loans. As a result, their non-interest earnings rose from 43% in 1994 to 75% in 1995. By comparison, the share for the Philippine National Bank was 16%, that for the PCI Bank was 10% and for Metro Bank, only 9%.[8]

One of the factors behind this rise in land prices and real estate investment is the increased domestic liquidity resulting from the influx of funds from overseas. Money supply (M1) at the end of June 1996 was 182.5 billion pesos, an increase of 20.3% in comparison with the previous year. Meanwhile, the drop in domestic interest rates has brought a shift toward real estate financing as part of the portfolio of investors and lenders. At present, the increase in demand for non-elastic, non-tradable assets (land) is not linked to inflationary trends. In business circles, however, debate has begun on healthy bank management, e.g. central bank setting of ceilings or other guidelines for the lending activities of commercial banks, and warnings about excessive real estate investment.[9]

(2) Tasks for the Future

As already mentioned, while the Philippine economy now reveals the positive results of economic reforms carried out under the Aquino and Ramos administrations, there are tasks that remain. First is sustaining self-reliant macroeconomic management. Current EFF with the IMF will expire in June 1997. Taking advantage of the favorable turnaround in the foreign currency situation, the Philippine government must effectively use its own discretion in pursuit of appropriate macroeconomic management. Of the issues left over from EFF, highest priority must be given to the Comprehensive Tax Reform Package (CTRP). CTRP envisages national revenue of 13.0 to 13.9 billion pesos as a result of simplified income taxes (down from 10 to 3 tax categories), reduced corporate taxes (from 35 to 30%), and the introduction of minimum corporate income tax (of 0.75% on taxable net assets) and so on.

Second is further improvement in the investment environment through deregulation and liberalization. This means improved productivity in an effort to enhance international competitiveness and further achievement of sustained growth through increased exports. There is a need to break away from the pattern of economic growth → increased imports → increased trade deficit.

Liberalization of the retail industry is already on the itinerary for deregulation. For example, there is a need to revise procedures under the Retail Trade Nationalization Law of 1954 which, at the time of enactment, was designed to prevent persons who are not citizens of the Philippines, mostly Chinese residents, from having a stranglehold upon economic life of Filipino residents, because the retailers have considerable economic and social influence over them. Improved productivity in the service industry is essential as the economy diversifies. Congress, however, reflecting public opinion, argues that competition with foreign businesses will have a major impact on small and medium retailers. Under the current proposal for the Retail Trade Act, wholly owned foreign retailers must have a minimum capital of 10 million pesos.

Reforms in the security market are also underway. In December 1996, the Philippine Stock Exchange was authorized by the Securities and Exchange Commission to operate as a self regulatory organization (SRO) able to enact its own rules and guidelines. Already, the processing of transactions has been automated, while terms are being established for the modernization of broker and dealer management. One of the future tasks is to monitor markets to prevent insider trading and other illicit activities.

Third is political stability. President Ramos is scheduled to complete his term in June 1998 and is unable to run for re-election under current constitutional rules. However, as nearly half of the congressmen in the House of Representatives will also be unable to run for election in the same year beyond three consecutive terms, a strategy has emerged to link the issue of extending the presidential term with that of extending the terms of congressmen. President Ramos has completely denied such speculation, but experts say that if he does not run again, he had better hand pick his successor early if he is to ensure that the future of politics will be transparent.

Notes:

(1) As the Gulf Crisis of August 1990 evolved into the Gulf War of March 1991, the Philippine government and IMF engaged in tough negotiations concerning the new economic stabilization program (ESP). A reduction of the widening CPSD was an issue in these negotiations. In February 1992, IMF approved the letter of intention for the ESP, but in the process leading up to that, oil product prices and public utility charges were raised and an import levy of 9% was introduced. The new import levy was a provisional measure to be effective until June 1992, as across-the-board tariff reductions under the Executive Order No. 413 of August 1990 were shelved due to opposition from business circles. However, importers continued waiting to see how the situation would develop, which also had a negative impact on exports. While there were objections within the Philippines to the introduction of ESP, the international environment surrounding the Philippines (the second Multilateral Assistance Initiative on international assistance for the Philippines, and negotiations over the continued existence of US military bases in the Philippines) left few options for the government.

(2) *"Philippine Daily Inquirer"*, December 30, 1996.

(3) There are other approval standards under the Philippine Export Zone Authority (PEZA) than the Board of investments, which consist of export processing zones, but the trends of results for these have been about the same.

(4) Even in the PEZA statistics referred to in note (2), the number of approved foreign investments in 1996 was decreasing, although this was because of a shortage in supply of export processing zones *"Tsusho Koho" (JETRO DAIRY)* March 10, 1997).

(5) *"Philippine Daily Inquirer"*, February 8, 1997.

(6) Interviews by the writer with development policy officers of provincial governments in July 1996.

(7) Reference to 'Bank's Exposure in the Real Estate Sector,' a featured article in *"Business World"*, August 19-22, 1996.

(8) Same as note (7).

(9) Concern about inflation driven by a shift toward real estate investment was also a subject of debate among international financial institutions, according to IMF Staff Country Report No. 95/114 (*"Philippine Background Paper"*) of November 1995, pp.16-18.