

BTI 2008 | Philippines Country Report

Status Index	1-10	6.15	# 51 of 125	
Democracy	1-10	6.30	# 57 of 125	↘
Market Economy	1-10	6.00	# 54 of 125	→
Management Index	1-10	4.91	# 67 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	83.1	HDI	0.76	GDP p.c.	\$	4,571
Pop. growth ¹	% p.a.	1.7	HDI rank of 177	84	Gini Index		44.5
Life expectancy	years	71	UN Education Index	0.89	Poverty ³	%	43.0
Urban population	%	62.7	Gender equality ²	0.53	Aid per capita	\$	6.8

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The Philippines faced two major challenges in consolidating its market-based democracy during the period under review: averting a fiscal crisis and managing a continuing crisis of legitimacy. While President Gloria Macapagal Arroyo's government adeptly handled the impending fiscal crisis by imposing higher value-added taxes and higher levies on alcohol and tobacco, it struggled with two impeachment charges, another failed coup attempt and lingering questions of legitimacy brought about by alleged electoral fraud in the 2004 presidential election.

Driven by the logic of regime survival, President Arroyo actively mobilized government resources, dispensing funds in order to consolidate support among her congressional and local government allies. She also resorted to a series of controversial actions inconsistent with democratic principles. She persecuted dissenters and critical media, tolerated the extrajudicial killings of left-wing personalities, and attempted to unilaterally change the constitution to suit her own political objectives.

Meanwhile, the Philippine economy gained momentum by achieving a modest GDP growth of 5.4% in 2006. This economic performance was attributed to private consumption fueled by remittances from abroad, exports in electronic products, business process outsourcing (BPO) and the renewed strength of the agricultural sector. The remittances of Overseas Filipino Workers (OFWs), amounting to \$12.8 billion in 2006, played a primary role in buoying up the economy.

Despite an average growth rate of 5% over the past five years, there were no significant inroads in job generation, poverty alleviation and hunger prevention. Historically rooted structural weaknesses continue to perpetuate poverty, impede long-term sustainable growth, and constrain the governance performance of political leaders. Corruption and an ineffective bureaucracy stymie reform efforts. Unabated population

growth continues to put enormous strain on public financial resources and the government's ability to both provide basic services and create economic opportunities. These factors contribute to the enduring sociopolitical conflicts in the country. On a positive note, however, the Philippines has a vibrant civil society with a tradition of civic engagement and a wellspring of social capital.

History and Characteristics of Transformation

The Philippines' experience with market-based democracy is characterized by a recurring boom-bust cycle in an economy that corresponds with a similar pattern of political development and decay. The economy has weathered a number of crises since Philippine independence in 1947. Until recently, the Philippines has not experienced a sustained period of growth since the 1970s. Growth momentum fell sharply in the 1980s and fluctuated erratically in the 1990s. Successive presidential administrations have attempted to introduce reforms to spur growth in the wake of every crisis. However, these policy reforms have repeatedly encountered political and institutional constraints.

Furthermore, these economic crises have been preceded by, or were the result of, repeated institutional breakdowns that historically ruptured into full-blown crises of legitimacy. Intense intra-elite competition, contested elections and the threat of armed revolution characterize the four major political crises in 1953, 1969, 1986 and 2004. Except for a brief period in the mid-1990s, when economic growth coincided with positive political development, elitist politics has continued to hinder the institutionalization of effective social and political reforms.

The Philippines re-democratized in 1986 through a peaceful popular uprising against the dictatorship of Ferdinand Marcos (1965 – 1986). President Corazon Aquino (1986 – 1992) presided over the restoration of formal democratic institutions. Her successor, Fidel Ramos (1992 – 1998), utilized liberalization and privatization to reorient the economy towards the global market. Movie actor Joseph Estrada (1998 – 2001) was elected with wide populist support but faced impeachment for corruption, and was subsequently ousted in a second popular uprising in 2001. Gloria Macapagal Arroyo's first term (2001 – present) began with serious challenges to the legitimacy of her government that included a failed attempt at a popular uprising by Estrada's supporters, and ended with a mutiny led by junior military officers in July 2003.

Despite serious charges of electoral fraud by the opposition in the 2004 election, Arroyo was re-elected for a full term. The allegation of massive fraud was only substantiated in June 2005, with the release of recordings of wiretapped conversations between the president and a high-ranking election official. The taped conversations

exposed the cabal of political operators who tampered with votes to favor the president. While the president has admitted to being one of the voices in the taped conversations, she has denied any wrongdoing and profusely apologized for the impropriety of her “lapse in judgment.” The controversy highlighted the issue of ethics in politics and the failure of the 2004 election as an institutional mechanism to mitigate the continuing crisis of legitimacy in the Philippines. The political controversy threatened the Arroyo presidency as she faced massive street protests, two successive impeachment charges in Congress, and a failed military-backed popular revolt in February 2006.

The lingering crisis of legitimacy also tested the limits of post-Marcos constitutional rule and renewed debates on the need for constitutional change. However, attempts to change the 1987 constitution and allow for a shift from the unitary-presidential form of government to federal-parliamentary proved to be unpopular, due largely to the perception that it is a ruse by President Arroyo to resolve her government’s crisis of legitimacy and extend her term as head of government. After the Supreme Court rebuked initial attempts by her local supporters to revise the constitution through a grassroots signature campaign, her political allies at the House of Representatives blatantly tried to push for constitutional amendments by bypassing the Senate. This resulted in a political backlash among the strategic sectors of Philippine society that included business, academe, labor, the middle class, the Roman Catholic Church and other influential religious organizations. These sectors threatened to mount another popular uprising. Faced with insurmountable opposition, the president’s majority coalition in the House of Representatives withdrew their attempt to change the constitution.

Transformation Status

I. Democracy

1 | Stateness

The Philippine state is adequately established, with differentiated power structures spread throughout the archipelago. The institutional scope and state functions are clearly outlined in the 1987 constitution.

Monopoly on the use of force

Through the years, however, the state's monopoly on the legitimate use of force continues to be challenged in remote areas of the country by the communist-led New People's Army, the secessionist Moro Islamic Liberation Front (MILF), the terrorist Abu Sayyaf, and private armies employed by local warlords and political clans. Hence, even as the scope of the Philippine state is clearly established, its strength or the capacity to perform its functions, such as providing basic services, ensuring peace and order, and promoting economic development, is often weakened by competing and diverse social interests or particularistic groups.

State identity

Although the principle of the separation of church and state is enshrined in the 1987 constitution, major religious groups and denominations, such as the dominant Roman Catholic Church, the homegrown Iglesia ni Cristo (Church of Christ), the Catholic charismatic El Shaddai, and the evangelical Jesus is Lord, exert influence in political and policy issues.

No interference of religious dogmas

Amid recent developments that threatened the political stability of the Philippine state (e.g., issues of electoral fraud, questions of legitimacy, persistent military restiveness, and attempts to change the constitution), Filipinos continue to narrowly hold on to the principles of democracy and the present constitutional structures. Nonetheless, in a survey conducted in July 2006 by Pulse Asia, a majority of citizens (82%) have serious doubts about the substance of Philippine democracy. This number can be further divided into the 41% who believe that the Philippines is controlled by a powerful few and ordinary citizens cannot do anything about it, and an equal 41% who are undecided and are unsure about whether oligarchic rule exists.

Basic administration

2 | Political Participation

The contested 2004 presidential election served to highlight the continuing paradox of Philippine electoral democracy. Despite its long tradition of institutionalized democratic practices and its history of popular struggles, Philippine society has engendered an elitist and clientelistic democracy embedded in an underdeveloped economy.

Free and fair elections

Given the socioeconomic background of elected officials and the interests they represent, democratic institutions, such as Congress, remain a bastion of elite dominance in Philippine society. Continued poverty and underdevelopment, coupled with the growing influence of mass media, have contributed to the emergence of “celebrity politics” and populist campaigns to win elections.

Effective power to govern

Faced with continued challenges to her political legitimacy after the contested election of 2004, President Arroyo turned to hard-line policies that placed partial constraints, inconsistent with democratic principles, on the freedom of association. These included the Calibrated Preemptive Response (CPR) policy, announced in September 2005, and Proclamation 1017, which placed the country under a week-long state of national emergency in February 2006. Both policies led to the violent dispersal of anti-government rallies and the arrests of several leaders.

Association / assembly rights

In addition, the freedoms of opinion and the press have been severely undermined by the indiscriminate filing of libel suits against known critics of the administration. Juan Miguel Arroyo has filed eleven libel suits against 45 journalists since 2003. The incidence of violence committed against journalist and media practitioners has risen. According to the International Federation of Journalists (IFJ), 13 journalists have been killed in the performance of their duties in 2006, bringing to 49 the number of media practitioners murdered since President Arroyo came to power in 2001. This number, IFJ reported, surpasses the number of journalists killed during the Marcos regime. Extrajudicial killings have not been limited to media practitioners; 290 political activists associated with left-wing organizations have been killed since 2004. As a result, Freedom House downgraded the country’s political rights rating from 2 to 3, and its status from “free” to “partly free” in 2006.

Freedom of expression

3 | Rule of Law

At the height of the legitimation crisis that has besieged her administration, President Arroyo extended the limits of executive powers through a series of controversial policies. The president effectively used Executive Order 464 to

Separation of powers

keep key senior government officials from appearing in congressional investigations. Equally controversial were the Calibrated Preemptive Response (CPR) policy and Presidential Proclamation 1017, which justified the violent dispersal of anti-government rallies and the arrest of its leaders. The ruling administration also attempted to change the 1987 constitution through a nationwide signature campaign conducted in village assemblies.

In a valiant display of judicial independence, the Supreme Court challenged the constitutionality of these executive actions and declared the CPR policy, as well as certain provisions of EO 464 and PP 1017, unconstitutional.

Independent
judiciary

Like many countries in Southeast Asia, the Philippines has a serious problem with corruption and abuse of office and power by public officials. Although such phenomena attract adverse publicity, officeholders are not adequately prosecuted.

Prosecution of
office abuse

The Supreme Court struck down the petition to amend the 1987 constitution through a people's initiative. Hence, the highest judicial body has effectively checked the abuse of executive prerogatives and ensured the protection of civil rights.

Civil rights

4 | Stability of Democratic Institutions

Cheating in elections, whether actual or perceived, has the effect of weakening legitimacy since it diminishes the faith in democratic procedures as a source of political authority. Simply put, the more secure the legitimacy derived from an electoral mandate, the greater stress a government will be able to withstand. If the legitimacy of government is weak, contested or disputed, its ability to function is heavily compromised. The current crisis facing President Arroyo can be viewed in this context. Her initial ascent to power in 2001 was justified as a replication of the popular uprising of 1986. While the Supreme Court upheld the legality of her assumption to office, her legitimacy has been held in doubt. Thus, she has faced a succession of serious political challenges in the form of popular uprisings and a failed mutiny during the first part of her term in office. These challenges further weakened the legitimacy of her rule. Despite her earlier avowal not to seek a second term, she stood for re-election in 2004 in order to achieve her own mandate. Allegations of electoral fraud raised questions of "disputed legality" or "contested legitimacy," and the factual basis of any infringement is difficult to ascertain.

Performance of
democratic
institutions

The necessity of political survival has emboldened her to prop up other means of legitimizing her rule, creating a manufactured legitimacy. The president has embraced economic recovery as the justification for her continued stay in office. She has doled out government resources in order to ensure support for her administration. She has cracked down on dissenters and the media, raised the specter of a communist threat, and pushed for constitutional change.

Commitment to
democratic
institutions

5 | Political and Social Integration

Elite dominance in the House of Representatives reflects the inability of the party system to maintain stable linkages with other civil organizations in particular and the citizenry in general. Legislators elected under the party list system to represent marginalized sectors have faced a hard choice: whether to engage in political compromise or to risk being isolated in the elite-dominated chamber. A survey conducted by the Social Weather Stations (SWS) in June 2004 reveals that 67% of respondents do not believe that any political party represents their interests. Since 1992, all governing and opposition coalitions have stabilized around four major political parties, namely: Lakas Christian Muslim Democrats (Lakas CMD), Nationalist People's Coalition (NPC), Liberal Party (LP) and the Laban ng Demokratikong Pilipino (LDP). Going into the 2007 midterm elections, two formerly moribund parties – the Nacionalista Party (NP) and the Kabalikat ng Malayang Pilipino (KAMPI) – have been revived, increasing their memberships by raiding the ranks of other parties. Senate President Manuel Villar currently heads the NP, the country's oldest party (founded in 1907), while KAMPI is the original party organized by Gloria Macapagal Arroyo in 1997.

Party system

The Philippines has a long and rich tradition of interest groups with intermediary functions, such as trade unions, business associations, and non-governmental organizations. From a functionalist point of view, however, the topography of interest groups is meager and remains dominated by a few players; important social interests are excluded or underrepresented.

Interest groups

The level of acceptance of democracy among citizens is high; however, comparable data are hard to get or are unreliable. Respondents in a survey conducted in July 2006 by Pulse Asia registered a split opinion on the possibility of Filipinos completely losing faith in the use of peaceful means in promoting democracy. Equal numbers of the public believed that such disillusionment toward democracy is possible (29%) and impossible (30%). A large majority (41%) is undecided in their assessment of the possibility of such disillusionment. Two other indicators in the same survey (optimism towards the future and intent to migrate) reinforce this trend. In terms of optimism about the country's future, 30% of Filipinos have expressed ambivalence on the matter of hopelessness, while 21% view the Philippines as hopeless. Hence, 30%, or at least 14 million Filipinos, would leave the country and permanently reside abroad if given the opportunity. Another 32% do not rule out the possibility of emigration.

Consent to democratic norms

While the Philippines has a tradition of social self-organization in traditional and modern forms of social interaction and organization, the latter reaching back into colonial times, social self-organization in civil society encounters manifold political, cultural, socioeconomic and other barriers. Social capital is unevenly distributed in this generally low-trust society.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

The Philippine economy experienced significant progress with an increase in GDP growth from 4.9% in 2005 to 5.4% in 2006. The expansion in the economy however, has not resulted to significant gains in employment. While unemployment rates have decreased from 11.8% in 2004 to 11.35% in 2005 and 7.3% in 2006, economic growth has been limited primarily to the service sector (i.e., finance and communications), which has limited multiplier effects on employment generation in other sectors. Furthermore, the rate of employment creation remains below the government's annual target of 1.5 million new jobs and can barely absorb increases in the labor force. Data show that, in 2005, an additional 928,000 workers entered the labor force, but only 735,000 net new jobs were created by the growing economy, with a residual of approximately 200,000 new job seekers adding to the ranks of the unemployed. This issue is further compounded by the considerably high rate of 25.4% underemployment. The average per capita income for the review period was the highest in the history of the country at \$1,400. This unprecedented growth, however, did not seem to benefit as broad a base of the population as was suggested by the results of the Social Weather Stations survey, which registered a hunger index of 17% and a self-rated poverty index of 60%. Thus, despite an upturn in the economy, income inequality is still a major concern in the country, with the richest 20% of Filipinos earning more than 11 times the income of the poorest 20% of the population.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	76,327	80,927	90,707	99,029
Growth of GDP	%	4.4	4.9	6.2	5.0
Inflation (CPI)	%	3	3.5	6	7.6
Unemployment	%	10.2	10.2	10.9	-
Foreign direct investment	% of GDP	2.0	0.6	0.8	1.1
Export growth	%	4	4.9	14.4	4.2

		2002	2003	2004	2005
Import growth	%	5.6	10.8	5.8	2.4
Current account balance	\$ mn.	-279.0	288.0	1633.0	2338.0
Public debt	\$ mn.	32,319.5	36,146.5	35,931.8	35,233.5
External debt	\$ mn.	59,906.7	62,589.1	60,918.1	61,527.1
External debt service	% of GNI	12.6	11.7	11.7	9.2
Cash surplus or deficit	% of GDP	-	-4.7	-4.0	-3.0
Tax Revenue	% of GDP	12.5	12.8	12.5	13
Government consumption	% of GDP	11.5	11.1	10.1	9.7
Public expnd. on edu.	% of GDP	3.2	3.2	-	-
Public expnd. on health	% of GDP	1.2	1.4	1.4	-
R&D expenditure	% of GDP	0.1	-	-	-
Military expenditure	% of GDP	1.0	1.1	0.9	0.9

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Although competition in the market economy is institutionalized, it is however characterized by a type of capitalism in which the oligarchic elite have influenced economic decisions, leading to distorted policies such as redundant fiscal incentives and excessive trade protection for selected sectors, including agriculture and manufacturing. This phenomenon has also led to the weakening of market institutions, with the regulatory bodies falling captive to the influence of large firms and businesses. Consequently, only 160 families have controlled political and socioeconomic power in the country for the past 25 years. According to the World Economic Forum, the country only slightly improved its competitiveness ranking from 73rd in 2005 to 71st in 2006 out of 175 countries. Despite this improved ranking, the country is still the least competitive in ASEAN, aside from Vietnam and Cambodia. The major impediments for competitiveness in the country have been attributed to poor infrastructure investment and high transaction costs. In terms of economic freedom, the Heritage Foundation ranked the country 97th out of 175 countries in 2006, a rank higher than the previous year. While the country is ranked 16th out of 30 in the Asia-Pacific region, it still falls under the “mostly unfree” category due to its poor

Market-based
competition

ratings in business freedom, investment freedom, property rights and freedom from corruption. The country also registered poorly in terms of corruption, ranking 121st out of 163 countries based on Transparency International's 2006 Corruption Perceptions Index.

The formation of oligopolies is only occasionally regulated.

Anti-monopoly
policy
Liberalization of
foreign trade

The government continued to advance trade liberalization in the country. The terms of trade however, have shifted against industry and in favor of services, with the share of industry in total output contracting from 30.84% in 2004 to 30.71% in 2005. Meanwhile, services have expanded their share in total output from 43.77% in 2004 to 44% in 2005.

The banking sector saw notable achievements during the review period. The country's central bank, the Bangko Sentral ng Pilipinas (BSP), implemented reforms and regulations that are in closer alignment with international standards and are more responsive to the globalizing banking industry. In 2005, about PHP 97 billion worth of non-performing assets were sold through transactions under the Special Purpose Vehicle (SPV) Act, reducing the stock of non-performing assets in the banking system by about 19%. Moreover, the non-performing loans ratio is the lowest in nine years at 7%. The mandatory application of International Financial Reporting Standards (IFRS) for the 2005 financial accounts has enabled banks to raise additional capital of more than \$200 million for both commercial and state-owned banks in the first half of 2006. Bank mergers and consolidation have also been undertaken to further strengthen the banking sector, which accounts for more than 80% of the total resources of the financial system.

Banking system

8 | Currency and Price Stability

Average inflation rates increased from 6.0% in 2004 to 7.6% in 2005, due to higher oil prices and the expansion of taxes. However, inflation eased to 6.7% in 2006 as a result of the decrease in international oil prices and the strengthening of the Philippine peso. The appreciation of the peso gained momentum as the political turmoil in the country temporarily subsided, and the peso continued to strengthen with the influx of remittances from overseas Filipino workers (OFWs) toward the end of 2006. The amount of dollars remitted by OFWs through the banking system surged by 19.4% to reach a record of \$12.8 billion. Tighter monetary policy, portfolio capital and foreign borrowings have also contributed to the strength of the peso. Since the start of 2007, the peso has appreciated by 78 centavos or 1.6%, reaching a high of PHP 48.25 against the dollar. Ironically, peso appreciation has in fact reduced the value of OFW income by more than 10%, estimated at PHP 84 billion.

Anti-inflation /
forex policy

Financial markets in the country improved considerably, with falling interest rates for local currency government borrowing, reduced spreads for global bond issues and a vibrant stock market, which reached a nine-year high in January 2007. Fiscal reforms have also been instituted to address long-standing budget deficits. The implementation of the Reformed Value Added Tax (RVAT) Law, which expanded the value added tax from 10% to 12%, boosted government revenue from PHP 706.7 billion in 2004 to PHP 815.7 billion in 2005. This has resulted in a decrease in the government's deficit from the PHP 187.1 billion deficit in 2004 to PHP 40.6 billion in 2005. The deficit for 2006 was recorded at PHP 48.5 billion only. These fiscal gains have allowed a moderate expansion in expenditures. The government resorted to the adoption of a revised budget when the Congress did not pass the 2006 budget. A supplemental budget of PHP 47 billion was signed into law to finance obligatory expenses such as salaries and internal revenue allotment. Improved fiscal performance was also tapped for debt payments. The government made headway in improving its debt position with significant increases in debt servicing, from \$225 million in 2004 to \$317 million in 2005 and \$389 million in 2006. The strong peso also encouraged the government to prepay \$220 million in loans to the IMF. The country's credit ratings have improved as a result of this administration's determination to institute fiscal reforms amidst political turmoil and high oil prices. Improved credit ratings, in turn, have lowered the interest rates on the country's debt and renewed investor confidence.

Macrostability

9 | Private Property

The government recognizes the importance of private firms and businesses as partners in steering economic growth. As such, property rights and laws are firmly in place to encourage further investments in the economy.

Property rights

However, the mutually reinforcing relationship between the oligarchic elites and the government has granted certain corporations a continued concentration of market power. The constitution limits foreign land ownership to 60-40 joint ventures with Filipinos, thus limiting the control of land to the dominant 160 families.

Private
enterprise

10 | Welfare Regime

Social security in the country is confined to the formal labor sector. There are two separate agencies that handle social security for private and public sector employees, the Social Security System (SSS) and the Government Service Insurance System (GSIS), respectively. The SSS experienced liquidity problems when it invested some of its funds in non-performing assets. Medicare, the

Social safety nets

healthcare component of social security, has been exposed to wide inequities in income- and area-based cross subsidization. While some elements of social safety nets are institutionalized (i.e., pensions and severance pay), there are still some issues that need to be addressed, such as incomplete coverage, poor enforcement, absence of unemployment benefits and limited access to social protection for the informal sector. Targeted poverty alleviation measures remain supplementary to the primary governmental focus on economic growth. Compared to other ASEAN countries, the Philippines ranked third in completion of primary education at 98%.

Women have consistently registered higher enrollment rates for primary, secondary and tertiary education than men. Otherwise, institutions designed to compensate for gross social differences have only very limited impact on the equality of opportunity in a highly stratified and unequal Philippine society.

Equal opportunity

11 | Economic Performance

The Philippine economy exhibited a steady increase in GDP growth from 4.9% in 2005 to 5.4% in 2006. While these growth rates are modest compared to the 2004 rate of 6.18%, this performance is noteworthy considering that the country was beset with uncertainties surrounding the political situation and the effects of sharp increases in international oil prices. The primary drivers of economic growth have been private consumption fuelled by remittances from abroad, exports in electronic products, business process outsourcing (BPO), and the resurgent strength of the agricultural sector. OFW remittances have been a significant factor in providing the most important safety net in the economy, with a remarkable increase from \$10.7 billion in 2005 to \$12.8 billion in 2006. Economic development, however, seemed to be hollow, since it did not contribute to significant reductions in unemployment and can barely absorb new entrants in the labor force.

Output strength

12 | Sustainability

National development strategies have always been anchored on the principles of sustainable development. The Arroyo administration, however, in trying to meet its economic targets of increased investments and employment opportunities, has vigorously encouraged foreign mining corporations to invest in the country. In 2006, a \$42 million foreign funded mining operation was suspended after cyanide-laced waste spilled on Rapu-Rapu island to the south of Manila.

Environmental policy

In terms of investing in and allocating budgets for education, the country fails to meet prescribed international standards, with education spending and standards

Education policy / R&D

trailing behind other Asian countries. According to the UN Human Development Index, the 2004 education expenditure has a budget share of only 3.2% of the GDP, a 0.2% decline from the 1995-1997 figures. There are a number of concerns in education, such as the shortage of infrastructure and school materials. Also, funding for state universities has continually declined. Research and development is also not prioritized by the government.

Transformation Management

I. Level of Difficulty

Historically rooted structural weaknesses perpetuate poverty, impede long-term sustainable growth, and constrain the political governance capacities in the Philippines. With a system of government susceptible to political factionalism, reforms do not deliver maximum utility. One of the barriers to development and poverty alleviation is the inability of political leaders to complement economic reforms with social and political reforms. Economic and social policies become secondary priorities, for the political climate necessitates strategizing for political survival. Several governmental attempts at pushing social and political reforms meant to curtail the power of vested interests have been saddled by a lack of sustained political will, a legal and regulatory environment laden with corruption, and a politicized and ineffective bureaucracy. Poverty continues to be a predominantly rural phenomenon, with around three-quarters of the poor living in rural areas. Despite posting a 3% per capita growth for five continuous years, economic growth for the last twenty years has been at a pace that makes it difficult to lift the country out of poverty. Unabated population growth continues to place enormous strain on public financial resources and the government's ability to provide basic services and create economic opportunities.

Structural
constraints

There is a strong tradition of civil society organizations with effective mobilization and organizational capacities, a long-term record of civic engagement and a deep reservoir of social capital.

Civil society
traditions

The Philippines continues to face enduring political conflicts with a resilient communist insurgency spearheaded by the Communist Party of the Philippines since 1968, a violent Muslim separatist movement since 1971, and a network of homegrown terrorists in the southern Philippines since the 1990s. Strong consumer spending, considerably boosted by OFW remittances, has primarily driven the recent economic upturn. Passage of the Reformed Value Added Tax (RVAT) Law prevented a looming fiscal crisis. However, poor fiscal management seriously affects the extent and quality of public goods and services provisioning, and leaves the government chronically short of resources to fund basic services, such as health and education. While education continues to be the

Conflict intensity

largest single governmental budget item, educational expenditures as a percentage of GDP are the lowest in the ASEAN region. Poorly targeted and inadequate public investment results in poor quality infrastructure, while frameworks for private services provisioning are not well-developed. Hence, poor infrastructure investments and the high cost of doing business, exacerbated by weak institutions and the lack of good governance, have been the structural impediments to high and sustainable economic growth in the Philippines.

II. Management Performance

14 | Steering Capability

The Arroyo administration's reform efforts, initiated in 2001, have been sidelined by the necessity of regime survival amid the crisis of legitimacy. Consequently, even as the economy shows positive signs of a recovery from the threat of a fiscal crisis, nagging questions remain regarding sustainability and distributive capacity. Because of the issues confronting the present administration, key institutional and policy reforms have not yet been realized.

Prioritization

Economic reforms previously implemented in the Aquino and Ramos administrations, bolstered by revenue increases brought by the RVAT implemented by the Arroyo administration in 2006, have borne fruit, with economic indicators showing positive signs of gradual and continual growth. Foreign exchange has become stronger, the GDP has grown steadily at over 5% per year, and the fiscal status has improved over previous years. Despite remarkable progress, there are still very serious problems like a high poverty level of 30%, low education expenditures, and a high income gap. According to a Social Weather Station survey, self-rated poverty is still high at 52%. Aside from these social concerns, economic reform is still not fully successful because of setbacks like the vulnerability of labor export policy and the national debt. The Philippines remains mired in the debt cycle, with a national debt still amounting to more than \$53 billion in 2006 and 13.7% of the GDP devoted to debt servicing, which is more than 30% of total government expenditure. The early payment of the IMF loan was a notable achievement and removes the country from the institute's supervision. This is owed to the significant and continued strengthening of the peso against the dollar, which decreased the debt considerably. Even with this development, a large percentage of expenditures are allocated to debt servicing, which diminishes expenditures on social investments like education, research, health, and other social services.

Implementation

The social and political problems that the country faces are apparently recurrences of past political mistakes. President Arroyo continues to face issues of electoral fraud that undermine her legitimacy to govern. This ongoing political crisis is the result of unresolved legitimacy questions that have deeply divided the nation. The unbroken process of electoral fraud, political division and the crisis of legitimacy have all become endemic in the political realm. Political uncertainties have greatly strained efforts to combat social ills like poverty, unemployment, national debt, corruption, and other problems that prevent the country from moving forward.

Policy learning

15 | Resource Efficiency

The bureaucracy has bloated to an inefficient level under the Arroyo administration. There are thirty more top-tier positions in the current government than in previous administrations. The number of employees, part-time salaried workers, and uniformed personnel in government agencies also increased significantly. The number of political appointees is the highest in the history of Philippine bureaucracy, drawing protest from the Career Service Executive Board (CSEB), the agency that oversees government appointments. Political appointments are regularly handed out to political allies, campaign contributors, retired military and police officials.

Efficient use of assets

Although there are some improvements in terms of the economy, the country still lags behind its neighbors. Low transparency, low investment in social services and high external debt have prevented the country from reaping the maximum benefits of economic reforms. Social policy reforms that would address structural inefficiencies are not prioritized. Although there are attempts at coordination within existing agencies and institutions, policy incoherence and inefficient service delivery remains the norm. Existing laws are not fully enforced due to questions of administrative responsibility, accountability and transparency. The lack of agency coordination and long-term planning, aggravated by corruption in the bureaucracy, hinders maximization of the recent economic gains.

Policy coordination

Corruption is still one of the primary causes of government inefficiency. In recent years, the country has progressively declined in transparency rankings, garnering a low Corruption Perceptions Index (CPI) score of 2.5 (with 10 being the least corrupt score). In the year 2000, the Philippines ranked at 65 in Transparency International's corruption survey. Perceived corruption increased as the country dipped lower in the rankings to 117th in 2005 and 121st out of 163 countries in 2006, on the same level as countries like Rwanda and Gambia. It is estimated that more than 30% of allotted budgets to government projects are lost to corruption. Moreover, a significant portion of government resources is

Anti-corruption policy

wasted through congressional pork barrel projects. Corruption is a structurally ingrained practice in the Philippines. The Bureau of Internal Revenue (BIR), the Department of Public Works and Highways, the Philippine Armed Forces and the Bureau of Customs have consistently topped surveys as the most corrupt government agencies. On a positive note, the Social Weather Station annual survey of enterprise managers reveals that there is a decline in involvement in corrupt transactions. However, the perceived government determination in the fight against corrupt has dropped in recent years. There have been attempts to curb corruption, like the government's lifestyle check program and the passage of a measure against money laundering. However, there has been little effective persecution and punishment of high-ranking government officials.

16 | Consensus-Building

There has been a rudimentary consensus on a market-based democracy since 1986. However, continuing political instability and an apparent inability to equitably spread the benefits of economic growth has put a considerable strain on this consensus. The legitimation crisis brought about by the contested election of 2004 continues to politically divide the nation.

Consensus on goals

The Philippines' political system is dominated by about 100 families who, via their politically strategic position, their de facto political or economic power, and their representatives in the government and parliament, can in effect block market economic reforms. Their obstructionist actions have significantly slowed the pace of reform in the past years. In addition, civilian control of the military is at best fragile; several insurgent groups such as the communist guerrillas or the Muslim insurgency in Mindanao challenge the state's monopoly on the use of force. After the attempted impeachment process against President Gloria Arroyo and rumors of a coup in February 2006, the reform process largely came to a standstill. There are doubts about the government's capacity to control actors with veto powers, such as the military, who can influence the speed and direction of the political process. Many observers agree that segments of the political elite will use their political influence and veto power to block any political or socioeconomic change that could threaten their political power or economic interests.

Anti-democratic veto actors

Although the government negotiated a peace treaty with the Moro National Liberation Front (MNLF) in 1996, efforts at resolving the conflict with the communist insurgents and the breakaway Moro Islamic Liberation Front (MILF) have so far failed to yield positive results. Peace efforts also suffered a major setback when a faction loyal to MNLF founder Nur Misuari staged a failed uprising in Mindanao in 2001. The Misuari faction again mounted an assault in February 2005 and engaged the military in running gun battles. The Arroyo

Cleavage / conflict management

administration has shifted its policy with regard to the communist insurgency from a negotiated peace to a hard-line military solution. This policy shift resulted in a rise in human rights violations and extrajudicial killings. On the other hand, this uncompromising military approach has yielded success in the near-decimation of the leadership and membership of the notorious terrorist organization, the Abu Sayyaf group, founded by one of Osama Bin Laden's lieutenants, Jamal Khalifa, and originally led by slain Filipino Muslim Abdurajak Janjalani, Bin Laden's comrade from the Afghan wars. The expanded reliance of the Arroyo administration on the support of the Philippine Armed Forces has re-politicized the military. The threat of military intervention re-emerged in late 2003, with a failed mutiny led by junior military officers and another failed coup attempt in 2006. Such military adventurism is a continuing legacy of the heavy military politicization during the Marcos dictatorship. In the late 80s, military rebels launched seven coup attempts against the Aquino administration.

Civil society organizations (CSOs) with varying issue advocacies continue to thrive outside the governmental sphere. The Philippines has a vibrant civil society comprised of a broad range of social movements, voluntary associations and non-governmental organizations. Civil society organizations are legally recognized in the country and are actively engaged in the policy-making process through both formal and informal channels. State and civil society relations range from cooperative to conflicting, and some civil society organizations have not been immune to government co-optation and elite influence. Similarly, some CSOs have also fallen victim to the government's recent hard-line militarist policy.

Civil society participation

17 | International Cooperation

The country has partnered with other states to address socioeconomic problems. It is a net benefactor of international aid, with Japan as its biggest donor. Official Development Assistance (ODA) amounted to \$462.8 million in 2004, and this amount constituted 0.5% of the GDP. A significant portion of this foreign aid is devoted to infrastructure building, business development, research and other developmental projects. Although foreign aid offers temporary solutions to various problems, it is unsuccessful in providing long-term solutions to addressing the country's enormous foreign debt.

Effective use of support

There are still a few roadblocks to projecting a positive international image for the Philippines. One of the international community's concerns is the increasing incidence of human rights violation and extrajudicial killings. This has compelled the international community, particularly the European Union and the United Nations, to exert pressure on the government. Domestic pressure also

Credibility

prevents the forging of important international treaties, such as open-air talks. The uncertainty brought about by inconsistent application and interpretation of the economic rules of the game has discouraged foreign direct investments and created low investor confidence.

In terms of international relations, the Philippines has been able to forge stronger relations with its neighbors. The revival of discussions on the formation of the ASEAN Free Trade Area and bilateral talks with countries like China and Korea are noteworthy developments in economic collaboration within the region. The Philippines has also been able to open negotiations on security cooperation for information and resource sharing in the pursuit of battling terrorism and promoting human security. Its hosting of the ASEAN Summit in Cebu City opened venues for increased partnerships among the member and partner states.

Regional cooperation

Strategic Outlook

A history of patrimonial plunder and rent-seeking behavior by a resilient national oligarchy is the foundation for the country's elite democracy. This national oligarchy, currently estimated at 160 families, has continuously ruled the country for the past 25 years or more. The absence of major social reform initiatives, such as a genuine land reform program, has condemned the majority of Filipinos to abject poverty and political marginalization. Thus far, the Philippines has been unable to sustain economic growth at a level that will put a dent in massive poverty, especially in the rural countryside. The failure to equitably distribute the benefits of economic growth, along with a lack of economic opportunities, has pushed Filipinos to emigrate. Ironically, what the flawed land reform programs of government failed to achieve, the Overseas Filipino Workers (OFWs) phenomenon has succeeded in achieving: namely, the creation of a new middle class. OFW remittances in the country were five times the amount of combined official development assistance, foreign direct investments and loans. This massive inflow of funds has practically insulated the economy from its continuing domestic political crisis and external global shocks. However, reliance on OFW remittances cannot be the basis for a forward-looking development strategy. For one, emigration threatens the sustainability of specific sectors experiencing the "hemorrhaging" of the best and brightest professionals and skilled workers. Moreover, the appreciation of the foreign exchange rate may have negative effects on other sectors of the economy (i.e., exporters) and the OFWs themselves. The strong peso has in fact reduced OFW income by more than 10%, or roughly PHP 84 billion.

A more forward-looking and comprehensive development strategy must be implemented in order for the Philippine economy to navigate the emerging threats and opportunities provided by a global environment characterized by rapidly changing markets, disruptive technologies and knowledge-based competition. To realize this strategy, the weakest link in national developmental efforts must be addressed: the bureaucracy. There is a need to improve administrative capacity and quality of public administration to bring greater congruence between governance structures and the requirements of economic and social development. There should be an end to the disruptive and elitist politics of the past. There must also be a negotiated peace settlement of the enduring conflicts with the communist insurgents and Muslim secessionists.

Well into the 21st century, Philippine politics is still conducted with nineteenth-century technology. It is imperative to harness available information and communication technology to modernize the electoral system. Decentralization

can bolster the institutionalization of political parties by establishing stable linkages with civil society organizations and local communities to avoid reliance on government resources (e.g., pork barrel allocations) for local political machines. A dispassionate and nonpartisan debate on the need for constitutional change must continue after President Arroyo's term in order to address the nationalist provisions that obstruct economic growth and to begin overhauling the outmoded political institutions. Lastly, social reform efforts must focus on visible improvement in delivery of services and safety nets, especially in education, food security, health care and jobs.