Political Governance, Economic Policy Reforms, and Aid Effectiveness: The Case of the Philippines with Lessons from the Ramos Administration

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Introduction

My lecture has three interrelated themes, namely, political governance, economic policy reforms, and aid effectiveness. The setting is the Philippines, with lessons drawn specifically from the Ramos administration. I will look at these three themes in terms of how each one contributes to two goals of economic development, namely, creating opportunities and expanding the breadth and scope of human choices. Viewing the themes this way yields a framework for organizing thinking about the various reforms carried out by the Ramos administration.

In 1992, when the administration of Pres. Fidel V. Ramos began, the Medium-Term Philippine Development Plan (MTPDP) 1992-98 made improving the quality of life of every Filipino its development vision. To realize this vision, the administration geared its policies and programs to creating opportunities and expanding the range of human choices in a sustainable manner. In line with this, the Ramos administration initiated reforms in many fronts: political, economic, and social

At the outset, it is useful to note that over the past two decades, one of the fundamental changes in thinking about growth and development is the increasing recognition of the possible contribution of political governance and institutions to economic growth. Political institutions and good governance have now joined economic factors like savings, investments in human and physical capital, and technological progress as key determinants of growth. At the most rudimentary level, public choice is able to expand private choice when markets fail or are unable to produce some commodities in the amounts commensurate to what society demands. When government is able to get society to agree about what public goods must be collectively supplied, then society benefits from the additional public goods that government provides. Some of the public goods assist private production. For example, roads, bridges, ports and airports that the private sector will not build may be provided by the government through a tax-and-spending system, or through a public-private partnership scheme.

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Meanwhile, economic policy reforms are undertaken in pursuit of efficient production and distribution, which in the process leads to growth. Such reforms, in so far as they increase reliance on the coordinative ability of markets guided by a price system, enable scarce resource to move to their most valued uses. Savings go to investments in human, physical capital, and technological capital to produce growth. At the same time, market reliance fosters competition, thereby yielding invention and innovation. As a result, there is growth, and human choices expand.

Furthermore, I note that official development assistance (ODA) continues to be the main instrument of the developed countries in assisting developing countries realize their development goals. The conduct of ODA is largely the product of a political process in the donor country. It is in the budget of the central government and so cannot miss being at the center of political debates. It generally comes in two forms: grants for technical assistance and capacity building, and concessional loans for project financing. ODA is a source of concessional financing largely for the social overhead capital requirements of the developing countries, where normally, long-term financing for infrastructure facilities is not available. In addition, technical assistance helps developing countries provide international public goods to their residents, such as, clean air and water, and disease-free surrounding for the poor. All this expands human choices in the developing countries.

Political Governance

It is widely agreed that markets require good governance and credible institutions to be able to help facilitate growth and development. If the government intrudes excessively in the price system, the latter loses its ability to signal which commodities are getting scarce or in surplus. Resources are thus misallocated. At the very least, the political structure in place must be stable. Rules are expected to be procedurally and operationally efficient across political administrations.

In addition, the police and the military must ensure that internal security is guaranteed and that the country is adequately protected against external aggressors. Furthermore, there must be a legal, judicial, and administrative system in place that is conducive to contractual performance. In case contractual disputes emerge, the same system must be able to adjudicate fairly and without undue delay.

Challenges and Responses

The 1986 Constitution of the Philippines provides for a presidential system, elected to a term of six years without reelection by direct voting. The candidate who garners the highest number of votes is proclaimed president.

The first important political challenge that Pres. Ramos faced was building and solidifying his administration's political base in Congress. He won with only a small majority in the presidential election of 1992. To succeed in his economic and social agenda, it was important to get the support of Congress.

The Constitution also provides for an elected Congress with two chambers, namely, the House of Representatives and the Senate. Representatives, no more than 250, serve a term of three years with reelection; they are subject to a maximum of three consecutive terms. Senators, 24 of them, are elected to a term of six years with reelection, but under a maximum of two consecutive terms.

The Constitution allows a multiparty system. In this political setting, an elected president has to build a coalition in Congress to heighten the likelihood of getting support for his or her legislative agenda. The dominant political party that emerged from the political maneuvers was Pres. Ramos's political party, namely, the LAKAS-NUCD.

The other challenge that the Ramos administration faced concerned internal security. Pres. Aquino had been the target of several military coup d'etats, all of which failed to unseat. However, her presidency was perceived to be unstable, yielding adverse economic consequences, especially on inflows of foreign investments.

To address internal insecurity, Pres. Ramos in his first State of the Nation Address delivered on July 27, 1992 issued Proclamation no. 10, granting amnesty to 4500 rebels consisting of former soldiers, communist party members, and Moro National Liberation Front (MNLF) members. Peace talks with the MNLF were aggressively pursued, culminating in the signing of a peace pact in November 2003. Ramos also created the Office of the Presidential Adviser on the Peace Process to oversee implementation of the peace program. This was in recognition of the importance of peace and order as a precondition for economic development. Mindanao, in particular, could not realize its growth potential in view of a pestering Muslim insurgency in the South. Once the peace accord with the MNLF was signed, an Autonomous Region for Muslim Mindanao was established.

The other challenge that the Ramos administration confronted came from the Judiciary. The latter was perceived as an activist court when it came to economic matters. The Constitution provides for this third branch of government whose justices are appointed by the President of the Philippines based on recommendations of the Judicial and Bar Council. Decisions of the Supreme Court become part of policy in so far as they constitute precedents.

To illustrate the activist stance of the High Court, during the time of Ms. Aquino, a foreign petrochemical company wanted to locate in Batangas; some government officials wanted the firm to put up its plant in Bataan. The case was brought to the Supreme Court and the foreign firm lost. In response, the foreign firm just abandoned its plan to invest in the

Philippines. To deal with this issue, the Ramos administration appointed justices that were pro-market and liberal minded. In addition, some ODA-funded technical assistance was worked out for the Judiciary in support of a judicial reform program.

To get support for his economic policy reform program, such as, accession to the World Trade Organization (WTO) and oil industry deregulation, the Ramos administration worked for the enactment of a law creating the Legislative-Executive Development Advisory Council or LEDAC. The LEDAC is chaired by the President and co-chaired by the Senate President and the House Speaker. The LEDAC serves as a forum for consensus building on the part of the Executive and the Legislative on important bills, particularly, economic policy reform measures.

In addition, in 1993, Pres. Ramos convened a Multisectoral People's Summit consisting of representatives from the Executive, Congress, and the private sector to forge a common legislative agenda supportive of development goals. The covenant that came out of the summit was called the Social Pact for People Empowered Development. Two of the agreements pertained to closing the fiscal gap and the electric-power shortage.

Economic Policy Reforms

When Mr. Ramos assumed the presidency in 1992, he inherited an economy with a large budget deficit. The economy had receded in 1991 largely as a result of austerity measures imposed by a standby credit arrangement with the International Monetary Fund (IMF) and the destruction from natural disasters like the eruption of Mt. Pinatubo. Pump priming the economy through increased government spending was ruled out in view of the large budget deficit of the national government. Instead, the Ramos economic program put great reliance on private initiatives. That shift in strategy called for several structural policy reforms, including, privatization and deregulation, all of which entailed institutional changes. The latter, meanwhile, needs strong political support. Pres. Ramos could already count on a majority coalition in Congress. Moreover, LEDAC was already being convened. But before the Administration could fully embark on its market-based strategy, it had to address a serious challenge—an electric power shortage.

Power shortage

In 1992, the economy was subjected to a severe shortage of electric power, which could be traced to the 1983 foreign debt crisis. After the government declared a moratorium on foreign-debt servicing, the National Power Corporation (NPC), a government monopoly in power generation and transmission, was unable to build new generating capacity, even to replace, for instance, the foregone power from the mothballed Bataan Nuclear Power Plant. At the height of the power shortage, the country experienced daily brownouts lasting 8 to 12 hours. All sectors of the economy, especially, non-agriculture, saw their respective output slow down.

To resolve the power crisis, it was important to build new power generating capacity in the quickest time possible. But existing government regulations on procurement posed obstacles to a rapid approach. Under the leadership of Pres. Ramos and with the help of Congress, the Electric Power Crisis Act was enacted into law, permitting negotiated contracts for power plants. At the same time, the Build-Operate-Transfer (BOT) Law was amended, which allowed independent power producers to operate. Five power plants were built under the Electric Power Crisis Act and 15 through BOT and its variants. These power plants added 770MW new capacity in Luzon, of which 715 MW were through BOT. As a result, the power outages were eliminated in December 1993. That strengthened the modest economic recovery that began in 1992, which gained strength through time until the 1997 Asian financial crisis intervened. Still, the economy was not hard hit by the financial crisis in view of the economic strengthening brought about by the other elements of the Ramos economic program, e.g., macroeconomic stabilization and financial-market liberalization.

Macroeconomic stabilization

The economic challenge was to sustain economic growth without triggering inflation and a balance-of-payments (BOP) crisis. Through the years, the economy experienced so-called boom-and-bust cycles on account of inconsistent fiscal, monetary and exchange-rate policies. Inflationary fiscal and monetary polices under a fixed exchange rate system, for instance, led to speculative attacks against the foreign reserves of the central bank, resulting in the collapse of the fixed exchange rate and a BOP crisis. To usher in stable growth, the Ramos administration adopted, first, a responsible deficit-reduction program.

Fiscal policy: Quite urgent was closing the budget deficit of the national government. When government borrows to finance the deficit, it absorbs funds that otherwise would go to private investments. However, the fiscal deficits of the previous years had starved the social sector of budgetary funds. A responsible deficit-reduction had to be implemented. As the Administration sought to balance the budget in the medium-term, it had to protect core values like health, education, shelter, and infrastructure. To do this, a combination of prudent spending and tax-enhancement measures had to be undertaken. The tax measures included an upward adjustment in the excise tax on cigarettes, withholding VAT or value-added tax on government contractors and suppliers, and establishment of a large taxpayers' unit in the Bureau of Internal Revenue (BIR). All of these measures resulted in an increase in the tax effort from 13.3% in 1992 to 15.2% in 1993.

By 1996, the consolidated public sector deficit, consisting of the deficits of the national government and of government-owned corporations, had posted a surplus, one year ahead of schedule.

Tax administration is also tax policy. In line with this, the computerization of the BIR and the Bureau of Customs (BOC) was undertaken. Tax reforms continued and in 1997, the Administration succeeded in having enacted the Comprehensive Tax Reform Act (CTRA) of 1997. It consisted of reforms of the personal income tax and of the corporate income. Reforms in tax administration were included.

The political base of Pres. Ramos in Congress helped ensure the enactment of CTRA. All tax measures emanate from the House of Representatives, approved by the Ways and Means Committee of the House, and then sent to the Senate for its concurrence.

This achievement in the fiscal front was helped by revenues raised from privatization of big-ticket items like PETRON, a government corporation engaged in oil refining and petroleum-product distribution, and the Philippine National Bank (PNB), a wholly owned government commercial bank that was the biggest in terms of assets at the time. Ramos also initiated the sale to the private sector of military base lands, such as, Fort Bonifacio and Clark Air Base. The Metropolitan Waterworks and Sewerage System (MWSS) in Metro Manila was also privatized.

Rationalization of national government spending, particularly, for activities devolved to the local government units (LGUs) also helped a lot. LGUS were already receiving during the latter part of the Ramos administration an internal revenue allotment (IRA) equal to 40% of the total internal revenue collection of three years ago.

Monetary policy: The central bank emerged from the martial-law years nearly bankrupt. It was saddled with huge liabilities incurred through time under inappropriate monetary and exchange rate policies. The institutional arrangement in the monetary board, which was then dominated by the fiscal authority, also created an incentive for inflationary monetary policy. The liabilities precluded conduct of sound monetary policy.

A major breakthrough in the conduct of monetary policy was the passage of the New Central Bank Act in 1994. The law created an independent monetary authority called the *Bangko Sentral ng Pilipinas* (BSP). It is independent in that it consists of tenured members of the Monetary Board appointed from the private sector, except for one, who is chosen by the President of the Philippines from one of the economic managers in the Cabinet. In addition, the balance sheet of the new BSP was cleared of liabilities.

The new charter upholds “price stability” as the major goal of the BSP. In line with this new mandate, the BSP has adopted inflation targeting as its monetary policy rule. With this rule, the economy has entered a low-inflation rate regime that has held up until now in spite of shocks like the recent oil-price spikes.

Again, this BSP Act would not have passed without strong support from Congress. The bill had been filed in Congress during the Aquino years but it was bottled up until Ramos came along.

Exchange-rate system: Prior to the Ramos years, there were recurrent BOP crises that could be traced to inappropriate exchange-rate systems. The system was either fixed or a managed float, none of which prevented an exchange-rate collapse.

The exchange-rate system favored by the Ramos administration was a flexible one. The exchange value of the peso against major foreign currencies was determined in foreign exchange markets. This system allowed large inflows of mobile foreign capital, funds that provided liquidity to the stock and bond markets, and led to episodes of a peso appreciation.

In the mid-1990s, currency appreciation became the norm in East and Southeast Asia. From hindsight, this helped sowed the seeds of the 1997 Asian financial crisis.

Long-term industrial restructuring

The unwanted growth fluctuations through the years posed another major challenge to the Ramos administration. In the 1980s, the Philippines had been left behind in the industrialization race by the likes of Thailand and Malaysia. How then could the Philippines rejoin and catch up with the newly industrializing economies in East and Southeast Asia? Pres. Ramos rallied the Filipinos under "Philippines 2000,' and made international competitiveness by the year 2000 a major goal. This meant reforms in industrial policies, foreign-trade policies, and foreign investments.

Industrial policy: This rested on raising agricultural productivity and accelerating investments in the non-agricultural sector, e.g., industry and services. To raise agricultural productivity, access to modern inputs, such as, seeds developed from research and development, was improved through import liberalization. Rural infrastructure development was stepped up. Irrigation was expanded, including the pest management program. To raise investments in industry and services, the Land Lease Law was enacted, extending leases to foreigners to 75 years. The Senate ratified accession to the Multilateral Investment Guarantee Agreement (MIGA). The Negative Lists in the Foreign Investments Act were trimmed, thereby expanding the industry areas that allowed hundred-percent foreign participation.

Import liberalization and tariff reduction: To enable domestic firms of any size to have access to least-cost imported inputs, such as, capital equipment, spare parts and components, import liberalization was accelerated. Executive Order (EO) no. 470
was issued providing for tariff reduction through time until a uniform rate of five percent was reached.

WTO accession: In 1994, the Senate ratified Philippine accession to the World Trade Organization (WTO), which was established following the conclusion of negotiations under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). The WTO is based on the Most-Favored-Nation (MFN) Principle. Any tariff privilege accorded to one member country can not be withheld from another. In other words, the principle of non-discrimination applies. The Philippines welcomed the WTO since it was able to access even the privileges forged bilaterally between developed member countries.

The Philippines, under Pres. Ramos, was also active in the ASEAN Free Trade Area, which was anchored on the Comprehensive Effective Preferential Tariff (CEPT) scheme. The CEPT puts tariffs on imports within AFTA between zero to five percent, except for items in the temporary exclusion list.

The Philippines, meanwhile, hosted the Leaders' meeting of the Asia-Pacific Economic Cooperation in 1996. APEC is an informal preferential trade and investment arrangement dedicated to "open regionalism." It adheres to WTO rules.

Financial market liberalization: Modern foreign trade is based on trade credits. In this regard, it was important to liberalize financial and capital markets alongside trade liberalization.

Under Pres. Ramos, commercial banking was opened up to foreigners with the entry of ten new foreign banks. And since trade in always conducted under risk and uncertainty, ten new foreign insurance companies were also allowed to operate.

In the stock market, the Ramos administration caused the merger of the two bourses operating in Manila and Makati. Undesirable arbitraging was thus eliminated.

Following these reforms, the Philippines got more integrated than before with the world economy through trade not only in commodities, but also in securities and national currencies.

Aid Effectiveness

. After the restoration of democratic political institutions in 1986, many donors expressed their support for the rebuilding efforts of the government. But for various reasons, aid commitment to the Philippines from donor countries got mired in low utilization and availment rates. In this regard, one of the first measures of Pres. Ramos was the setting up of a Presidential Task Force on Right-of-Way Acquisition. One of the first major expressways that got completed was C5, which traversed a former military camp, e.g., Fort Bonifacio, today a high-rent commercial, residential, and financial center.

In addition, Pres. Ramos issued orders to the Development Budget Coordination Committee (DBCC) inter-agency committees, to protect the budget appropriations of ODA-funded projects approved by the Investment Coordination Committee (ICC).

When foreign borrowings of the government neared the limits, he caused the enactment of the Official Development Assistance Act of 1996, which exempts ODA funds from the said foreign borrowing limit.

In terms of institutional arrangements, one of the achievements of the Ramos administration to make foreign aid effective is the strengthening of the links between planning and budgeting. The DBCC and the ICC worked closely to link the MTPDP and the public investment program to the annual budget of the national government. In addition, high-level senior officials participated in programming dialogues with missions from the donor countries, ensuring agency commitment to ODA-funded projects.

Outcomes of the Reform Process

The Ramos approach to governance and the comprehensive economic policy reforms based on market reliance and getting prices right did not fail to produce sound economic outcomes. In 1993, the economy recovered from stagnation of 1992 brought about by natural disasters and power shortages. Over time, real GDP growth gathered strength reaching a peak of 5.8% in 1996. In 1997, the Asian financial crisis broke out. The economy, however, escaped a recession that year, unlike, Thailand, South Korea, and Indonesia. When the crisis persisted, the economy slowed down and contracted slightly in 1998 by .58%. Meanwhile, as a result of financial reforms and prudent monetary policy, inflation was kept at the single-digit level; over the period 1993-97, it averaged 7.5%.

The economy's openness was enhanced by the trade reforms. As a result, growth rate of gross exports expanded nearly five times from 1992 to 1997. Gross international reserves rose in that same period to four months worth of imports, helping stabilize the exchange value of the peso against the US dollar.

A major accomplishment was the strengthening of the fiscal position of the national government. Tax effort went up while government spending was prudent.
One unfinished business in the fiscal from was the rationalization of special fiscal incentives, a major source of foregone tax revenues.

NEDA's Role

One of the working principles of Pres. Ramos was "complete staff work." In other words, any agenda item brought to the Cabinet for approval was expected to have been subjected to inter-agency assessment. In this regard, the NEDA became highly useful to the Ramos administration. The NEDA Board, which the president chairs, has at least four important inter-agency committees. These are the Development Budget Coordination Committee (DBCC), Investment Coordination Committee (ICC), Infrastructure Committee (Infracom), and the Social Development Committee (SDC).

The DBCC, chaired by the Secretary of the Budget and Management, prepared the budget submission of the president to Congress. The budget has both the macroeconomic outlook and the budget outlook (the program of spending, revenue raising, and financing of the deficit if any).

The ICC recommended for approval by the NEDA Board all major capital projects of the government. It is chaired by the Secretary of Finance. The ICC gets to determine the capital budget each year. It also evaluates all BOT projects.

The Infracom, chaired by the NEDA Director General, determines the infrastructure program over the medium term, from which the annual infrastructure projects are taken each year for inclusion in the budget.

The SDC is the policy making IAC for social development projects, including those for health and education. It is also chaired by the NEDA Director General.

The coordination done by the NEDA IACs went distance in accomplishing the programs and projects of Ramos administration. Coherent policies, not discretionary measures, emanated from the IACs. Accordingly, the private sector responded positively to the stable and predictable policies.

In closing, Philippines 2000 achieved what it set out to do, i.e., demonstrate the capacity of the Philippines to compete globally. Real per capita income recovered and reached more than a thousand US dollars by 1998. Exports expanded enabling the Philippines to elude the painful impacts of the 1997 Asian financial crisis. When Ramos exited in 1998, he handed a long-term plan to the incoming president that embodied a 2020 vision, essentially a continuation of the comprehensive reform process aimed at transforming the Philippines into a newly industrializing economy by the year 2020.