Development FOCUS

Poverty and Economic Policy in the Philippines

Past economic policies that hampered growth, and the resistance of powerful elites to much-needed reforms, were largely responsible for the high incidence and persistence of poverty in the Philippines. Recent policy changes have spurred growth, but additional reforms could accelerate the reduction of poverty.

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POVERTY is both more widespread and more persistent in the Philippines than in neighboring ASEAN (Association of South East Asian Nations) countries. While the poverty rate has decreased in the Philippines over the past 25 years, the decline has been slower than in other ASEAN countries. Some of the blame for the Philippines' slow progress in reducing the incidence of poverty can be attributed to past economic policies that retarded growth by discriminating against agriculture and discouraging investment in human capital. These policies, in turn, sustained powerful interest groups that blocked or delayed economic reform.

The Philippines began to undertake political and economic reforms in the late 1980s and early 1990s, however, and GDP growth has accelerated to about 5 percent a year since 1994. With faster growth, the percentage of Filipinos living below the poverty line is decreasing, but agricultural reform and increased investment in human capital would allow a more drastic reduction in the poverty rate.

Income distribution and poverty

The incidence of poverty in the Philippines was not unusually high in the early 1970s, compared with a representative sample of Asian countries (Table 1), but very slow subsequent progress in reducing the rate of poverty meant that by the early 1990s, the poverty rate was dramatically higher in the Philippines than in its neighbors. (It is worth noting that comparisons of poverty rates across countries are complicated because poverty thresholds are calculated differently in every country. Poverty rates in these countries have also been affected by the recent economic downturn in the region.) In addition, income distribution in the Philippines, as measured by the Gini coefficient (a ratio of income inequality, with 0 representing absolute equality and 1 representing absolute inequality), is extremely unequal. Moreover, the Gini coefficient barely changed during 1957–94, varying only between 0.45 and 0.51 (Table 2). In 1994, the richest 20 percent of the population received 52 percent of the country's total income, nearly 11 times the share of the poorest 20 percent. These figures had changed little since the 1980s and had even become slightly worse: in 1985, the richest 20 percent of the population received the same share of national income as in 1994 and their average income was about 10 times that of the poorest 20 percent. The distribution of assets has also shown little improvement over the last few decades. Between 1960 and 1990, for example, the Gini coefficient on landholding worsened slightly.

Although an improvement in income distribution is often accompanied by a decrease in the poverty rate (absent a sharp decline in national income), the two are not necessarily

Table 1

Poverty incidence in selected Asian countries [1]

(percent)

	Years	Annual reduction	First year	Last year
Philippines	1971–94	0.7	52	36
Indonesia	1970–90	2.0	58	19
Korea	1970–90	0.9	23	5
Malaysia	1973–87	1.6	37	14
Thailand	1962–88	1.4	59	22

Sources: World Bank, 1996, and Philippines, National Statistical Coordination Board, 1996.
[1] Defined as proportion of families living below the poverty line.

Table 2

Income distribution in selected years, 1957–94

	1957	1961	1965	1971	1985	1988	1991	1994
Gini coefficient	0.461	0.497	0.513	0.494	0.447	0.445	0.468	0.451
Percent of income, top 20 percent	48.6	56.5	56.0	54.0	52.1	51.8	53.9	51.9
Percent of income, bottom 20 percent	6.5	4.2	3.5	3.6	5.2	5.2	4.7	4.9
Ratio of incomes of top 20 percent to bottom 20 percent	7.5	13.5	16.0	15.0	10.0	10.0	11.5	10.6

Sources: 1957–71, Deininger and Squire, 1996; and 1985–94, Philippines, National Statistics Office, various years.

Table 3

Gini coefficients in selected Asian countries

	Years	First year	Last year
Philippines	1957–94	0.461	0.451
Indonesia	1964–93	0.333	0.317
Korea	1953–88	0.340	0.336
Malaysia	1970–89	0.500	0.484
Thailand	1962–92	0.413	0.515

Sources: Deininger and Squire, 1996, and Philippines, National Statistics Office, 1994.

linked. It is quite possible for poverty rates to fall even when the distribution of income becomes more unequal. In fact, while progress in fighting poverty in the Philippines has been slow by Asian standards, the country's disappointing experience in improving income distribution is not unique in Asia. None of the countries cited in Table 1 as being more successful in reducing poverty rates over time has experienced a large decline in its Gini coefficient in recent decades (Table 3). Instead, these countries seem to have lowered their poverty rates by increasing incomes for all income groups. This suggests that decades of very slow growth, rather than inequality, may have been the most important cause of the persistence of poverty in the Philippines. Indeed, between 1970 and 1995, real GDP in the Philippines grew at an annual rate about half that of the other Asian countries and barely exceeded population growth (see chart).

Poverty in the Philippines, as in most countries, tends to be associated with low education levels for heads of households and with large family size. Poor Filipinos are disproportionately employed in agriculture, fishing, and forestry: these occupations account for 62 percent of poor households, but for only about 40 percent of the employed labor force. The poor also seem to be disproportionately rural: 60 percent of the poor were living in rural areas in 1991, compared with 51 percent of the total Philippine population. Since 1960, the proportion of the population classified as urban has increased from about 30 percent to 50 percent, while the proportion of the poor living in urban areas has grown from 30 percent to 40 percent. Although these figures could be interpreted as suggesting that migration from rural to urban areas has led to a reduction in poverty rates, they reflect, in part, a statistical artifact: rapidly growing rural areas tend to be reclassified as urban, while slowly growing ones do not. In fact, between 1970 and 1990, poverty rates declined faster in areas that were initially classified as rural than in areas that were classified as urban.

Economic policy and poverty

The sluggish pace at which the Philippines has reduced poverty over time can be traced to economic policies that hobbled growth, many of which have recently been abandoned, as well as to policies that have more directly perpetuated income inequality.

Exchange and trade policies. For many years, the Philippines pursued an industrial policy that encouraged import substitution rather than promoting exports. Until tariff reforms were introduced in 1991, trade policies heavily penalized the primary and agricultural sectors and benefited the manufacturing sector. In addition, the overvaluation of the Philippine peso during several periods between the 1950s and the 1980s contributed to declines in the prices of exports in peso terms and diverted resources away from agriculture and toward import-substituting manufacturing. In addition, incomes in the agricultural sector were depressed by heavy regulation. Beginning in the 1970s, price controls were imposed on rice and other products, and the importation of wheat and soybeans was monopolized. The government introduced controls on the production, marketing, and processing of coconuts and created a price stabilization fund, while fertilizer and pesticide imports were controlled through licensing requirements.

Overvaluation of the peso, tariff policies, and heavy government regulation discouraged investment in agriculture, with a disastrous effect on productivity. For example, during 1982–85, productivity in the coconut sector—which had long been the country's most important agricultural industry in terms of export earnings and employment—averaged 1.0 metric ton per hectare, exactly the same as during 1962–66. Low agricultural productivity remains a drag on growth, partly because some agricultural tariffs have been maintained at the maximum level permitted by World Trade Organization (WTO) agreements, even though tariffs were dramatically lowered in almost all other sectors during the early and mid-1990s. While real GDP growth has averaged 5 percent annually since 1994, growth in the agriculture, fishing, and forestry sectors has averaged less than half this rate.

The overvaluation of the peso, as well as fiscal and other incentives (such as tax exemptions for imported capital equipment), has also reduced the cost of capital and encouraged the substitution of capital for labor. As a result, the share of the industrial sector in total employment has grown only from 13 percent in 1960 to 16 percent in 1996. Between 1980 and 1996, 5 million new workers joined the Philippine workforce. The agricultural and services sectors accounted for nearly 80 percent of the increase in employment, while

fewer than 10 percent of the new workers joined the manufacturing sector.

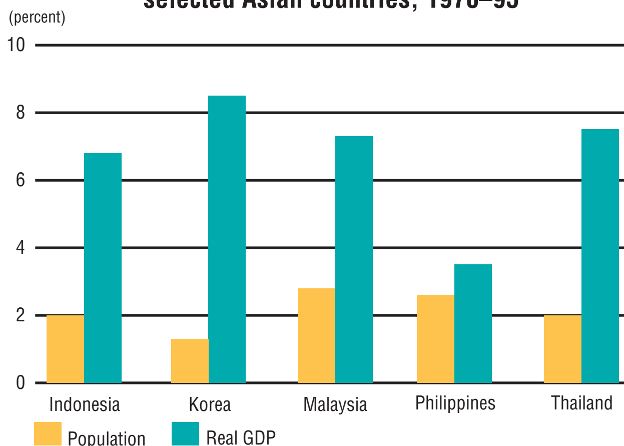
Federal government expenditures. Because the poor are better endowed with labor than with physical capital, public expenditures on education and health can exert an important influence on poverty and income distribution. Unfortunately, public investment in human capital in the Philippines was both low and inefficiently allocated for many years and thus had a limited effect on poverty and inequality. Historically, public education in the Philippines has been underfunded relative to other ASEAN countries; central government expenditures on education, both as a percentage of GDP and as a percentage of total government spending, were significantly lower than in Malaysia and Thailand, for example. Moreover, the distribution of education spending among levels of schooling is skewed toward secondary and tertiary education. The government now subsidizes a greater share of education expenses at the university level (78 percent) than at the primary level (69 percent). While participation rates in primary schools are high, they drop sharply by age 13 for lower-income pupils in urban areas, and by age 11 for those in rural areas. Scores on achievement tests and data on the number of textbooks per student raise concerns about the quality of education received by low-income students, particularly in rural areas. If spending were reallocated toward primary education, the quality would improve significantly and a greater proportion of lower-income students might remain in school, especially in rural areas.

Spending on health and nutrition in the Philippines is also relatively low by ASEAN standards, and the composition of expenditure is biased toward higher-income consumers. Per capita spending on health care tends to be higher, and access to primary health care stations better, in urban areas than in rural ones—Metropolitan Manila, which has the lowest poverty incidence (about 8 percent) in the country, is particularly favored. In addition, expenditure has concentrated on expensive, tertiary-level care, which lower-income families cannot afford; between 1981 and 1990, the share of total health care expenditures captured by preventive care fell from 35 percent to 14 percent, while the share of curative care rose from 55 percent to 65 percent. This distribution of expenditure is not out of line with international averages: the World Bank's *World Development Report 1993* calculated that the average developing country government spent two-thirds of its health care budget on secondary and tertiary care in 1990. However, the report also noted that an optimal allocation of health care spending would be less than one-third going to secondary and tertiary care, with the bulk going to primary care, whose impact (in terms of reducing mortality rates) is much greater.

Tax policy. Indirect taxes (for example, value-added taxes, excise taxes, and customs duties) account for about 70 percent of tax revenues in the Philippines; it would therefore be easy to conclude that the overall tax system must be regressive. Because the poor consume a larger percentage of their incomes than do the wealthy, consumption-based taxes are nearly always somewhat regressive in their impact, even when food is exempt. However, the fairness of any particular tax—and, indeed, of the tax system as a whole—must be viewed in the context both of the alternatives for raising revenues and of the progressivity of the expenditure side of the budget—that is, who benefits from tax revenues. In other words, indirect taxes may be less regressive than the other revenue-raising alternatives available to the government, and, if revenues are raised in a mildly regressive manner and spent in a highly progressive way, the impact of fiscal policy could still prove to be progressive.

Although the Philippines' individual income tax system is quite progressive, at least on paper, it is easier for the wealthy than for the less well-off to reduce or avoid taxes (as is the case in many countries). Although the Philippines has withholding taxes on the incomes of wage earners, the earnings of businessmen are harder to measure, and the wealthy have more opportunity to engage in perfectly legal tax-reduction strategies, such as tax-free investments and deposits. In countries where the administration of taxes on the wealthy is difficult, and where there are many tax incentives and preferences that benefit the wealthy, effective tax rates for this group may be much lower than statutory ones, and an income tax that is progressive on paper may be neutral or even regressive in practice. When income taxes can easily be avoided, shifting the tax burden to consumption may actually be more progressive, with the wealthy paying a higher proportion of tax revenues and a higher percentage of their incomes in tax. Recently, the Philippine government introduced a number of tax reforms designed to enhance the overall progressivity of the tax system—for example, by bringing into the income tax net individuals (mostly high-income ones) who were previously out of the tax system's reach.

Annual population and real GDP growth rates in selected Asian countries, 1970–95



Source: International Monetary Fund, 1997, *International Financial Statistics Yearbook* (Washington).

More generally, it is very difficult in any country to effect a major redistribution of income through the tax system, in large part because many of the very poorest citizens are outside the tax net. For this reason, targeted expenditure programs that use revenues raised in an economically efficient manner may be more effective in helping the poor. While recent tax reforms and improvements in tax administration that reduce the scope for income tax evasion will make the Philippine tax system more progressive, ultimately it is very much a question not just of where the money comes from but also where it goes that determines the impact of fiscal policy on income distribution and poverty.

Income distribution and government policies

While economic policies have clearly affected poverty rates and income distribution in the Philippines, unequal income distribution has made it difficult to enact reforms that would increase equity. Given the costs of organizing political activity, the wealthy have a political influence in most countries that is greater than their numbers might justify. The more unequal the distribution of income, the smaller will be the number of individuals exerting political influence and the greater the resistance to policy reforms designed to redress income inequalities. At the same time, the industrial strategy pursued by the Philippines, which was based on heavy regulation and import substitution, created many opportunities for rent-seeking behavior and thus contributed to the concentration of power in an elite. The manipulation of economic policies for the benefit of a small group of well-connected individuals probably reached its most notorious stage during the presidency of Ferdinand Marcos (1965–86), when tax breaks, low-cost loans, debt bailouts, and monopoly rights were frequently granted to supporters of the president at the expense of taxpayers, workers, or small farmers.

The coconut industry provides an interesting case study of the interaction between economic policies and income distribution. Beginning in the early 1970s, a series of presidential decrees created a single institution with control of all stages of coconut production, from the purchase of coconuts from farmers to the sale of processed oil on the domestic and international markets. Although the measures were purportedly motivated by a desire to improve conditions for coconut growers, the main beneficiaries seem to have been a small number of politically well-connected individuals. Aided by a substantial levy on coconut producers and by its monopsony power (which enabled it to increase profit margins on its production by 600 percent), the United Coconut Mills/United Coconut Planters' Bank complex amassed vast sums of money at the expense of millers and traders, who were driven out of business, and of growers, who were forced to sell their output to one extremely powerful buyer.

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Although the coconut monopoly was dismantled by the administration of Corazon Aquino, progress in reforming the agriculture sector has been slow. For example, land reform efforts have met with little success, in large part because of the power of landed elites. While efforts to break up large land holdings began in the 1950s and have recurred sporadically since then—including the Comprehensive Agrarian Reform Program (CARP) initiated in 1987—landholding actually became more concentrated between 1960 and 1990. Given the large budgetary expense that would be required to achieve a significant redistribution of land, abandoning CARP in favor of additional spending on rural education and health might ultimately do more to reduce poverty rates.

Conclusion

To a great extent, the relative lack of progress in improving poverty indicators in the Philippines can be attributed to the country's poor growth performance. Economic growth in the Philippines has been dampened by economic policies that favored capital over labor and import-substituting industries over agriculture, and that led to underinvestment in the human capital of the poor. These policies had a devastating effect, particularly on the agricultural sector, whose low productivity remains a drag on growth. The persistence of policies that have failed to stimulate growth owes much to the important role played by elites in Philippine politics and society. The Philippine government has introduced a number of reforms that have stimulated growth, and these should, in turn, help to alleviate poverty. It could achieve even more by eliminating remaining biases against agriculture and investing more in health and education, especially in rural areas. F&D

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