The Political Economy of Philippine Rural Development Since the 1960s

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This paper reviews the progress of rural development in the Philippines since the 1960s, identifies major government policies that affected rural development, and explores the political economy behind such policies.

Economic development in Southeast Asia during the last few decades has generally been quite impressive compared to developing countries in other regions such as South Asia and Africa. Compared to the other two countries of this study, however, the Philippines has lagged behind Indonesia and Thailand in its efforts to improve the welfare of its people. As of 1965, for example, real per capita GDP in the Philippines (using the 1995 PPP U.S. dollars) was highest among the three countries at more than twice that of Indonesia, with Thailand closely following the Philippines (Table 1). In the late 1960s, the Philippines had the smallest share of agricultural value added in GDP among the three countries (Table 1).

Furthermore, the Philippines tended to have the best human development indicators in the early 1960s — a longer life expectancy than in Indonesia (although roughly equal to that of Thailand), the lowest infant mortality rate at almost one-half of Indonesia's rate, the highest primary school enrollment ratio, and lowest illiteracy rate among the three countries (Table 2). During the subsequent few decades, both Indonesia and Thailand not

<table>
<thead>
<tr>
<th>Country</th>
<th>Real per capita GDP (1995 PPP dollars)</th>
<th>Agricultural share of GDP (percent)</th>
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</thead>
<tbody>
<tr>
<td>Thailand</td>
<td>1,570 6,723</td>
<td>40 23 11</td>
</tr>
<tr>
<td>Indonesia</td>
<td>817 3,346</td>
<td>54 24 16</td>
</tr>
<tr>
<td>Philippines</td>
<td>1,736 2,475</td>
<td>26 25 20</td>
</tr>
</tbody>
</table>

Source: Ahuja et al. (1997)
only caught up to the Philippines, but surpassed the country in many aspects of economic development. Both Indonesia and Thailand had achieved higher income growth, more dynamic structural transformation, and much more impressive poverty reduction by the 1990s (Tables 1, 2 and 3).

A natural question thus arises — relative to its Southeast Asian neighbors, why did the Philippines fail to achieve its economic development goals despite a very favorable initial position in the 1960s? We will review the last few decades drawing primarily on the existing literature, and will examine government policies and the economic development process in the rural sector (where the bulk of the nation’s poor are found). Starting with the next section, we will briefly review the aggregate Philippine economy over the last three decades, and then focus on the rural sector by reviewing rural development outcomes such as agricultural production and rural poverty. We will then discuss government policies that had major effects on rural development, followed by a discussion of the background behind such policies, and ask why such policies were adopted

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<thead>
<tr>
<th>Human development indicator</th>
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<th>Indonesia</th>
<th>Philippines</th>
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<tr>
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<td>1996</td>
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<td>64.6</td>
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<th>Infant mortality rate (per 1,000 live births)</th>
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<th>1970</th>
<th>1980</th>
<th>1996</th>
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<td>73</td>
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<tr>
<td>1970</td>
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<td>1980</td>
<td>90</td>
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<td>1980</td>
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<tr>
<td>1996</td>
<td>28.1</td>
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<tbody>
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<td>1960</td>
<td>32.3</td>
<td>21.4</td>
<td>12.0</td>
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<td>61.0</td>
<td>43.4</td>
<td>32.7</td>
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<tr>
<td>1996</td>
<td>5.4</td>
<td>116</td>
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Source: World Development Indicators, World Bank.

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<thead>
<tr>
<th>Table 3. Agriculture and gross domestic product growth in Thailand, Indonesia, and the Philippines, 1965 to 1997</th>
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<tr>
<td>Country</td>
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</tr>
<tr>
<td>Thailand</td>
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<tr>
<td>Indonesia</td>
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<tr>
<td>Philippines</td>
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</tbody>
</table>

Source: World Development Report, World Bank (various issues); Asian Development Outlook, Asian Development Bank (various issues); and Food and Agriculture Organization (FAO) of the UN.
in the context of political processes and policymaking. Finally we will offer a summary and some conclusions.

**A Macroeconomic Overview — 1960-1997**

During the 1960s and the 1970s, the Philippines experienced macroeconomic growth but relatively little structural transformation compared to Thailand or Indonesia (Tables 4 and 5). The aggregate real GNP grew at annual average rate of 5.4 percent, and the real per capita GNP at 2.3 percent between 1960 and 1965. Inflation averaged about 5 percent during the 1960s. While the growth rate slipped slightly during the latter half of the 1960s to 4.3 percent (aggregate GNP) and 1.1 percent (per capita GNP), economic growth in the Philippines accelerated during the 1970s. The aggregate annual GNP growth rate averaged 6 percent and per capita GNP about 3.5 percent throughout the 1970s. The average inflation rate also accelerated in the 1970s, however, averaging between 9 and 10 percent. During this period, the relative importance of exports in the national economy increased, with the share of exports in GDP increasing from 12 percent in 1961 to 23 percent in 1981.

Despite relatively high aggregate growth rates during the 1960s and 1970s that were roughly comparable to those of its Asian neighbors, unlike its neighbors, the sectoral composition of the economy changed relatively little. The share of industry in GDP increased from 27 percent in the mid-1960s to 33 percent in the early 1970s. Industrialization proceeded moderately during the 1970s, when the share of industrial GDP grew from 32 to 39 percent. Similarly, the relative importance of agriculture in the national economy changed relatively little in the Philippines compared to its neighbors. The share of agricultural GDP remained stable at 26 percent between 1961 and 1966, but it then increased to 30 percent during the late 1960s and remained at that level through the early 1970s. Subsequently, the share declined to 24 percent by the early 1980s. The

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<tr>
<th>Table 4. Aggregate economic performance in the Philippines, 1960 to 1997&lt;sup&gt;a&lt;/sup&gt;</th>
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<tbody>
<tr>
<td>------------------------------------------</td>
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<tr>
<td>Per capita GNP (constant 1995 US$)</td>
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<tr>
<td>Annual GNP growth rate (%)</td>
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<tr>
<td>Per capita annual GNP growth rate (%)</td>
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<tr>
<td>Gross domestic investment (% of GDP)</td>
</tr>
<tr>
<td>Inflation (GDP deflator)</td>
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<tr>
<td>Value added by sector (% of GDP)</td>
</tr>
<tr>
<td>Agriculture</td>
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<tr>
<td>Industry</td>
</tr>
<tr>
<td>Exports of goods and services (% of GDP)</td>
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<tr>
<td>Share of merchandise exports (%)</td>
</tr>
<tr>
<td>Food</td>
</tr>
<tr>
<td>Manufactured goods</td>
</tr>
<tr>
<td>Agricultural labor force (% of total)</td>
</tr>
</tbody>
</table>

<sup>a</sup> Three-year averages with year indicated as middle year.
Source: World Bank, World Development Indicators
share of the labor force in agriculture, on the other hand, did decline steadily from 63 percent in the early 1960s to 57 percent in the early 1970s and further to 52 percent by the early 1980s. Changes in the sectoral composition of exports appear to be relatively more pronounced. The share of food exports declined from 54 percent in the mid-1960s to 34 percent in the early 1980s, while that of manufacturing exports rose from 6 to 23 percent during the same period.

The sustained aggregate growth in the national income failed not only to induce structural transformation, but also to reduce the incidence of poverty to a significant degree during the 1960s and 1970s. The absolute poverty rate declined somewhat (although consistently) through the 1960s and 1970s. The headcount poverty ratio fell from 75 percent in 1961 to 62 percent in 1971 and 60 percent in 1985. The income inequality, already at a quite high level by international standards, increased slightly during the early 1960s (Gini index of nationwide income inequality increased from 0.486 in 1961 to 0.491), but declined in the latter half of the 1960s (falling to 0.478 in 1971) and then through the 1970s (falling further to 0.446 in 1985), but the rate of such decline was quite modest (Balisacan, 1993). Throughout the period, population continued to grow consistently at a relatively high rate of 2.9 percent between 1965 and 1980. Such a high rate of population growth appears to have contributed to the continuous increase of unemployment, the decline in real wages, and the decline in average farm size.

After the growth period during the 1960s and 1970s, the Philippines went through a major series of political and economic crises followed by macroeconomic stabilization measures starting in the early 1980s. The economic crisis in the early 1980s was precipitated in the 1970s by economic growth driven by foreign debt under President Marcos, an unsuccessful expansionary and countercyclical policy in 1979-82, and the heightened political crisis, especially after the assassination of the opposition leader Benigno Aquino. The crisis triggered a series of stabilization measures including sharp devaluations, a contraction of public investment (due to reduced tax revenues and increased interest payments), massive monetary contraction, and high interest rates (Lim and Montes, 2000). As a result, the economy fell into a depression, with the real GNP growth rate turning negative between 1984 and 1985 — the average annual GNP growth rate was negative 1.7 percent on aggregate and negative 4.1 percent on per capita basis during the first half of the 1980s.

The relatively brief stabilization episode in 1983-85 was followed by (an equally short-lived) recovery during the latter half of the 1980s. With inflation under control, the balance of payments became positive, and under the new Aquino administration, the

<table>
<thead>
<tr>
<th>Years</th>
<th>Average annual GNP growth (percent)</th>
<th>Average annual per capita GNP growth (percent)</th>
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<tbody>
<tr>
<td>1960-65</td>
<td>5.4</td>
<td>2.3</td>
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<tr>
<td>1965-70</td>
<td>4.3</td>
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<td>1970-75</td>
<td>6.1</td>
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<td>1975-80</td>
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<td>3.7</td>
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<tr>
<td>1980-85</td>
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<td>-4.1</td>
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<tr>
<td>1985-90</td>
<td>5.2</td>
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<td>1990-95</td>
<td>2.9</td>
<td>0.4</td>
</tr>
<tr>
<td>1995-97</td>
<td>6.2</td>
<td>3.9</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators

Table 5. Growth of gross national product in the Philippines
severe stabilization measures were relaxed and the Philippines underwent economic
recovery. In the latter half of the 1980s, GNP growth recovered to 5 percent on aggregate
and 2.4 percent on a per capita basis. Such recovery in the Philippine economy in the late
1980s was short-lived, however. The looming debt and government assumption of the
liabilities of the private and government sectors guaranteed a quick return to tight fiscal
constraints. An increasing import demand and heavy international interest payments also
made external constraints strongly binding again. Inflation soared again, approaching 15
percent in 1990 (Lim and Montes, 2000). Both fiscal and external constraints triggered an
another episode of macro stabilization — tight monetary and fiscal policies and currency
devaluation. The economy stagnated once again with negative per capita GNP growth
from 1991 to 1993. The relatively high rate of population growth continued at 2.5 percent
during the 1980s and 2.3 percent between 1990 and 1995.

It looks as though the industrialization process had virtually ended by the early 1980s
in the Philippines — the share of industrial GDP declined through the 1980s and 1990s
from 39 percent in 1981 to 32 percent in 1996. The share of agricultural GDP, on the
other hand, remained stable at 24 percent during the early 1980s and then declined
slightly during the late 1980s to 22 percent by the early 1990s. As of 1996, agriculture
still accounted for 20 percent of GDP. The share of the labor force in agriculture
continued to decline very slowly throughout the 1980s, from 52 percent in 1981 to 46
percent in 1991. The structural transformation of exports also continued. The share of
food exports fell further from 34 percent in the early 1980s to 11 percent in the mid-
1990s while the share of manufacturing exports jumped from 23 to 57 percent during the
same period. Despite such transformation in the composition of exports, manufactured
exports were characterized by a low local value-added such as garments and electronics
(e. g., semiconductors). Furthermore, the pattern of agricultural trade in the Philippines
hinds at a loss of the country’s competitive edge, particularly in light of generally slow
growth of the agricultural sector compared to that in other Asian countries, as well as the
sluggish pace of industry and manufacturing in recent decades. The ratio of agricultural
imports to agricultural exports increased dramatically from 32 percent in the mid-1960s
to 152 percent in the late 1990s, illustrating how the farm sector has shifted from being a
net foreign exchange earner to a net importer. Noticeable declines in measures of
comparative advantage for agriculture as a whole and for all major crops accompanied
this trend (David, 1999).

A more salient transformation, measured by the change in the share of agriculture in
GDP, occurred in other Southeast Asian countries between 1960 and 1997. While the
share in the Philippines decreased from 26 to 20 percent, reductions in other regional
countries were more impressive — Malaysia (37 to 13 percent), Thailand (40 to 11
percent), and Indonesia (54 to 16 percent). The slow drop of agriculture’s share in total
employment, together with the sluggish absorption of labor in the industrial sector,
suggests an inability of the latter to create a sufficient number of jobs. Instead, additions
to the labor force over the years were mostly in agriculture and the informal service
sector where self-employment is more common and wages more flexible. Thus, the
process has merely served to limit the growth of labor productivity and real income in
these two areas (Balisacan, 1998b).
After the stabilization episode of 1990-92, with balance of payment and domestic inflation under control, monetary and fiscal policies were relaxed and the economy started to recover (Lim and Montes, 2000). The per capita real GNP finally started to grow in 1994 and the average annual GNP growth rate recovered to 3.8 percent on aggregate and 1.4 percent on per capita basis between 1990 and 1997. Nevertheless, the economic crisis during the 1980s and early 1990s was severe enough so that the country’s real per capita income level in 1996 was still roughly equal to its pre-crisis 1981 level.

The devaluation of the Thai baht in July 1997 set off the Asian currency crisis, with the Malaysian ringgit, the Philippine peso, and the Indonesian rupiah also coming under attack. The Thai baht lost one-third of its value, and the rupiah and peso lost about one-fourth of their value within several weeks (Montes, 1998). As the effects of the crisis spread through the region, the GDP growth rate in the Philippines fell from 5.2 percent in 1997 to negative 0.5 percent in 1998. Compared to its Southeast Asian neighbors, however, the negative effects of the ‘crisis’ were much smaller in the Philippines. For example, the annual GDP growth rate for Indonesia was 4.9 percent in 1997 and negative 13.7 percent in 1998, while figures for Thailand were negative 0.4 percent in 1997 and negative 8.0 percent in 1998 (Asian Development Bank, 1999). The Philippines, with a smaller pre-crisis expansion of its financial system, suffered relatively fewer macroeconomic setbacks from the Asian crisis than did its neighbors (Montes, 1998).

While the ‘crisis’ effects largely subsided at the macroeconomic level after the initial two years, there were important distributional effects from the negative shock during the crisis that could linger for a longer period. The negative effects tended to hit the poorest groups hardest, and that one of the notable responses among poor households was to withdraw their children from school (Balisacan, 1999b). Such issues are beyond the scope of this paper; we will focus on long-term rural development in the Philippines during the 30-year period prior to the outbreak of the Asian crisis in 1997.

### Agricultural and Rural Development in the Philippines, 1965-1997

This section focuses on the outcome of economic development efforts in the rural Philippines over the last three decades. Based on secondary data sources and existing literature, our discussion will cover growth in agricultural production and its sources, changes in rural poverty and income distribution, and changes in human development indicators in rural households.

**Regional diversity**

Most of the discussions that follow deal with the national aggregate. It is worth noting, however, that there is great diversity in the crops that are grown, as well as the production organizations and socioeconomic structure among regions. In fact, there is a major contrast between:

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1. It should be noted, however, that the contraction in 1998 was as much the result of the El Nino phenomenon that hit the agricultural sector.
• the rice-growing ‘old-settled areas’ (such as Luzon island) where the agrarian structure can be broadly characterized by ‘peasant agriculture’ of small and medium farms, and
• the ‘frontier areas’ (such as Negros Occidental and Mindanao) where large-scale plantations grow cash crops for export (such as sugar, banana, and pineapple).

The latter are somewhat reminiscent of the typical Latin American mode of production. For example, as of 1980 the average size among the rice farms and among the ‘old’ sugar areas on Luzon island was 2-3 hectares, while the average sugar farm in Negros Occidental was 16 hectares and pineapple farms in Bukidnon and South Cotabato (on the island of Mindanao) were 16-18 hectares (Census of Agriculture as cited in Hayami et al., 1990). Among the traditional export crops such as sugar and coconut, production organization differs between the areas dominated by the peasant production with share tenancy (e.g., Laguna, Quezon, and Bicol) and the areas dominated by plantations with central management and hired labor (e.g., South Cotabato and Davao Oriental). Even within Luzon island, production organization varies between ‘inner Central Luzon’ where rice and sugar haciendas are characterized by a combination of large-scale landlordism and share tenancy, and the ‘coastal Luzon’ areas (including Southern Tagalog) where small and scattered peasant farms dominate and hacienda type landlordism is absent.

Agricultural production

The agricultural sector performed quite well in aggregate during the 1960s and 1970s, with an average annual growth rate of 4.6 percent. This rate was substantially higher than the norm for most developing Asian countries and compared favorably with those for Thailand and Indonesia (Table 3). Growth among the major sub-sectors, however, was far from uniform (Table 6). For example, fishing grew the fastest, averaging 5.2 percent during the period and accounting for about a one-fifth of total agricultural growth. Its share in the sectoral gross valued added (GVA) rose from 12 percent in the mid-1960s to 20 percent in the 1980s (Table 7). The growth of crop GVA, averaging 3 percent per year during the period, also emerged as outstanding by historical standards. This sub-sector contributed about four-fifths of the observed growth of agricultural output. Exceptional increases were achieved in production of bananas (12 percent), maize (6 percent) and ‘other crops’ (8 percent). These items contributed 5, 8, and 40 percent, respectively, to total agricultural growth.

Growth in the share of ‘other crops’ in agricultural GVA — from 15 percent in the mid-1960s to 20 percent in the mid-1980s — was mainly from the rapid expansion of fruit and vegetable production, as well as non-traditional exports such as pineapple and coffee. On the other hand, the average growth of rice, the nation’s staple crop, was not particularly high compared to the average for the entire agriculture sector, although its share in total crop GVA remained substantial (at about 25 percent in the early 1980s).

2. This paragraph draws heavily on: Hayami et al., 1990, Chap. 2.
3. This is an understatement because the share of ‘other crops’ in agricultural GVA might have actually doubled because agricultural activities and services were lumped under this classification in periods prior to 1980.
Despite such a large share of rice in total production, increases in production contributed a modest share of 14 percent to the growth of agriculture during the period.

In the 1980s and the early half of the 1990s, production growth rates for virtually all crops decelerated — the annual average growth rate fell to 0.68 percent during the crisis period of the 1980s, and during the 1990s, the sector grew at an annual rate of 2.2 percent. Most of the country’s main crops then experienced a slight resurgence in the latter part of the 1990s, at least prior to the slump in 1998 when agricultural output fell by

<table>
<thead>
<tr>
<th>Table 6. Average growth rate of gross value added (GVA) in agriculture, by sector, 1965-97, percent per yeara</th>
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</thead>
<tbody>
<tr>
<td><strong>Crop or sector</strong></td>
</tr>
<tr>
<td>Agriculture</td>
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<tr>
<td>All crops</td>
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<tr>
<td>Rice</td>
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<tr>
<td>Maize</td>
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<tr>
<td>Coconut</td>
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<td>Sugarcane</td>
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<tr>
<td>Banana</td>
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<td>Other crops</td>
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<tr>
<td>Poultry &amp; livestock</td>
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<tr>
<td>Agricultural activities and services</td>
</tr>
<tr>
<td>Fishery</td>
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<tr>
<td>Forestry</td>
</tr>
</tbody>
</table>

a. Figures in parentheses are contributions of the indicated crop or sector to total agricultural growth.
b. Included in ‘other crops’ category.

Source: Philippine Statistical Yearbook (various issues), National Statistical Coordination Board (NSCB)

<table>
<thead>
<tr>
<th>Table 7. Crop or sector share in gross value added to agriculture, 1965-97a</th>
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<tbody>
<tr>
<td><strong>Crop or sector</strong></td>
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<tr>
<td>Agriculture</td>
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<td>Fishery</td>
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<td>Forestry</td>
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</tbody>
</table>

a. Three-year averages centered on year shown. Figures may not tally due to rounding.
b. Included in ‘other crops’ category.

Source: Philippine Statistical Yearbook (various issues), National Statistical Coordination Board (NSCB)
almost 6.6 percent due to the drought brought on by the El Nino phenomenon. The
country suffered a brief rice crisis in 1995 when a drought-induced shortage (which also
plagued the country’s other crops) sent food prices soaring and brought inflation to
double-digit levels largely due to policy missteps. Crop production, however, still grew
by 3.5 percent yearly from 1995 to 1997 with the biggest recoveries posted in sugar and
banana production (where real GVA expanded by 10 and 7 percent, respectively). Output
of almost all crops grew 2-4 percent during the period with the exception of coconut.
Coconut production has been in decline for over a decade, and as a result, its contribution
to total agricultural GVA has fallen from 9 percent in the 1960s and 1970s to only 4
percent in the 1990s.

The poultry and livestock sub-sector has emerged as the only consistent performer
through the years, growing at an average of 6 percent annually in the 1980s, and about 5
percent for most of the succeeding decade. Its strong showing contrasts with the declining
performance of fishing and the diminished role of forestry (Tables 6 and 7). The share of
poultry and livestock output in agricultural GVA climbed steadily from 14 percent in the
mid-1960s to 22 percent by 1997. This robust performance partially explains why the
growth rate of maize, which doubles as animal feed, typically exceeded that of rice until
the 1980s. The macroeconomic difficulties of the 1980s and early 1990s did not prevent
poultry and livestock from reaching respectable growth rates. Their expansion rate was
the highest rate among all agricultural sub-sectors, contributing over 50 percent in the
1980s and 1990s. Growth in poultry production (mainly chicken) accounted for much of
the progress, which could be partially explained by the relatively high nominal protection
rate induced by domestic policy.

**Sources of crop growth**

Increases in land productivity became the major source of growth in food production
beginning the mid-1960s. At the height of the Green Revolution, yield increases
accounted for much of the growth in agriculture. These gains were brought about mainly
by expanded irrigation systems, increased fertilizer use, adoption of high-yielding
varieties, and investments in rural infrastructure and education.

More than 80 percent of production growth for rice (averaging 4.0 percent annually
from 1965 to 1980) can be attributed to yield growth. Output increases narrowed
significantly in the following decades as productivity growth declined, especially in the
latter part of the 1980s. The annual rate subsequently tapered to 2.8 percent from 1980 to
1997. Major reasons for a slowdown include the continued decline of world rice prices,
stagnation of public investments in irrigation, high-yielding varieties that had reached
their production potential, and degradation of the environment from monoculture
cultivation (especially in irrigated areas), and soil erosion from rapid deforestation
(Balisacan, 1998a). Harvested area also stagnated and even fell slightly in some years due
to a series of natural calamities and shifting land out of rice production.

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4. These include the government’s failure to make quick import decisions and the imposition of
ill-fated price ceilings. According to Abrenica et. al. (1996), the government predicted the rice
shortage, but may have delayed imports because of possible effects on an upcoming election
(in May 1995).
The area of irrigated rice expanded at 2.6 percent yearly from the mid-1960s to the early half of the 1990s, while the rain-fed area diminished at an annual rate of 1.4 percent (Balisacan, 1998a). Irrigated area thus increasingly accounted for a greater proportion of the harvested area, rising from 33 percent in 1965 to 61 percent at the start of the 1990s. Because adoption of modern varieties and fertilizer was more rapid in irrigated areas than in rain-fed areas, yield growth tended to be faster in those areas, at least during the early stage of the Green Revolution. Irrigated areas also increasingly accounted for a greater proportion of total rice production, rising from 43 percent in the mid-1960s to 71 percent in the early 1990s. Even with an expansion in harvested area, growth of rice output continued to decelerate well into the decade as yield increases practically stopped.

Production of maize, the country’s other main staple, grew at similarly robust rates beginning in the mid-1960s until the late 1980s, with strong growth averaging 5.7 percent annually from 1965 to 1980, with exceptionally rapid growth in harvested area in the early 1970s. However, the area dedicated to the crop virtually stopped expanding by the next decade, leading to a slight dip in output growth. Harvested area declined drastically in the first half of the 1990s, dropping by 6.5 percent annually from 1990 to 1995. On average, the area planted to maize contracted at a rate of 1 percent yearly from 1980 to 1997, although output rose by 1.8 percent.

The country’s main traditional export crops, coconut and sugar, exhibited similar growth patterns. Coconut production grew by 3.8 percent annually from 1965 to 1980 even with declines in productivity as planted area expanded. The sector saw outstanding growth in the early 1970s when output grew by about 10 percent yearly due to significant yield increases. Output growth slowed thereafter as a result of declines in both harvested area and yield increases, although a brief recovery was staged in the second half of the 1980s when production grew by over 5 percent on average as yield expanded at about 6 percent annually. The area planted to coconut declined beginning in the mid-1980s.

Sugar production followed virtually the same pattern as that of coconut, growing rather spectacularly between 1965 and 1980, and contracting in succeeding years. Output growth similarly started plunging in the mid-1970s but recovered in the late 1980s and the succeeding decade. The area planted to the crop began declining in the mid-1970s until the late 1980s, but rebounded in the succeeding decade. Overall, from 1980 to 1997, production rose by an average of only 1 percent yearly.

The coconut and sugar sectors share similar histories in that they were both subject to heavy government intervention in the 1970s (export taxes, production levies, and/or export monopolies) and negatively affected by a persistent overvaluation of the local currency (Intal and Power, 1990). The two industries were deregulated in the late 1980s, and trade in sugar, a highly protected crop, was partially liberalized in the mid-1990s.

As we have seen, production growth rates for virtually all crops decelerated in the 1980s and the early half of the 1990s. One explanation is the decline in new area brought

---

5. In addition, development of irrigated areas and the widespread adoption of high-yielding varieties contributed substantially to more intensive fertilizer use in the rice sector. Fertilizer use on rice rose from an average of only 9 kg/ha NPK in 1964 to 67 in 1990. Harvested area planted to modern varieties also soared, from barely 10 percent of total harvested area in the mid-1960s to about 90 percent at the turn of the 1990s.
into cultivation. While agricultural land increased at an annual rate of 3.6 percent in the
1970s (brought about primarily by deforestation), the rate dipped to only 0.8 percent per
year in later decades. Other exogenous factors also contributed to the deceleration in the
1980s, including a drop in world commodity prices that affected traditional export crops,
a series of droughts and other natural calamities, and the virtual completion of the Green
Revolution by the early 1980s. In addition, however, there were policy-related factors,
including uncertainty about the Comprehensive Agrarian Reform Program (CARP) and
the sharp decline in public investments in agriculture.

Rural Poverty
We now turn to the patterns of rural poverty in the Philippines during the last four
decades. Measured by real per capita income or expenditures, rural families generally do
not fare as well as their urban counterparts (Table 8). Moreover, at 52 percent of the total
population, the rural sector continues to account for roughly 70 percent of national
poverty using simple head count indicators.6 The agricultural population is 63 percent of
the total rural population. The agricultural population accounted for 65 percent of the
total number of poor people nationwide, and had the highest poverty headcount (60
percent) in 1997, following the usual pattern. Available data further demonstrate that
agriculture typically registered the lowest rate of poverty reduction among all the
employment sectors while accounting for a majority of the poor in the country.

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</thead>
<tbody>
<tr>
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<tr>
<td>Population share (%)</td>
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<td>50.2</td>
<td>52.4</td>
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<tr>
<td>Poverty incidence (%)</td>
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<td>55.0</td>
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<td>51.4</td>
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<tr>
<td>No. of poor persons (‘000)</td>
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<td>18,118</td>
<td>17,346</td>
<td>17,988</td>
<td>19,591</td>
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<tr>
<td>Share of total poverty (%)</td>
<td>70.2</td>
<td>71.4</td>
<td>60.8</td>
<td>65.7</td>
<td>72.2</td>
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<tr>
<td><strong>Agriculture (urban and rural)</strong></td>
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<tr>
<td>Population share (%)</td>
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<td>45.5</td>
<td>44.5</td>
<td>43.3</td>
<td>40.1</td>
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<tr>
<td>Poverty incidence (%)</td>
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<td>61.7</td>
<td>63.7</td>
<td>62.0</td>
<td>60.3</td>
</tr>
<tr>
<td>No. of poor persons (‘000)</td>
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<td>15,552</td>
<td>17,910</td>
<td>18,103</td>
<td>17,561</td>
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<tr>
<td>Share of total poverty (%)</td>
<td>61.3</td>
<td>61.7</td>
<td>62.7</td>
<td>66.2</td>
<td>64.7</td>
</tr>
</tbody>
</table>

a. Official methodology uses region-specific poverty lines, differentiated by urban and rural areas and current income as a broad measure of household standard of living.

Source: Authors' estimates based on the Family Income and Expenditures Surveys (various issues).

6. Other poverty measures are more sensitive to income and expenditure distributions, e.g., poverty gap index (measures depth) and distribution-sensitive Foster-Greer-Thorbecke index (measures poverty severity), but the simple headcount index is sufficient for present purposes and does not change the general direction of results and conclusions.
Characteristics of the rural poor

In 1997, the rural poor accounted for about three-fifths of the total poor and their average income was about 20 percent below the poverty line, a figure that had fallen, albeit not dramatically, over the last decade. According to past studies, poverty incidence in rural areas has been characteristically high among those engaged in farming and fishing, while less so for households dependent on income earned outside of agriculture. Within the agricultural sector, among the poorest were farm workers in sugarcane, rice, maize, coconut, and forestry; maize, ‘other crop’, and coconut farmers; and fishermen (Balisacan, 1996b). Rice producers normally have lower average income shortfalls and fewer members below the poverty threshold, but they contribute the bulk of overall poverty in the agriculture sector by sheer numbers. The latest estimates show that the self-employed in agriculture account for a sizable number of the poor in the country (Table 9). Rural dwellers supporting themselves from their own farm-based enterprises (primarily lessees, tenants, and small owner-cultivators) contribute about 54 percent of total poverty based on the headcount index.

While the majority still earn their livelihood through entrepreneurial activities, increasingly more families in the overall rural population rely on wages and salaries as well as other sources of income (Table 10). While only about 5 percent of the total rural families depended on other sources of income in the 1960s, the figure jumped to 16 percent in 1997. This trend coincides with the substantial growth of overseas employment (mainly contract workers) beginning in the 1970s, which yielded substantial transfer income to rural households. The country’s poor still tend to be young, have large families, and be poorly educated (Balisacan, 1999b). In the agriculture sector in particular, poor families are characterized by a high level of underemployment (partly because of the monsoon-dependent nature of agricultural production), inadequate access to

<table>
<thead>
<tr>
<th>Income source</th>
<th>Population share</th>
<th>Incidence</th>
<th>Share in total poverty</th>
</tr>
</thead>
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<tr>
<td>Wage earners</td>
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<td>37.2</td>
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<td>Agriculture</td>
<td>7.8</td>
<td>43.8</td>
<td>13.7</td>
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<td>Non-agriculture</td>
<td>44.9</td>
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<tr>
<td>Self-employed</td>
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</tr>
<tr>
<td>Agriculture</td>
<td>32.0</td>
<td>42.1</td>
<td>53.9</td>
</tr>
<tr>
<td>Non-agriculture</td>
<td>14.7</td>
<td>14.8</td>
<td>8.7</td>
</tr>
</tbody>
</table>

Source: Authors’ estimates based on the 1997 Family Income and Expenditures Survey

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<tr>
<td>National Total families (’000)</td>
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<td>11,975</td>
<td>14,192</td>
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<td>Main source of income (percent of total families)</td>
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<td></td>
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<tr>
<td>Wages and salaries</td>
<td>36.0</td>
<td>43.0</td>
<td>44.1</td>
<td>47.9</td>
</tr>
<tr>
<td>Entrepreneurial activities</td>
<td>58.0</td>
<td>51.0</td>
<td>38.9</td>
<td>34.7</td>
</tr>
<tr>
<td>Other sources</td>
<td>5.9</td>
<td>6.0</td>
<td>17.0</td>
<td>17.5</td>
</tr>
<tr>
<td>Rural Total families (’000)</td>
<td>2,921</td>
<td>4,434</td>
<td>6,037</td>
<td>7,442</td>
</tr>
<tr>
<td>Main source of income (percent of total families)</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>26.0</td>
<td>33.1</td>
<td>34.1</td>
<td>38.3</td>
</tr>
<tr>
<td>Entrepreneurial activities</td>
<td>68.7</td>
<td>61.7</td>
<td>50.2</td>
<td>45.3</td>
</tr>
<tr>
<td>Other sources</td>
<td>5.3</td>
<td>5.2</td>
<td>15.7</td>
<td>16.4</td>
</tr>
</tbody>
</table>

Source: Authors’ estimates based on the Family Income and Expenditure Surveys (various issues)
or use of modern technology (mainly because of lack of credit), and weak access to social services, including healthcare and family planning (Balisacan, 1996b). For the large number of poor owner-cultivator farmers, farms are typically small and located in unfavorable areas (for example, outside of irrigated areas).

Rural poverty is common in areas where agricultural productivity is typically low and where droughts and typhoons occur frequently, such as the Bicol region and Eastern Visayas. In these areas, rural non-farm employment, apart from transfers, forms an important source of supplementary household income. In such cases, the poor are concentrated in traditional industries with low skills and capital requirements and very low labor productivity. Moreover, the pressure from brisk growth of the labor force in rural areas (nearly 3 percent on average over the past three decades) has led to a decline in real wages, especially for unskilled workers (Balisacan, 1996b). In areas such as Central Luzon where growth of agricultural productivity is high, the substantial growth of non-farm employment has slowed the decrease in real wages.

Regional profiles of income poverty

Poverty also varies considerably regionally.7 Metro Manila accounted for about 14 percent of the population, had the lowest poverty level, and contributed merely 2 percent of national poverty in 1997. On the other hand, Mindanao, the Visayas, and Bicol contributed about 70 percent of national poverty. The latest statistical surveys identify Eastern Visayas, Bicol, Western Mindanao, Central Visayas, and Central Mindanao (in that order), which are agriculture-dependent provinces, as having the highest poverty levels among all the regions.

Rural poverty trends over time

Table 11 summarizes estimated rural poverty measures8 at various points between 1961 and 1991 based on the Family Income and Expenditures Surveys (FIES). Table 12 similarly shows estimates of changes in the welfare levels of the rural population using the Labor Force Survey (LFS) conducted during the late 1970s and early 1980s, years not adequately covered by FIES but which are nevertheless important for present purposes. Table 13, meanwhile, compares poverty estimates between 1985 and 1997 using alternative poverty lines including both the ‘official poverty lines’ as well as the alternative approach using absolute cost-of-basic-needs (CBN) lines, which we refer to as the ‘preferred’ approach.9

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7. While this paper would prefer to focus on poverty measures in the rural sector of the various regions of the country, such estimates present comparability problems similar to the discussion in Appendix I.

8. Because definitions of ‘rural areas’ changed frequently among different rounds of FIES, we report here changes in rural poverty using both official definitions of rural areas (which changed over time) and rural areas as fixed physical areas identified as ‘rural’ by the 1970 population census (i.e., controlling for the problem of ‘shifting physical areas’ in the official definitions).

9. The preferred approach differs from the official one in three ways: (a) it makes use of current consumption or expenditures rather than current income as the broad indicator of household/individual welfare; (b) it imposes consistency in the construction of absolute
### Table 11. Rural poverty, FIES and fixed physical areas, 1961-1991 (percent, except t-ratios)\(^a\)

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<tbody>
<tr>
<td><strong>FIES rural areas</strong></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population share</td>
<td>64.5</td>
<td>68.7</td>
<td>69.6</td>
<td>61.4</td>
<td>62.1</td>
<td>50.4</td>
</tr>
<tr>
<td>Incidence</td>
<td>64.1</td>
<td>55.2</td>
<td>57.3</td>
<td>59.4</td>
<td>50.2</td>
<td>52.4</td>
</tr>
<tr>
<td>Depth</td>
<td>30.4</td>
<td>26.2</td>
<td>27.1</td>
<td>23.5</td>
<td>18.6</td>
<td>19.0</td>
</tr>
<tr>
<td>Severity</td>
<td>18.0</td>
<td>16.1</td>
<td>16.4</td>
<td>12.2</td>
<td>9.0</td>
<td>9.0</td>
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<tbody>
<tr>
<td><strong>Fixed physical areas</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Population share</td>
<td>68.5</td>
<td>68.4</td>
<td>68.0</td>
<td>65.3</td>
<td>64.6</td>
<td>64.2</td>
</tr>
<tr>
<td>Incidence</td>
<td>60.3</td>
<td>55.5</td>
<td>58.7</td>
<td>55.9</td>
<td>48.3</td>
<td>41.1</td>
</tr>
<tr>
<td>Depth</td>
<td>28.6</td>
<td>26.3</td>
<td>27.7</td>
<td>22.1</td>
<td>17.9</td>
<td>14.9</td>
</tr>
<tr>
<td>Severity</td>
<td>17.0</td>
<td>16.2</td>
<td>16.7</td>
<td>11.5</td>
<td>8.7</td>
<td>7.1</td>
</tr>
</tbody>
</table>

\(^a\) Figures in parentheses are t-ratios for poverty difference between the year indicated and preceding year. The test is based on Kakwani's (1990) methodology. Critical t-value at 5% significance level is 1.96; 1% level, 2.58. This table applies poverty lines estimated by the National Statistical Coordination Board for 1988 with real values held fixed for the period under study.

Source: Authors' estimates based on the Family Income and Expenditures Surveys (various issues).

### Table 12. Rural poverty, labor force survey data, 1977-1983 (percent, except t-ratios)\(^a\)

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</thead>
<tbody>
<tr>
<td>Incidence</td>
<td>56.2</td>
<td>55.7</td>
<td>48.6</td>
<td>49.4</td>
<td>57.1</td>
<td>60.6</td>
</tr>
<tr>
<td>Depth</td>
<td>28.1</td>
<td>28.4</td>
<td>24.3</td>
<td>24.7</td>
<td>28.5</td>
<td>30.3</td>
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<tr>
<td>Severity</td>
<td>14.0</td>
<td>14.5</td>
<td>12.1</td>
<td>12.4</td>
<td>14.3</td>
<td>15.2</td>
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</table>

\(^a\) No data available for 1979. Figures in parentheses are t-ratios for poverty difference between the year indicated and the preceding year. The test is based on Kakwani’s (1990) methodology. Critical t-value at 5% significance level is 1.96; 1% level, 2.58. This table applies poverty lines estimated by the National Statistical Coordination Board for 1988 with real values held fixed for the period under study.


Figures 1 and 2 summarize long-term poverty trends. Before discussing poverty trends during the past four decades in the rural Philippines, we should note the severe limitations imposed by the available data. As noted above, the poverty data for the period between 1977 and 1983 (LFS) and those for all other data years (FIES) derive from different sources, meaning that income levels captured by different data collection instruments are not directly comparable. Furthermore, the poverty lines used for FIES and LFS data are not the same. For these reasons, the estimated poverty incidence levels from FIES and LFS are not necessarily comparable. Unfortunately, there is no data series on poverty in the Philippines that is comparable over the entire four decades. In the absence of such data, we will attempt to interpret poverty trends using all available data, but being mindful of the severe limitations to such an exercise.
Table 13. Poverty estimates using official and preferred approaches, 1985-1997

<table>
<thead>
<tr>
<th>Grouping and year</th>
<th>Population share</th>
<th>Poverty incidence</th>
<th>Share of total poverty</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Official approach</td>
<td>Preferred approach</td>
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<tr>
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<tr>
<td>1985</td>
<td>100.0</td>
<td>49.2</td>
<td>40.9</td>
</tr>
<tr>
<td>1988</td>
<td>100.0</td>
<td>45.4</td>
<td>34.4</td>
</tr>
<tr>
<td>1991</td>
<td>100.0</td>
<td>45.2</td>
<td>34.3</td>
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<tr>
<td>1994</td>
<td>100.0</td>
<td>40.6</td>
<td>32.1</td>
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<td>1997</td>
<td>100.0</td>
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<tr>
<td>Urban</td>
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<tr>
<td>1985</td>
<td>38.7</td>
<td>37.8</td>
<td>21.7</td>
</tr>
<tr>
<td>1988</td>
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<tr>
<td>1997</td>
<td>47.6</td>
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<td>Rural</td>
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<tr>
<td>1985</td>
<td>61.3</td>
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<td>1988</td>
<td>62.0</td>
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<tr>
<td>1997</td>
<td>52.4</td>
<td>51.4</td>
<td>36.9</td>
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</table>

Source: Authors’ estimates based on the Family Income and Expenditures Surveys (various issues).

Figure 1. Rural poverty and per-capita GNP, 1961-97*

Source: FIES and LFS data
After a notable decline during the first half of the 1960s, rural poverty remained relatively stable at between 55 and 60 percent until 1978 (Figs. 1 and 2), which suggests that despite the respectable performance of national income growth, the level of poverty was hardly affected. Furthermore, poverty in rural areas was also relatively insensitive to the aggregate growth in agriculture during most of the 1960s (with the possible exception of the early 1960s when there was a significant reduction in poverty) through the late 1970s (Ranis and Stewart, 1993; Balisacan, 1993; Bautista and Lamberte, 1996). The poverty estimates based on LFS data show that headcount poverty did finally fall sharply between 1978 and 1980, but rural poverty increased rapidly again between 1980 and 1983 during the early period of the economic and political crises of the 1980s.

While rural poverty did finally decline rapidly between 1978 and 1980, the seeming insensitivity of poverty reduction to economic growth from the mid-1960s until the late 1970s appears to be an anomaly, given the commonly observed pattern in developing countries where agricultural growth serves as a powerful stimulus to increase rural employment and income. In many developing countries where rapid agricultural expansion occurred (e.g., Bangladesh, Colombia, Costa Rica, and the Punjab of India), relatively strong farm and non-farm links induced increases in rural real wages, reductions in rural poverty, and to some extent, a more egalitarian distribution of income. The rural areas in the Philippines have a higher incidence of landlessness compared to its Southeast Asian neighbors from a combination a plantation sector growing tropical cash crops and the high incidence of tenancy within the peasant sector. Such characteristics, as Hayami (this volume) argues, appear to be deeply rooted in both the ecological
conditions of the country and policy development during the colonial period.

Furthermore, there are numerous village level studies suggesting a rapid increase in the proportion of landless households in the rural Philippines during the 1960s and 1970s (Kirkvliet, 1990; Hayami and Kikuchi, 2000; Fuwa, 1999; Umehara, 1992). Given a high inequality in the distribution of land holdings and the increasing proportion of landless population in rural areas, it is no surprise that even the substantial growth in aggregate agricultural production barely benefited the rural poor.

Herdt (1987) and others have argued that the adoption of modern technologies in the 1960s and early 1970s tended to be initially concentrated among large-scale farmers, with small-scale farmers catching up in later years. Finally, some observers have pointed out that various policy measures during the period — including pricing and infrastructure policies, foreign trade and payment restrictions, a low interest rate policy, and effective credit rationing — tended to be biased against small- and medium-scale non-farm enterprises in rural areas, weakening the response of the rural economy to agricultural growth. (Balascan, 1998a)

The LFS data show that rural poverty increased significantly during the period between 1980 and 1983. This period signaled the beginning of the extreme economic difficulty for the country precipitated by unfavorable domestic and global events (political turmoil, current account and fiscal deficits, escalation of foreign debt amid an emerging global debt crisis, and a second world oil price shock), which necessitated severe economic stabilization measures. GDP contracted by over 7 percent in 1984 and 1985 which, until today, remains as the country’s worst post-war performance.

The trends over time in both per-capita GNP and headcount poverty (Figs. 1 and 2) suggest a notable shift in the responsiveness of poverty reduction to aggregate economic growth around the mid-1980s. It appears that poverty reduction became somewhat more sensitive to economic growth after the mid-1980s. Based on the FIES data, headcount poverty declined rapidly from 53 percent in 1985 to 37 percent in 1997. Both the very sharp increase in poverty in the early 1980s in response to the economic crises and the rapid poverty reduction in the 1990s (as well as between 1978 and 1980) are in contrast to the relative stability in the level of rural poverty between the mid-1960s and the late 1970s, despite the sustained growth in national income and agricultural production.

10. For example, in the Laguna village studied by Hayami and Kikuchi (2000) the share of ‘agricultural laborer’ households increased from 30 percent in 1966 to 61 percent in 1997.

11. In fact, the direction of change in rural poverty levels between 1988 and 1991 requires a closer examination given conflicting results depending on the definition of rural areas (Table 11). Rural poverty levels, as measured by headcount, worsened significantly during the period if the physical area of the rural sector is allowed to change in accordance with the shifting official definition of rural areas, although there was no significant change if poverty was measured by alternative poverty indices. In contrast, the same data show that rural poverty declined between 1988 and 1991 if poverty estimates were based on population distributions using the physically fixed rural areas (i.e., rural villages as defined under the 1970 census). The discrepancy arises mainly from ‘shifting of physical areas’ as rural villages become urbanized due to a rise in population and/or greater economic activity leading to the decline in poverty in fixed areas. The sharp contrast in the direction of rural poverty changes between poverty estimates apparently highlights the scale of this phenomenon (i.e., urbanization) during the period (see Appendix I).
We need to be quite careful in interpreting these data, however, because poverty estimates obtained from different data sources that are not necessarily comparable were combined. For example, there is a possibility that the estimated poverty levels based on the Labor Force Survey tend to be overestimated compared to those based on FIES. If this is the case, then the poverty rates comparable to the FIES estimates between 1977 and 1983 might have been lower than as indicated in Figure 1, which in turn would mean that there was a significant decline in rural poverty in response to economic growth during the 1970s through the beginning of the 1980s. Such a scenario cannot be ruled out. On the other hand, there have been studies which argue that poverty remained unchanged or even worsened during the 1970s (ILO, 1974; Boyce, 1993). Given the absence of a consistent data series on poverty that is comparable throughout the 1970s and 1980s, it is very difficult to draw a definitive conclusion about whether and to what extent there was poverty reduction in the Philippines in response to aggregate growth during the 1970s through the early 1980s. Nevertheless, it is possible to conclude that poverty reduction was relatively more responsive to economic growth after the mid-1980s than during the 1960s (and possibly the 1970s).

Based on their case study of a village in Laguna province, Hayami and Kikuchi (2000) argue that increase in income for the rural poor resulted from increased non-farm employment. The increase in non-farm income for the rural poor, in turn, resulted from both greater integration of rural into urban labor markets and the increase in non-farm income opportunities within rural areas (such as petty trading and local transportation services). In a larger context, the reduction of rural poverty arising from increased non-farm income opportunities for the poor can be seen as a part of widening industrialization that started in the mid-1980s in Southeast Asia where foreign direct investments moved toward lower wage countries (Hayami and Kikuchi, 2000).

In addition, as we will discuss later, substantial deregulation of agricultural markets, particularly in coconuts, sugarcane, and to some extent grains, was introduced during the early Aquino period. Some observers have thus noted that the significant reduction in rural poverty after the mid-1980s seems to suggest that policy measures for deregulation likely benefited small-scale farmers as well.

In sum, despite some fluctuations in the poverty level over relatively short horizons, there has clearly been a consistent trend in poverty reduction in rural areas after the mid-1980s. Overall, however, the pace of poverty reduction during the past four decades in the Philippines is a disappointment compared to poverty reduction in neighboring Asian countries. Using the internationally comparable ‘$1 a day’ poverty line used by the World Bank, for example, headcount poverty at the national aggregate fell by 10 percentage points from 36 to 26 percent between 1975 and 1995 in the Philippines. During the same period, poverty reduction was far more impressive in Indonesia, where headcount poverty dropped from 64 percent to 11 percent and in Thailand where poverty fell from 8 percent to near zero (Table 1).

Non-income dimensions of rural poverty
Changes in the welfare level of the rural population cannot be captured solely by changes in income and consumption. Equally important are access to the resources needed for the opportunity to lead a long and healthy life, and the ability to acquire and use knowledge.
Considerable improvement in life expectancy, literacy, and child health occurred between the early 1960s and the 1980s, but as with income growth, these achievements paled in comparison to those of neighboring Thailand and Indonesia (Table 2). The average annual changes in these indicators outpaced those for the Philippines, although some improvement occurred in the 1990s.

A little more than one-half of the entire rural population in the Philippines had access to safe water and sanitation services in the 1980s, but this situation substantially improved by the next decade (Table 14). The same is true for access to sanitation services, although the progress has not been as distinct. Rural-urban disparities in access to services have also narrowed somewhat over time. Access to safe water used to be available to a greater proportion of the rural population than it was for the urban population, while the opposite was true for sanitation services. Despite such developments, however, rural households still have much less access to sanitation services.

From an international perspective, a relatively large percentage of the rural population in the Philippines has access to basic services. On average, only about 60 percent of rural populations in developing Asia have access to safe water. For sanitation services, the corresponding figure is even lower at slightly less than 40 percent.12

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Thailand</th>
<th>Indonesia</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural population (%)</td>
<td>78</td>
<td>73</td>
<td>62</td>
</tr>
<tr>
<td>Rural population with access to services (%)</td>
<td>66</td>
<td>36</td>
<td>54</td>
</tr>
<tr>
<td>1988-1993</td>
<td>72</td>
<td>43</td>
<td>59</td>
</tr>
<tr>
<td>Sanitation</td>
<td>1985-1987</td>
<td>66</td>
<td>36</td>
</tr>
<tr>
<td>1988-1993</td>
<td>72</td>
<td>36</td>
<td>56</td>
</tr>
<tr>
<td>Urban population with access to services (%)</td>
<td>1985-1987</td>
<td>56</td>
<td>43</td>
</tr>
<tr>
<td>Water</td>
<td>1988-1993</td>
<td>87</td>
<td>68</td>
</tr>
<tr>
<td>Sanitation</td>
<td>1985-1987</td>
<td>78</td>
<td>33</td>
</tr>
<tr>
<td>1988-1993</td>
<td>80</td>
<td>64</td>
<td>79</td>
</tr>
<tr>
<td>Rural-urban disparity (parity = 100)</td>
<td>1985-1987</td>
<td>118</td>
<td>84</td>
</tr>
<tr>
<td>Water</td>
<td>1988-1993</td>
<td>83</td>
<td>63</td>
</tr>
<tr>
<td>Sanitation</td>
<td>1985-1987</td>
<td>59</td>
<td>115</td>
</tr>
<tr>
<td>1988-1993</td>
<td>90</td>
<td>56</td>
<td>78</td>
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</tbody>
</table>

Source: UNDP, FAO database

**Government Policies Affecting Rural Development**

In this section we will review the evolution of government policies over the last four decades. Instead of attempting a comprehensive review of different aspects of economic policies, we will primarily focus on the policy measures that likely had major effects on rural development, especially agricultural growth and rural poverty reduction. Given their major effects on rural poverty, we will start with a discussion of development strategies and economy-wide policies, and then look at agricultural policies and other policy instruments that directly focus on rural areas.

12. These figures must of course be taken with extreme caution given the low quality of available data in many developing countries, including the Philippines.

Revised Final 19
The Philippines long maintained a development strategy oriented toward import substitution that heavily protected the industrial sector. Such industrial protection policies, however, tend to raise the price of protected industrial products relative to the price of agricultural products, and consequently, hinder agricultural and rural development. It is now widely accepted that depression of agricultural prices through industrial protection had major negative effects on the growth of agricultural production and thus rural development in many developing countries (Krueger, Schiff, and Valdez, 1988). In the case of the Philippines, such negative ‘indirect protection’ against agriculture remained much larger in magnitude than the negative ‘direct protection’ aimed at the agriculture sector. Furthermore, import substitution policies also encouraged capital intensive, rather than labor intensive, patterns of industrialization, thereby limiting absorptive capacity of the industrial sector for labor, and thus seriously hampering poverty reduction effects of industrialization and economic growth.

**Development strategies and macroeconomic policies**

The Philippines failed to grow robustly on a sustainable basis and reduce poverty during the last half century because there was no ‘effective allocation mechanism’ that allowed the true comparative advantage of various industries to emerge (Bautista and Lamberte, 1996; Power and Sicat, 1971; Bautista et al., 1979; Medalla, 1990). Instead, past governments introduced distortions in economic policies, which, in not a few cases, made socially undesirable investments attractive to private investors and desirable ones (i.e., promising and efficient activities) relatively unprofitable (Power and Sicat, 1971; Bautista et al, 1979; Medalla et al, 1995). Such policies not only hampered economic growth at the national aggregate level, but also produced side effects deleterious to rural development. From the 1950s to the 1980s, an array of policies meant to push the country toward import substitution industrialization inadvertently stunted the development of the rural sector by creating a bias towards large-scale, capital-intensive manufacturing industries located in urban areas (especially Metro Manila). These policies were detrimental to rural enterprises that are inherently smaller, hire more labor, and make greater use of local materials (Medalla et al, 1995; Ranis and Stewart, 1987).

These policies also created an incentive structure that was significantly biased against agriculture — the economic backbone of the rural sector. Trade and exchange rate policies then distorted the relative prices of agricultural inputs and products, preventing efficient resource allocation, and tended to heavily favor the manufacturing sector over agriculture, non-tradable over tradable goods, and import-competing over export products. In the long run, resources moved away from agriculture and export sectors and new investment in these sectors was discouraged. Because agricultural production is more labor-intensive, less import-dependent, and more efficient in earning (or saving) foreign exchange than industrial production, the premature shift of resources away from agriculture dampened employment and product growth in rural areas.

The bias did not come largely from measures aimed directly at agricultural commodities, although government interventions in the form of taxes, customs duties, subsidies, quantitative trade restrictions, import prohibitions, price controls, and monopoly control in international trade had, up until the late 1980s and mid-1990s, affected agricultural incentives. It was rather the indirect effect of the overall
development strategy that accounted for a substantial part of the policy bias in the past
(Intal and Power, 1990; Bautista, 1987; David, 1983). The primary channel had been an
overvalued domestic currency traced to the industrial protection system and fiscal,
monetary, and exchange rate policies, specifically those adopted to promote import
substitution and accommodate current account imbalances.

Marcos administration — 1965-1986

By 1965, the Philippines had already been using an import substitution policy for
industrialization for 15 years, characterized by a protective tariff system and an incentive
scheme that favored (mostly capital-intensive) manufacturing at the expense of
agriculture and exports. Under President Ferdinand Marcos, the government implemented
the Investment Incentives Act of 1967, which provided a comprehensive approach to
industrial development and created the Board of Investments (BOI). This law empowered
the BOI to determine the preferred areas of investments and administer granting
incentives — mainly tax exemptions and tax credits — to BOI-registered firms. The
incentive scheme, however, remained strongly biased in favor of import-substituting
firms, particularly in capital-intensive manufacturing. By the 1970s, strong efforts were
made to adopt an outward-looking development policy such as a flexible exchange rate
(partly in response to the foreign exchange crisis of late 1969) and broadening fiscal
incentives granted to preferred firms through the Export Incentives Act of the same
year. Coupled with a (partial) peso devaluation, these fiscal incentives partly offset the
anti-export bias of the country’s protection system.

Nevertheless, these measures failed to substantially affect the structure of the
economy. Despite the various laws providing fiscal incentives to the export sector, the
industrial protection system still highly favored industrial consumer goods over capital
goods and penalized export production relative to the other industries (Medalla et al,
1995; Tan, 1979). The large nominal devaluation in 1970 and the subsequent (managed)
floating of the peso also did not correct for overvaluation of the local currency. Intal and
Power (1990) estimated the average overvaluation at 24 percent in 1970-74 and 32
percent in 1975-79, which were higher than those derived for Thailand (16 and 24
respectively), and Malaysia (2 and 0.4 percent) using the same estimating method
(Medalla et al, 1995; Bautista, 1990).

As a result of continuing policies geared toward import-substitution industrialization,
relative agricultural prices continued to be depressed, likely hampering agricultural
development. While the agriculture sector recorded respectable growth during this period,
such growth might have been even higher had it not been for the bias against agriculture
in the pricing system. Without the policy bias against labor-intensive industries as a result
of import substitution strategies that favored capital intensive industrialization, economic
growth could have been more successful at reducing poverty in rural areas by employing
more people in the industrial sector.

13. Designed to complement the Investment Incentives Act of 1967, this law entitled BOI-
registered firms with various kinds of tax exemptions (including exemptions from export
taxes), deductions (of export revenues) from taxable income, and tax credits on raw materials
used in export production. The combination of these benefits became a tax subsidy of about
15 percent of input value or a 5-16 percent increase in the rate of return for projects (Tan,
1979).
Several policy developments that can be considered either transitional or emergency measures marked the early 1980s. The pressure for reforms came from a confluence of factors, including the oil shock of 1979-80, the deep recession in the country’s trading partners, the emerging global debt crisis that capped off with a debt moratorium in 1983, interest rates soaring to new heights, the sharp fall in the country’s external terms of trade, and domestic political instability. Also as a result of these factors, the rural poverty situation worsened significantly in the early 1980s (Table 11), potentially contributing to the further deterioration in political stability. The Marcos government, in response to such pressures and with financial and technical support from the World Bank, initiated structural adjustments in the early 1980s that included rationalizing fiscal incentives, restructuring the tariff system, liberalizing imports and finances, and adjusting exchange rates.\textsuperscript{14} The reforms had to be cut short, however, due to the external debt-related foreign exchange crisis in 1983. Deregulation measures would have been accompanied by import liberalization and agricultural pricing reform, but short-term considerations arising from the balance-of-payments (BOP) crisis that erupted in the latter part of 1983 led to a return of import and foreign exchange controls. These controls also rendered the ongoing tariff reform ineffective.

Given the situation, the government had to undertake a stabilization program, including fiscal and monetary restraints and devaluing the domestic currency. This meant a sharp fall in economic activity, particularly in the import-dependent manufacturing sector and overall government spending. The fall in government spending was proportionately greater for economic (particularly agriculture) and social services, thereby most severely affecting low-income households whose welfare depended on these services. Inflation also reached its highest post-war level (50 percent in 1984), which had the worst effect on fixed income, low-paid, blue-collar workers and landless rural farmers.

Aquino administration — 1986-1992

The departure of the Marcos government from the political scene in 1986 presented the newly instituted Aquino government with an opportunity to undertake deep economic reforms. Given the economic and political circumstances at the time, the pronounced strategy of the Aquino government was designed to signal a complete break from the distortionary policies of the past with liberalization, privatization, and decentralization as the key elements. In essence, the reform package of the new government was a continuation of economic reforms initiated in the early 1980s that were postponed because of the crisis.

The Aquino government made greater headway in the import liberalization program that had failed to take off under the previous administration as the economy collapsed in the mid-1980s (Alburo, 1993). Non-tariff barriers and import quotas were removed, especially in the critical years of 1986 to 1988. The coverage of non-tariff measures in all

\textsuperscript{14} The Investment Incentive Act of 1983 changed the character of BOI incentives from one that was predominantly capital-biased to one that depended more on performance. The 1981-85 tariff reform program reduced the spread of statutory rates from 0-100 percent to 10-50 percent. About 31 percent of the number of import items banned or requiring ‘prior approval’ by the Central Bank and other government agencies were liberalized.
sectors of the economy fell from 33 percent (of total product categories) in 1984 to a mere 8 percent in 1990 (Medalla, 1992). Reductions in the indicators of the extent of quantitative restrictions were substantial for the agriculture, fishing, and forestry sectors (from a coverage of 31 percent in 1984 to 5 percent in 1990) as well as the manufacturing sector (from 33 percent to 8 percent during the same period).

Although there had been some success in attempts to liberalize the economy, these left much to be desired. The continued failure to match ongoing liberalization efforts with appropriate macroeconomic policies was considered a serious flaw (Alburo, 1993). The exchange rate, which remained overvalued by over 20 percent, barely adjusted to trade policy requirements to prevent a dilution of the new policy’s efficacy. Moreover, trade reforms of the early 1990s might have brought down the overall protection level of the economy, but studies later showed that these were not enough to completely remove the bias of the trade regime that continued to confer greater protection to import-competing rather than to export activities (Tan, 1994).

Furthermore, apart from the limited structural effects of the trade liberalization program, the industrial incentive scheme hardly improved as the Aquino administration opted to grant perks to favored firms and industries. The new industrial policy indeed proved even worse than that of the latter years of Marcos (Lim, 1996). Under the new investments code, fiscal incentives were to be given only to enterprises listed in the Investments Priorities Plan (IPP) or those exporting at least half of their output. While policy guidelines introduced some degree of neutrality between exporters and non-exporters, it tended to encourage capital-intensive over labor-intensive production because tax holidays and duty exemptions significantly brought down user costs (Medalla et al., 1995; Manasan, 1990). As a result, the Marcos-era policy bias against agricultural growth and poverty reduction in rural areas still continued, although to a somewhat lesser degree.

The Aquino government also undertook substantial fiscal reforms during its term. It immediately removed export taxes on all items except logs by July 1986 and issued several executive orders to launch its tax reform program. Vast improvements were made in direct and indirect taxation, especially in terms of simplifying the income tax system, unifying corporate taxes, applying a single ad valorem system, and enhancing revenue collection through a value-added system. According to some critics, however, the nation’s tax system could have been substantially strengthened had the government been able to introduce property taxes, which it was not able to do (Montes, 1991). The focus on decentralization, meanwhile, sharpened in 1991 when Congress passed a law devolving the functions of government — mainly in social services and infrastructure development — to local government units.

Financial liberalization proceeded gradually from 1986 to 1992 as the Aquino government first had to grapple with a badly weakened financial system (Paderanga, 1996). It was only in 1990 that monetary authorities lifted the freeze on the entry of new domestic banks and in 1991 that bank branching was liberalized. Foreign exchange transactions were partially liberalized in 1991 when the central bank lifted the 100 percent surrender requirement and allowed foreign exchange earners to retain at most 2 percent of their holdings in foreign currency (although with certain restrictions on use). Monetary authorities raised this retention limit to 40 percent in January 1992, allowing
unrestricted use of foreign exchange holdings by April. The intention was to abolish foreign exchange controls by December that year, but the succeeding government fast-tracked the plan and pushed through full liberalization in August 1992 — four months earlier than scheduled.

**Ramos administration — 1992-1998**

The Ramos government came to power during an economic recession due to an energy crisis and high interest rates that stifled local production. The first order of the day was to deal with the severe power shortage and continue to manage growing macroeconomic imbalances. The new administration, with a strong intention to continue the structural changes initiated during the previous two governments, was able to fast track at least one reform in its initial year — full liberalization of foreign exchange transactions. In addition, inroads were made in the tariff reform program with several executive orders in the mid-1990s that further reduced tariffs. These tariff cuts were scheduled to be phased out over a period of 10 years toward a uniform tariff level of 5 percent by 2004. The target was the same for agricultural products, a number of which were still subject to quantitative restrictions. The progress in trade liberalization owed much to the country’s entry into various free trade agreements such as through the Asean Free Trade Agreement (AFTA), the World Trade Organization (WTO), and the Asia-Pacific Economic Cooperation (APEC). The conversion of all quantitative restrictions — including those on sensitive agricultural products except rice — into equivalent tariffs formed part of the country’s commitment to the WTO.

The country’s industrial incentive system, however, continued to be governed largely by the Omnibus Investment Code of 1987, which gave firms registered with the Board of Investments blanket income tax holidays that lasted 8-10 years and allowed duty-free import of capital equipment. This approach retained some of the traditional bias against agriculture, but in favor of capital-intensive industrial products and import substitutes.

The real exchange rate continued to be highly overvalued, although this was largely brought about by a strong inflow of capital due to improved investor sentiment rather than by measures related to fiscal imbalance. The domestic currency appreciated sharply between 1993 and 1996 as foreign capital was lured by a perception of an improved domestic economy and encouraged by the deregulation of foreign exchange transactions. Tight monetary policies contributed to the strong capital inflow by keeping domestic interest rates attractively high. The stock market boomed and remained strong until 1996. The Export Development Act, which served to partly offset the policy bias against exports by granting fiscal incentives, was signed into law in 1995 under intense lobby by exporters for “a more competitive exchange rate”.

Overall, the Ramos government’s main economic strategy was to foster competition and encourage private-sector participation in the domestic economy. Indeed, the biggest

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15. But some of the reforms were unilaterally adopted by the Philippine government over and above its trade commitments. A ‘practical’ reason for a relatively speedy schedule (i.e., uniform, low tariff rates by 2004) traces to the AFTA, under which imports from the Asean region will be charged tariffs up to 5 percent (Clarete, 1999). Adopting rates that are close to this structure makes tariff collection administratively simpler as well as discourages smuggling.
impact could be seen in the services sector where entry was liberalized and monopolies dismantled. The most visible improvements were in the telecommunications, banking, and transport industries. The privatization program was also given a big push by the Ramos administration, progressing more rapidly from 1992 to 1998 than during the Aquino term. Fiscal surpluses during the mid-1990s traced largely to the non-recurring privatization revenue, raising a concern over sustainability of the country’s strong fiscal position. Greater private sector participation had similarly been encouraged in the provision of basic infrastructure and services such as power, roads and transportation, and utilities.

Between 1994 and 1997, aggregate national income grew at an annual average rate of 5 percent, with the agricultural sector growing at a rate of 3 percent. Despite being incomplete, the sweeping reforms aimed at increasing competition in key sectors appear to have worked as a stimulus during the period. Furthermore, as a result of the robust economic growth, the nation’s poverty incidence (in both urban and rural areas) continued to decline significantly between 1991 and 1997 (Table 12 and Fig. 1). Income inequality declined substantially between 1991 and 1994, but had returned to the 1991 level by 1997.

While the privatization strategy certainly helped the country’s fiscal position, there was a pressing need for reforms to improve long-term revenue generation. The Ramos government attempted to address this through the 1997 Comprehensive Tax Reform Program (CTRP). The program was meant to widen the revenue base, plug tax loopholes, and make the tariff structure more equitable. An earlier restructuring of the tax system expanded the valued-added system in 1993 to cover services as well as goods, which replaced various excise and indirect taxes and substantially improved government collection. The Ramos government, however, failed to substantially rationalize fiscal incentives as originally planned under the proposed tax reform package.

Sectoral policies

Agricultural policies under the Marcos presidency

Agriculture policies during the Marcos era are relatively well documented (David, 1983; Bautista, 1987; and Intal and Power, 1990). Government intervention increased to unprecedented levels in the early 1970s, while earlier, direct government intervention was usually limited to rice and maize. The primary form of intervention was import disbursements to consuming centers. For export crops, direct marketing and policy intervention were largely confined to sugar, and mainly involved allocation of the U.S. sugar import quota to local sugar producers. The import quota provided an export premium for Philippine sugar because the sugar price in the U.S. market was almost always higher than the world market (Intal and Power, 1990).

Intervention in the rice sector was precipitated by a crisis in 1971/72 resulting from local conditions (poor weather, pest infestation, and the great flood in Central Luzon) and a sharp price hike in the world market. The government responded by imposing price controls on rice and embarking on a massive program aimed at achieving rice self-

16. This section draws largely from Balisacan (1989).
sufficiency. Dubbed *Masagana 99* and launched in 1974, the program called for
government assistance in the form of credit, irrigation, extension services, and fertilizer
subsidies. During its initial year, the program provided subsidized credit to 529,000 rice
farmers in the wet season and 356,000 in the dry season, with coverage reaching 40
percent of the rice area. The program soon faced serious repayment problems and
coverage declined to 100,000 farmers per season with only about 10 percent coverage by
the end of the 1970s.\(^1\) Furthermore, the National Grains Authority (NGA), the state rice
and maize agency, expanded its control of the food sector to include effective
monopolization of wheat imports (beginning in 1975) and soya imports (beginning in
1978).

Marketing controls included all food commodities by the early 1980s when the NGA
was transformed into the National Food Authority (NFA), which became the
government’s food price stabilization arm. The NFA financed its expanded operations
partly from price margins on its duty-free imports.\(^2\) The Marcos administration’s
intervention in export crops shifted from its traditional role of allocating domestic sugar
quotas, collecting minor export taxes, and undertaking research and extension in tandem
with the private sector, to one of monopolizing domestic and export marketing. For
example, the government mandated that the Philippine Exchange (Philex) — a subsidiary
of the Philippine National Bank (PNB) and the primary financial institution serving the
sugar industry at the time — to be the sole buyer of sugar from mills as well as the sole
exporter.\(^3\) In the coconut industry, the intervention broadened from a collection of minor
export taxes to include direct control on production, processing, and international trade,
including the collection of the Coconut Consumer Stabilization Fund (CCSF) levy and
the export premium and taxes on coconut products. As with rice, the sharp rise in the
world prices of coconut oil and copra in the early 1970s — the so-called ‘cooking oil
crisis’ — provided a major impetus for the intervention.

In most cases, the government interventions were either ineffective or yielded results
contrary to avowed intentions. In the case of rice, for example, while increased
government intervention during the 1970s reduced seasonal fluctuations of paddy prices,
the intervention was inadequate to maintain producer prices at the official floor price
(Unnevehr, 1985). This meant that opportunities to sell at the official price had to be
rationed, often to the disadvantage of small-scale farmers. In addition, because the
difference between official ceiling and floor prices was insufficient to cover normal
marketing margins, the intervention prevented the development of private trading and
storage. Arguably, the government’s objective of reducing marketing margins could have
been achieved with non-price policy interventions such as investments in transport and
communications infrastructure.

Yield gains from high-yielding varieties (HYV) of irrigated rice during the 1960s and
1970s were impressive, and irrigation was the largest category of public spending on

\(^1\) Lim (1986) as quoted in Boyce (1993, p. 94), and David (1979) as quoted in Fegan (1989).
\(^2\) A more detailed discussion of NFA in conjunction with the political regime can be found in the
chapter by Amelina and Pressmann (this volume).
\(^3\) In addition, the government further strengthened its hold on the industry by acquiring and
operating leading transport and bulk storage enterprises. An additional discussion of the
sugar sector policy can be found in the chapter by Amelina and Pressmann (this volume).
agriculture at that time (Fig. 3). Apparently the combination of Green Revolution
technologies and increased government spending in agriculture contributed to agricultural
growth in the 1970s, but critics have suggested that the patterns of public investment in
agricultural research, input and output subsidies, and infrastructure tended to
disproportionately benefit larger-scale farmers at the expense of small-scale farmers
(Balisacan 1998a). Small-scale farmers, along with landless laborers, are a significant
portion of the rural poor, thus such anti-poor biases in public investment patterns appear
to partially explain sluggish poverty reduction in rural areas (including the increased
poverty amid economic growth in the late 1960s), despite robust growth in aggregate
agricultural production.

The effectiveness of the *Masagana* 99 program in facilitating the growth of rice
production in the 1970s, on the other hand, has been seriously questioned in the literature.
Observers argue that the growth would perhaps have occurred even without the program,
given use of HYV and increased investment in irrigation, and that the program was
expensive (Sacay et al, 1985). Furthermore, access to the program by intended
beneficiaries — small-scale farmers — was limited. For example, despite the substantial
resources devoted to subsidizing formal credit institutions, the amount that reached small-
scale farmers was small. Esguerra (1981) estimated that only one-third of the potential
credit subsidies reached farmer beneficiaries.\(^{20}\) A number of studies have concluded that
unfavorable effects of the low interest rate policy and the effective rationing of
institutional credit, as well as foreign trade and payment restrictions, were often much
greater for small-scale farmers than for large-scale farmers (Bautista, 1987). Moreover,

![Figure 3. Share of agriculture in government expenditures and agricultural GVA](image)

*Source: David and Inocencio, 2000*

\(^{20}\) The potential credit subsidies were estimated as the difference between the market interest
rates and the nominal interest rates under the *Masagana* 99 program multiplied by the total
loan amount. (Esguerra, 1981)
the credit policy spurred lending (by formal commercial sources) away from agriculture, thereby reducing the overall flow of credit to the sector (Tolentino, 1986).

The huge fertilizer subsidies from 1973 to 1982 mainly benefited the few local fertilizer producers/importers and not farmers (Balisacan, 1990). Controls on fertilizer imports and distribution increased domestic prices to levels above those that would have prevailed in the absence of controls. Together with the traditional rural social structure characterized by high landlessness, policy biases against small-scale farmers and ineffective fertilizer subsidies appear to have contributed to the slow pace of poverty reduction in rural areas.

The domestic price of copra was on average 22 percent lower than export prices for the period 1973 to 1982, an effect of coconut policies (David, 1983). The attempt to influence the world price also proved futile since the country’s exports of copra and coconut oil were only 5 percent of the world’s fat and oil market. This attempt to exploit the world coconut oil market resulted in substitution of other oils, thus depressing the country’s earnings from coconut exports.

Sugar interventions, on the other hand, led to payments from sugar producers to a select few close to the ruling elite. In addition to heavy intervention by the government (through export taxes and production levies), the persistent overvaluation of the exchange rate during the 1970s also negatively affected export crops such as coconut and sugar. The negative impact of these policies appears to at least partially explain the rather unspectacular production growth, accompanied by low (in the case of sugar) or negative (in the case of coconut) productivity growth during the 1970s, which was followed by stagnation in the early 1980s. Honma and Hagino (this volume) show that raw sugar exports from the Philippines lost market share as world demand stagnated between the early 1970s and mid-1990s. Sugar exports from Thailand during the same period, however, increased because market share rose.

Finally, there was one other policy that was high on the agenda during the initial years of the Marcos martial law regime — land reform. Land reform had continuously been on the political agenda in the Philippines at least since the early part of the 20th century. Just one month after the declaration of martial law in September 1972, President Marcos issued a decree that all rice and maize fields larger than 7 hectares were to be transferred to the tenants who tilled them at a price 2.5 times the value of the average annual production. In addition, all rice and maize fields smaller than 7 hectares under share tenancy were to be converted to fixed-rent leasehold with the official rental ceiling at 25 percent of the average output for the three ‘normal’ years prior to land reform.

21. de Dios (1984) showed that the sugar trade monopoly resulted in:
   • a loss to producers of between P11 billion and P14 billion;
   • additions to the marketing chain that either increased mark-ups, redistributed income from actual traders to favored ‘paper traders,’ or both;
   • a loss of foreign exchange due to financing through foreign loans; and
   • a loss to the economy because from operating losses by the agencies, despite estimated gross profits enjoyed from the differential between export revenue and purchase price.

22. The following two paragraphs draw heavily on Hayami et al. (1990), Riedinger (1995), Putzel (1992), and Fuwa (2000).
Compared to earlier land reform legislation, this decree expanded the potential coverage of the reform program. Land reform during the Aquino and Ramos administrations was much more effective than reform during the Marcos regime, despite his rhetoric and the increase in potential coverage. Of the total area potentially covered by programs in the three administrations, 59 percent was redistributed during the Aquino administration, 27 percent during the Ramos presidency, and a mere 3 percent during the Marcos regime. Nonetheless, while implementation of the Marcos decree was limited to rather specific geographical regions (mainly for political reasons), many village-level studies found significant effects from land reform in target areas (such as Central Luzon).

The decree virtually eliminated the traditional rice hacienda system in much of inner Central Luzon, and also led to significant income transfer from former landowners to former share tenants because the large increase in land rent due to the Green Revolution was appropriated by the latter (Fegan, 1989; Hayami et al., 1990; Hayami and Kikuchi, 2000; Otsuka, 1991; Umehara, 1997; Riedinger, 1995).

At the same time the decree adversely affected rural landless laborers because not only were they excluded as land reform beneficiaries, but their potential access to land through tenancy contracts was severely restricted as landowners became increasingly reluctant to rent their land because they feared confiscation. In addition, the reported incidence of tenant eviction as a response to the land reform program further crowded the rural labor markets (Hayami et al., 1990; Otsuka, 1991).

Agricultural policies under the Aquino presidency

As noted previously, the 1970s under President Marcos saw unprecedented government intervention in agriculture with price and quantitative controls, levies and taxes, as well as entry into activities for which the public good argument was unjustified. The Aquino government promised to undo these policies and move toward a market-oriented agricultural economy. Deregulation began as soon as the new leadership stepped into power:

- The export ban on copra and export taxes on copra (10 percent) and coconut oil (5 percent) were lifted.
- Sugar and coconut trading were reformed, and monopoly control over international trade in coconut oil, maize, soya, and soya meal were removed.
- Fertilizer distribution and import were liberalized.
- Price controls on rice, poultry products, and pork were removed.
- Imports of wheat, flour, and animal feeds were privatized.
- The National Food Authority (NFA) was removed from non-grain activities and reoriented to its primary function of price stabilization for rice and maize.
- Commodity-specific funds were consolidated into the Comprehensive Agricultural Loan Fund (CALF) to unify various agricultural lending programs and minimize government participation.

As we noted earlier, the national economy registered robust aggregate growth and rural poverty declined substantially through the latter half of the 1980s. The benefits to
small-scale farmers in rural areas appear to have derived from the swift and wide-ranging
deregulation of agricultural markets during the early years of the Aquino administration
(Balisacan 1998b).

Despite these reform measures, deregulation of agriculture was incomplete. Reforms
did not include abolition of remaining restrictions, including:

- NFA monopoly of international trade and domestic market operations in rice and
  maize;
- import controls on sugar;
- import prohibitions on onions, potatoes, garlic, cabbage, coffee, and seeds;
- area controls on banana production;
- centralized import of ruminants (for breeding and/or slaughter) and beef;
- bans on buntal and ramie planting materials;
- export restrictions on animal and animal products; and
- licensing and/or registration of production and domestic trade for some agricultural
goods.

Rather than expanding the scope of deregulation that would have benefited the rural
population, the Aquino government instead strengthened agriculture regulations,
especially for international trade. A few months prior to the 1992 national elections,
Congress passed the Magna Carta of Small Farmers, which barred import of agricultural
products that were produced domestically in sufficient quantities.\(^{23}\)

Another major government program initiated during the Aquino regime with a
potential for profound effects on agriculture was the Comprehensive Agrarian Reform
Program (CARP). Unlike its predecessor land reform programs, this program covered all
agricultural land regardless of commodity and tenurial arrangement, and included
provision of support services for farmers. CARP intended to redistribute about 580,000
hectares of rice and maize land (which had been covered under the old order), and more
than 2 million hectares of privately-owned non-rice/maize land (which were newly
covered under CARP) over 10 years. The program budget was estimated to be P221
billion, roughly 30 percent of the 1987 national budget (Balisacan, 1995a), of which one-
quarter was initially allocated by the administration. The huge budgetary requirement of
the program, together with the limited capacity of agencies assigned to implement it,
stood in the way of swift implementation — 59 percent of the potential rice and maize
land and only 4 percent of non-rice/maize land were redistributed during the Aquino
administration. In the end, the Aquino administration spent P17 billion with an average
per beneficiary expenditure of P3,600 for land acquisition plus P10,000 for support
services.

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23. The implementing order issued by the succeeding administration specifically prohibited
import of maize and its substitutes (including wheat used for feeds), poultry and poultry
products, hogs and pork products, and meat and meat products (except beef and beef
products), unless certified by the Department of Agriculture as necessary to meet an actual or
anticipated shortage in local output. The order gave enormous regulatory power to the
department, and practically swept away whatever gains were made from earlier trade
deregulation.
Moreover, certain sectors (for example, prawn and sugar farms) constantly lobbied Congress for exclusion from the land reform coverage. As a result, the uncertainty surrounding program implementation discouraged the flow of private investments into agriculture as well as encouraged leaving land idle and premature conversion of agricultural land to non-agricultural uses. This trend was exacerbated by weak government monitoring and absence of a comprehensive land-use policy (Medalla and Centeno, 1994). Aside from dampening the flow of agricultural investments, CARP also diminished the collateral value of agricultural land by constraining private land sales. This feature of the program caused the demise of private markets for agricultural land. Indeed, the size of loans (at constant prices) granted by private and government banks in the early 1990s was only one-half that of the early 1980s. Loans by private institutions, including private commercial banks, dropped by much more than loans by public institutions (Fig. 4). Loans per peso of agricultural value added fell from about 0.42 in 1980-82 to 0.20 in 1985-87 and 0.16 in 1991-92 (Balisacan, 1998b).

Production growth rates decelerated during the 1980s and early 1990s for most crops, a trend that can be attributed to a combination of some exogenous factors (such as price changes in world markets, natural calamities, and droughts) and government policies. The negative impact of a sharp fall in public investment in agriculture — especially rural roads, irrigation, and research — in the 1980s and early 1990s also contributed (David 1999). Investments in agricultural research and development (R&D), the single most important source of long-term output growth, stagnated in the 1970s and then dropped in absolute value in the 1980s. The total spent on R&D in the early 1990s was a mere 60 percent of that spent in the early 1970s.

**Agricultural policies under the Ramos presidency**

In order to open market competition, the Ramos administration embarked on major economic policy reforms. Although much was achieved in opening local industries to competition, the same cannot be said for agriculture, which seemed to have moved in the opposite direction (David, 1999; Bautista and Lamberte, 1996). Even in the beginning,

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24. If a farmer defaulted on a loan from a lending institution, the lender could only sell the land to the government, which had the sole right to set the price and timing of the sale, as well as decide who was eventually allowed to buy the land.

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**Figure 4. Share of agriculture in total loans granted by formal financial institutions**

Source: Llanto, 2000
the Ramos administration’s agricultural policy was constrained by laws such as the newly
enacted Magna Carta of Small Farmers, which kept major commodities subject to
quantitative restrictions until early 1996.

A change in the policy environment was anticipated with the country’s 1995 entry in
the World Trade Organization (WTO). Local agricultural markets were required to be
open to competition and laws prescribed by the trade treaty were to be enacted.\textsuperscript{25} Political
negotiations to win public support severely weakened the drive toward greater openness
in the farm sector. Rice, for instance, was exempted from the trade commitments for a
period of 10 years. In 1996, Congress passed a law that lifted all quantitative restrictions
on agricultural imports (except rice) but replaced non-tariff barriers with the highest
possible tariff protection of 100 percent (i.e., the ceiling or binding tariff rates).\textsuperscript{26} The
‘tarrification’ resulted in tariff levels that exceeded the corresponding equivalent rates of
most products (Clarete, 1999). The tariff rate equivalent of quantitative restrictions on
maize, for example, was estimated to be only 60 percent, but the government set the
maximum rate of 100 percent.\textsuperscript{27}

The WTO allowed a provision that enabled consumers of major agricultural
commodities to take advantage of lower tariffs through a minimum access volume
(MAV) system. This provision was designed to lessen the effects of high tariffs and avoid
disrupting the flow of farm products in the world trading system as a result of apparent
overcompensation for lost protection levels. Under this scheme, lower (in-quota) tariffs
are applied to imports falling within an assigned quota, which comprises a small fraction
of domestic consumption, while higher (out-quota) tariffs are paid on imports exceeding
this limit. Despite some effort for greater transparency in the allocation of import quotas
and improved access to the MAV system, the incentive for rent-seeking remains high
given the size of these quotas. With the exception of live pork and poultry, allocated
volumes are typically lower than import demand at the in-quota tariff, creating a situation
where large quota rents cannot be controlled unless a reliable and fair bidding mechanism
is established (David, 1999). Aside from the resulting inequities, the MAV system has
been criticized for its high administrative cost, inefficiency in allocating government
revenue from imports (supposedly earmarked for agricultural support services), and for
prolonging government intervention in agricultural trade.

After a decade of stagnation during the 1980s, production growth in the agriculture
sector recovered in the 1990s (Table 5). The combination of sweeping reforms in non-
agriculture sectors and increasing government protection for agriculture apparently led to
a rise in relative prices of agricultural products in the domestic market, which may
partially explain the upturn in agricultural growth (David, 1999).

\textsuperscript{25} Commitments included a prohibition on the use of (additional) non-tariff measures,
conversion of all existing quantitative restrictions to tariff measures (except for rice, which has
been deferred for 10 years), binding tariffs at ceiling rates, tariff reductions (average cut of 30
percent), and harmonization of sanitary and phytosanitary measures.

\textsuperscript{26} These binding (tariff) rates are slated to drop to 40-50 percent for the various crops in 2004 in
accordance with the WTO agreement.

\textsuperscript{27} Binding rates on maize are scheduled to drop to 50 percent after a 10-year period. High tariff
protection of maize, which is used as livestock feed, in turn spurred high tariff protection of
hogs, poultry, and meat products as a compensatory measure.
The Ramos government enacted the Agriculture and Fisheries Modernization Act (AFMA) in 1997 in response to opposition from farmer groups to WTO entry, which argued that their inability to compete in world market was partially caused by lack of infrastructure development. The AFMA prescribes a coordinated set of measures, including guidelines on the devolution of communal irrigation systems to local government units, simplified public bidding for irrigation projects, budgetary allocation for R&D projects, a phase-out of directed credit programs, and the creation of a council that can coordinate R&D and extension work.28

While the Ramos administration persuaded the legislature to enact vital reforms, crucial restrictions remained such as the continued monopoly of the NFA over rice trade and area controls on banana production. In addition, profitability on sugar and maize was becoming artificially high as a result of increased protection afforded by the new tariff regime as well as regulatory barriers that reduced the competitiveness of allied industries. Yellow maize is the primary feed used by the livestock sector, while sugar is an essential ingredient for the food processing industry.

The land reform program, meanwhile, could not be completed as scheduled by 1997, although relevant local agencies performed relatively well compared to their predecessors (Fig. 5). Only a little more than one-half the total coverage was achieved. Implementation was particularly slow for public alienable and disposable (A&D) lands and private agricultural lands (other than rice and maize lands). Of the total coverage under the program, the former constituted 45 percent and the latter 25 percent. For public land, the poor performance was mainly delays in land surveys, slow reconstitution of land records, and sluggish resolution of land conflicts among competing claimants (Balisacan, 1996a). For private agricultural land, the main problems included the time-consuming process of land acquisition and distribution, insufficient technical capacity of the implementing agencies, legal disputes over coverage and land valuation, landowner resistance, harassment, an unstable ‘peace and order’ condition, and budget constraints. The negative side effects of this slow and incomplete implementation and the uncertainty created as a result continue to be a serious problem for agricultural development.

Poverty reduction policies during the Ramos presidency

Unlike the Aquino government that constantly faced problems ranging from coup de états to volcanic eruptions, the Ramos administration was able to establish a program to alleviate poverty in the short term. In 1994, it launched the Social Reform Agenda (SRA), which mainly targeted 20 priority provinces, poor municipalities around the country, and special peace and development zones in Mindanao and Palawan.29 The distinguishing feature of this effort was recognition of the government’s limited resources

28. The law also focused on food security and poverty alleviation and appropriated some P120 billion over a period of 7 years to fulfill the plan. This step to fund agricultural modernization follows similar initiatives to prepare the country for global free trade by setting aside resources to develop the agriculture sector. For example, the budget of the grains sector alone increased from P540 million in 1993 to P4 billion in 1997 (Clarete, 1999).

29. The program encompassed agricultural development; conservation, management, and development of fisheries and aquatic resources; protection of ancestral domains; delivery of social services; workers’ welfare and protection; socialized housing; credit expansion; livelihood programs; and institution-building and political participation.
and a focus on areas where the majority of the population failed to achieve even minimum basic needs (Collas-Monsod and Monsod, 1999). It also consolidated the various social reform programs of different government agencies and entrusted local government units (LGUs) with greater responsibility over poverty alleviation efforts. To ensure project implementation, poverty targets were included in the criteria used to appraise local officials and cabinet officers. Provincial governors and city mayors were held accountable for welfare improvements in their territories. Political concessions were not absent, however, because some of the chosen provinces were not necessarily the poorest. To date, there has been no rigorous empirical evidence about the impact of these policies.

**Measuring policy consequences**

**Nominal Protection Rates (NPR)**

The effects of commodity-specific policies on agriculture can be summarized by the nominal protection rate (NPR), defined as the proportional difference between the domestic price and the comparable border price evaluated at the official exchange rate. NPR measures the effect of price controls, export taxes or quotas, and other such policies affecting the domestic (producer) price of a tradable agricultural product. A positive NPR value suggests that domestic policies confer protection to producers of the commodity while a negative figure indicates that policies penalize them.

Figure 6 shows the trends in nominal protection for various agricultural commodities between the 1970s and the late 1990s. With the exception of a few (e.g., sugar, maize, and chicken), NPRs for most products were either negative or near zero until the mid-1980s, suggesting that price incentives provided to the agriculture sector were relatively weak during this period. NPRs for most products (including major import-competing goods such as sugar, maize, and rice), however, moved up in the late 1980s, which was a period of pervasive government intervention. NPRs in the early 1990s were similarly higher than those in the early 1980s, also a period of heavy regulation of agricultural markets. Reforms of distorted pricing policies instituted over the past two decades have evidently been favorable to agricultural producers.
Figure 6. Nominal protection rate for various agricultural products, 1970-98 (percent)

Nominal protection rate (NPR) is the percentage difference between the domestic price and the comparable border price evaluated at the official exchange rate. Note:

- For exportable products, the border price is the FOB export value unit. For importable products, it is the world price adjusted by 15 percent to approximate the CIF import unit value. For pork and chicken, the CIF import unit value of Singapore was used.

- For sugar, figures are the weighted averages of NPR on sugar exported to the U.S. (ratio of export unit value to the border price) and NPR on sugar for domestic use (ratio of domestic wholesale price to the border price). Border price is the FOB world price of sugar adjusted by 15 percent to obtain CIF price.

- From 1995 to 1998, imports of rice, sugar, and recently, maize, did not pay either in-quota or out-quota tariffs except for sugar imports in late 1998, which paid out-quota tariffs.


Among the major import-competing agricultural commodities, sugar continues to be the most highly protected. Historically, nominal protection of sugar was strong because of the quota system, which allowed sugar producers favored access to the U.S. market at premium prices. The sector experienced a period of low (even negative) nominal protection between the 1970s and early 1980s (the quota system was terminated in 1973), when the government attempted to control domestic sugar prices and taxed sugar exports in response to sharp increases in world sugar prices (Intal and Power, 1990). NPRs eventually resumed their upward trend in the late 1980s, and the domestic sugar price has been about equal to (and often greater than) export prices to the U.S. and much higher than CIF world prices.
Maize received comparably high nominal protection over the past three decades because import substitution remained a major government policy. It became a specific concern in the 1970s, which was also the time when the nominal rate of protection from direct price interventions noticeably increased. The commodity was briefly unprotected in the mid-1970s when world maize prices soared, although it still enjoyed greater protection than other major crops whose border prices also rose during the period. The allied livestock industry received equally high nominal protection from the 1970s until the mid-1990s. By 1995, the NPRs of chicken and pork had risen to a high of 84 and 44 percent, respectively.

Nominal protection of rice was negative through the 1970s until the early 1980s when rice self-sufficiency was achieved. Subsequently, it started to increase through the late 1980s and the mid-1990s, rising to about 65 percent above the world price in 1995 and 1996, which appears to be a reversal of rice policy, a switch from a historically pro-urban to a pro-farm bias (David, 1999).30

Nominal protection levels of import-competing commodities (except sugar) dipped after a major devaluation in 1997 because relative prices fell when evaluated against the (higher) official exchange rate. This trend is expected to continue given the government’s attempts to protect domestic consumers from sharp increases in food prices. David (1999) reported that the nominal protection rates for rice and maize (and most likely pork and chicken) predictably declined in 1998, an election year, when the government authorized more imports to prevent domestic prices increases. In contrast, the NPR of sugar rose substantially in 1998 to about 100 percent, indicative of a surge in domestic prices.

In sum, exportable agricultural commodities entered a more neutral environment after being penalized for a very long time from the 1970s through the early half of the 1980s through various taxes and levies and monopsonistic control of quasi-government agencies (particularly for coconut). NPR levels stabilized at zero toward the end of the 1990s for coconut products, bananas, pineapple, tobacco, and abaca. In general, protection levels of the various agricultural commodities have become more widely dispersed in recent years than they were a couple of decades ago.

Positive or negative protection of the agriculture sector can result from indirect protection directed to non-agriculture sectors as well as from direct protection directed to agriculture sectors. Indirect protection occurs from economy-wide measures such as fiscal and exchange rate management and industrialization policy (including trade interventions and domestic taxes and subsidies on non-agricultural products), which all affect the relative price of agricultural commodities (Schiff and Valdes, 1992).

The magnitude of the bias against agriculture (i.e., negative nominal total protection rate) has consistently been higher in the Philippines than in Indonesia or Thailand except in the 1960s when it was lowest in the Philippines (Akiyama and Kajisa, Table 2, this volume, which extended the earlier study by Schiff and Valdes, 1992). The negative total

30. For example, rice tended to be protected when imports occurred and less protected as self-sufficiency or an export surplus was achieved. Also, government tended to control domestic rice prices in the event of a sharp increase in the world price or a devaluation of the domestic currency (e.g., through price controls, anti-hoarding, and quantity rationing measures).
The protection rate declined dramatically in the 1980s and then the total protection rate turned positive in both Indonesia and in Thailand, whereas in the Philippines the negative protection rate remained quite sizable even in the early 1990s. Furthermore, in the Philippines (and in Indonesia as well, but not in Thailand), relatively large negative indirect protection rather than direct (negative) protection was the major source of the bias against agriculture. Indirect protection policies, but not direct protection policies, had significant negative effects on the competitiveness of agricultural exports from the Philippines (although the explanatory power of the regression model is quite low) (Honma and Hagino, this volume).

The magnitude of negative indirect protection remained substantially larger in the Philippines than in the other two countries since the 1970s through the 1990s (Akiyama and Kajisa, Table 2, this volume). We can also see from the same table that there was a major policy shift in the 1980s from negative to positive nominal direct protection for agriculture in Indonesia and Thailand, but that a similar policy shift in the Philippines did not occur until the 1990s.

**Effective Protection Rates (EPR)**

Another convenient summary measure of the direct effects of trade and industrial policies is the effective rate of protection (ERP), defined as the percentage excess of protected value-added over non-protected value-added of a particular economic activity. This measure takes into account the changes in the domestic prices of both inputs and output arising from tariffs and import controls. Analogous to the NPR, a positive ERP implies that the sector is accorded protection by the system of tariffs and import controls while a negative ERP indicates that the system penalizes the activity of the sector.

The primary and agriculture sectors typically had lower ERPs than manufacturing between 1965 and the early 1990s — most of the period under our review; thus the agriculture sector as a whole was penalized in terms of relative prices up to the early 1990s compared to the manufacturing sector. Through the 1990s, however, such bias against agriculture (at least on aggregate) appears to have finally disappeared — the ERPs for agriculture became roughly equivalent to the ERPs for manufacturing. Such a result can largely be attributed to the substantial changes in the country’s tariff structure over the last 10 years. Medalla (1992) indicates that the tariff reform program moved the country toward a lower, sector-neutral, and trade-neutral effective protection policy.

With the steady progression of the tariff reform program, the 1990s saw both declining protection rates for manufactured inputs (including agricultural inputs) and increased (tariff) protection for major agricultural commodities for which quantitative restrictions had been removed. Falling input prices (with the obvious exception of yellow maize for the livestock industry) imply that the effective protection level of agriculture afforded by domestic policy has outstripped the nominal protection level of the sector.

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31. The problem, however, was that complementary adjustment in the exchange rate was not pursued. Imports rose substantially, while export supply response was very sluggish. Consequently, deficits in the government budget and current accounts rose to unsustainable levels in 1991, when another round of monetary and fiscal contraction occurred in 1992.
Exchange rate movements

One major source of the ‘indirect’ protection is the consequential overvaluation of the domestic currency, which in turn results from protectionist policies. An overvalued domestic currency acts as a tax on tradable goods, depressing their prices (in domestic currency terms) relative to non-tradable goods. This distorts incentives and encourages the movement of resources toward non-tradable or domestic production. Since domestic goods form a larger part of non-agricultural than agricultural production, the effect of exchange rate overvaluation on domestic relative prices shifts resources toward non-agricultural production.

Trade restrictions, movements in external terms of trade, and the balance of trade all influence the real exchange rate. In the 1950s and 1960s, protectionist trade policies and large trade deficits accounted for much of the overvaluation of the Philippine peso. In the 1970s and 1980s, however, deterioration of external terms of trade and an unsustainable imbalance in the external accounts assumed greater importance.

Several studies document the overwhelming negative influence of domestic currency overvaluation on production incentives in the agriculture and export sectors (Bautista, 1987; Intal and Power, 1990). The overvaluation of the local currency (averaging 38 percent in the 1960s, 20 percent in the 1970s, and 25 percent in the 1980s) penalized agriculture and labor-intensive exports. The figure was estimated at about 20 percent in 1992, which still represents a hefty penalty, especially to traded agricultural goods (Medalla et al., 1995). The extent of peso overvaluation clearly increased between 1990 and 1996 (by about 28 percent for both RER and DARER), as the nominal exchange rate fell and domestic inflation exceeded that of major trading partners during the period (Fig. 7). With the deregulation of foreign exchange transactions and increased investor confidence in the economy, large amounts of foreign capital were attracted, which allowed the country to accommodate a growing current account deficit and maintain a strong domestic currency. The real exchange rate fell substantially with the (de facto) devaluation of 1997 (depreciating by about 30 percent from 1996 to 1998), improving the comparative (price) advantage of the tradable goods sector, both exportable and import-competing agricultural commodities. Nevertheless, domestic terms of trade in agriculture (i.e., agriculture/non-agriculture) declined slightly during the period since government allowed greater imports of agricultural products, still (effectively) subject to quantitative trade restrictions (David, 1999).

Incremental Output-Capital Ratios (IOCR)

Maintenance of many of the import substitution policies created distortions in the incentive structure that made socially low-return investments attractive to private investors and efficient activities relatively unprofitable. As a crude indicator of such a policy consequence, we can examine the changes in the incremental output-capital ratios (IOCR), defined as the ratio of increase in GDP to net fixed capital formation in the current year (Boyce, 1993). The aggregate ratio of investment to income increased

32. Monetary authorities allowed the peso to ‘trade on a wider band’ and ‘reflect the underlying market sentiment’ in July 1997, after a staunch defense of the domestic currency against speculators and after keeping the nominal exchange rate virtually fixed for three years despite the pronounced policy of a market-determined exchange rate.
steadily during the 1960s and the 1970s. IOCR, on the other hand, indicates a somewhat upward trend until the early 1970s, but then declined rather sharply during the latter half of the 1970s through the early 1980s. A decline in investment returns, therefore, set in during the midst of the rapid and sustained economic growth in the 1970s, well before the debt crisis started in the early 1980s. This observation is consistent with our argument that distortions introduced with the industrial protection policies during the 1960s and 1970s encouraged relatively inefficient economic activities at the expense of investment in activities where the Philippines had a comparative advantage.

**Trends in real wage rates**

The level of rural poverty remained relatively stable despite sustained economic growth in the 1970s. In contrast, after the mid-1980s poverty reduction appears to have become more sensitive to aggregate growth. One contrast between these two growth episodes can be found in the trend in real wage rates. Both skilled and unskilled urban wages declined consistently during the 1970s and early 1980s after relative stability during the 1960s (Table 15). The real wages of urban skilled and unskilled workers in the mid-1980s was nearly one-quarter of the wage level in the early 1960s. Given such a sharp decline in real wages, the slow reduction in poverty despite the aggregate growth is not surprising.

Policies oriented toward import substitution adopted in the Philippines during the 1960s and 1970s tended to encourage capital-intensive industries at the expense of labor-intensive ones. As a result, the growth in labor demand in the industrial sector was slow and not able to absorb the rapidly increasing labor force in both urban and rural areas.

While the high rate of population growth placed constant downward pressure on the wage rate, it is likely that slow growth in the labor-absorbing capacity of the economy as a result of government policies further exacerbated the decline in the real wage rate through the 1970s.

**Figure 7. Trends in real exchange rate (RER) and debt-adjusted real exchange rate (DARER)**

![Graph showing trends in RER and DARER](source: Author calculations. DARER based on Fabella (1992))
The real wage rate in agriculture (deflated by the consumer price index) fluctuated widely, but the downward long-term trend is obvious — the real agricultural wage rate declined from 41 pesos (in 1986 pesos) in the early 1960s to around 30 pesos in the mid-1980s. Such decline in the agricultural wage rate appears to be the result of slow growth in employment in rural and urban areas. In addition to slow growth in labor absorption in the industrial sector, some observers have argued that farm mechanization during the late 1970s partially contributed to the decline of rural wage rates. Adoption of modern varieties, which tends to increase labor demand, was followed by adoption of labor-saving technologies (such as the use of tractors, threshers, and direct seeding) during the late 1970s, although it does not mean that the former causes (or requires) the latter (David and Otsuka, 1994). Some observers have attributed, at least partially, the substitution of machinery for labor amid stagnating agricultural wage rates to policy distortions such as cheap credit and overvalued exchange rates, which made farm mechanization artificially more profitable than its social return (Boyce, 1993; Barker, 1978).33

In contrast, the trend in real wages appears to have turned upward at some point in the early to mid-1980s. While consistent nationwide data on wages throughout the past four decades is not available, the available data seem to indicate that real wages increased between the mid-1980s and the 1990s. For example, Hayami and Kikuchi (2000) show that real agricultural wages in a Laguna village declined during the 1970s by almost two-thirds but then recovered after 1980, and that real wages in the mid-1990s were roughly equivalent to those in the late 1960s. Industrial sector wages also increased after the mid-1980s after a sharp downward trend during the 1960s and 1970s (Hayami and Kikuchi, 2000, p. 232). To the extent that policy reforms in the manufacturing and service sectors after the mid-1980s encouraged expansion of the labor demand — as reflected in the rise in real wages — these policy reforms may have contributed to a higher responsiveness of poverty reduction to aggregate growth during the economic recovery in the late 1980s and 1990s.

Political Economy of Delayed Economic Reforms
The adoption and maintenance of industrial protection policies appears to be a major source of the sluggish performance in rural growth and rural poverty reduction in the Philippines during the past several decades.34 While import substitution industrialization

33. Other than policy distortions, however, one of the main explanations for mechanization is the motivation to save supervision costs of hired labor, especially on larger farms (Boyce, 1993; David and Otsuka, 1994). On the other hand, Hayami and Kikuchi (2000) explain the adoption of labor-saving technologies in a Laguna village in the late 1970s in terms of the upturn in agricultural wages (relative to the price of outputs) that appears to have occurred around the same time.

34. A detailed discussion comparing government interventions in the rice and sugar sectors can be found in Amelina and Pressman (this volume). To the extent that their discussions point to different characteristics of Philippine politics than we do, such differences arise mainly because our discussions attempt to explain very different sets of policy outcomes. In particular, this discussion of ISI policies tends to emphasize the factors that did not change before, during, and after the Marcos dictatorship (despite the regime changes), while Amelina and Pressman highlight the differences between the Marcos era (authoritarian regime) and the period before and after that era to explain the rise and demise of the National Food Authority.
(ISI) became a universally popular development strategy in the post-war period
especially in the 1950s, many developing countries shifted their development strategies
away from ISI toward more export-oriented policies after the 1960s. The Philippines,
however, maintained its policies oriented toward import substitution and depressing
agricultural prices (mainly through negative indirect protection on agriculture via
industrial protection) for a much longer period than did most of its Asian neighbors. A
major policy shift toward reducing the bias against agriculture occurred in the 1980s in
Indonesia and Thailand, whereas a similar policy shift in the Philippines would have to
wait until the 1990s. In this section we examine the history of political dynamics behind
such policies and address the question of why the Philippines retained a policy
orientation toward import substitution longer than did many other developing countries.

Table 15. Trends in real wages (1986 pesos, deflated by consumer price index as
reported by the International Monetary Fund)

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Urban wage (unskilled)</th>
<th>Urban wage (skilled)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>41.31</td>
<td>89.50</td>
<td>126.74</td>
</tr>
<tr>
<td>1963</td>
<td>41.37</td>
<td>87.31</td>
<td>120.77</td>
</tr>
<tr>
<td>1964</td>
<td>36.16</td>
<td>80.92</td>
<td>112.94</td>
</tr>
<tr>
<td>1965</td>
<td>34.07</td>
<td>84.07</td>
<td>112.76</td>
</tr>
<tr>
<td>1966</td>
<td>38.68</td>
<td>86.02</td>
<td>112.90</td>
</tr>
<tr>
<td>1967</td>
<td>38.99</td>
<td>85.19</td>
<td>111.81</td>
</tr>
<tr>
<td>1968</td>
<td>39.04</td>
<td>92.95</td>
<td>118.38</td>
</tr>
<tr>
<td>1969</td>
<td>36.39</td>
<td>96.06</td>
<td>123.03</td>
</tr>
<tr>
<td>1970</td>
<td>31.36</td>
<td>92.42</td>
<td>113.37</td>
</tr>
<tr>
<td>1971</td>
<td>29.76</td>
<td>81.27</td>
<td>98.25</td>
</tr>
<tr>
<td>1972</td>
<td>30.68</td>
<td>79.61</td>
<td>95.27</td>
</tr>
<tr>
<td>1973</td>
<td>28.19</td>
<td>70.08</td>
<td>86.08</td>
</tr>
<tr>
<td>1974</td>
<td>22.40</td>
<td>56.42</td>
<td>70.12</td>
</tr>
<tr>
<td>1975</td>
<td>29.13</td>
<td>57.27</td>
<td>68.31</td>
</tr>
<tr>
<td>1976</td>
<td>37.17</td>
<td>55.11</td>
<td>65.01</td>
</tr>
<tr>
<td>1977</td>
<td>36.62</td>
<td>52.79</td>
<td>65.36</td>
</tr>
<tr>
<td>1978</td>
<td>36.20</td>
<td>51.23</td>
<td>68.40</td>
</tr>
<tr>
<td>1979</td>
<td>31.87</td>
<td>45.92</td>
<td>64.12</td>
</tr>
<tr>
<td>1980</td>
<td>27.18</td>
<td>40.37</td>
<td>57.69</td>
</tr>
<tr>
<td>1981</td>
<td>25.68</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>1982</td>
<td>26.84</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>1983</td>
<td>29.96</td>
<td>36.83</td>
<td>61.81</td>
</tr>
<tr>
<td>1984</td>
<td>25.51</td>
<td>27.29</td>
<td>43.42</td>
</tr>
<tr>
<td>1985</td>
<td>26.82</td>
<td>23.21</td>
<td>35.55</td>
</tr>
<tr>
<td>1986</td>
<td>29.20</td>
<td>23.04</td>
<td>35.28</td>
</tr>
</tbody>
</table>

a. Average of rice and maize daily wages (without meals) as reported by the Bureau of
Agricultural Economics. Estimates for 1962-65 were derived seven-crop aggregates
reported by Balagot and Librero (1975)

b. Daily wage data for 1962-80 as reported by the Central Bank. Wages estimates for 1983-86
were calculated from March 1983 data in World Bank (1985) and quarterly nominal wage
growth rates for 1983-86 reported in Montes (1987)

Source: Boyce (1993)
In order to understand industrial protection policies it is necessary to start with the history of Philippine politics that largely shapes today’s political economy. (See Hayami’s chapter in this volume for a more detailed discussion of how geography and colonial policies have historically interacted to form the different socioeconomic structures of Indonesia, the Philippines, and Thailand.) The combination of the historical dominance of politics by a ‘landed oligarchy’, the weak state bureaucracy vis-à-vis such family enterprises, and the largely personal basis of politics without well-defined political parties is the prominent theme in the literature on the Philippine political economy. Perhaps one of the most notable features of Philippine politics is the historical dominance of the initially land-based family enterprises, or the ‘landed oligarchy,’ and their rampant rent-seeking (McCoy, 1994; Hutchcroft, 1998; Intal and Power, 1989; Putzel, 1992; Riedinger, 1995). The origin of their dominance dates back to the Spanish colonial period. The islands’ vast lands were initially held by the Catholic church, but the church estates were later (especially in the 19th and 20th centuries) acquired (through lease, purchase, and government transfer) by a small number of elite families. Opening the colony to exports of tropical agricultural products in the late 18th century provided a major impetus for land consolidation by the Filipino elite (Fegan, 1989; Hayami, et al., 1990; Hayami and Kikuchi, 1982; Putzel, 1992). By the end of the 19th century, many of the prominent family enterprises, such as Ayala (1834), Soriano (1890), Cojuangco (1870), as well as sugar haciendas in Negros had been founded (Putzel, 1992).

The U.S. colonial rule after the late 19th century introduced an elected legislature, political parties, a strong presidency, and independent judiciary (Wurfel, 1988). Shortly after the introduction of these institutions, government positions in the bureaucracy and legislature were rapidly ‘Filipinized’ (mainly between 1913 and 1921) by the landowning elite (Wurfel, 1988; Putzel, 1992). Thus the pattern was established by the early 20th century that prominent family enterprises, initially based on vast land ownership, had almost exclusive access to government policymaking and engaged in various rent-seeking activities (Hutchcroft, 1998; McCoy, 1994). The dominance of the landed oligarchy has been reflected in many aspects of economic policymaking in past decades, including the extremely slow pace of legislating and implementing land reform (Hayami et. al., 1990; Putzel, 1992; Riedinger, 1995).

A relatively weak state bureaucracy reflects the dominance of the landed oligarchy in Philippine politics. Political offices at the national level are won with the electoral support of provincial elites and Manila’s oligarchs. During World War II, “the collapse of central authority and the distribution of infantry weapons to anti-Japanese guerillas broke Manila’s monopoly on firearms”, leading to the loss of central government control of the countryside to regional politicians and the emergence of local ‘warlords’ and endemic political violence. (McCoy, 1994, p. 14) The dependence of the president and members of Congress on the provincial elite for votes and the loss of monopoly control of the military to the same elite thus set the stage for a political economy characterized by a weak state and powerful oligarchy throughout the post-war period.
Origin of import substitution policies

As a result of reciprocal free trade with the United States during the colonial period, the Philippines became heavily dependent on the U.S. market for its exports of agricultural products such as sugar, copra, coconut oil, and abaca. Diversification was discouraged. The free trade regime continued after independence in 1946 together with limitations placed on economic policymaking under the Bell Trade Act, such as the requirement for permission from the American president before altering the peso/dollar exchange rate.

After independence, the exchange rate was maintained at the pre-war level despite high inflation, which would presumably protect the interests of U.S. investors as well as U.S. agricultural producers. Even though U.S. aid was applied to the large trade deficits, the Philippines hit the first of numerous post-war balance of payments crises in 1949. In the face of the crisis, the newly founded Central Bank instituted import controls on foreign exchange while maintaining the overvalued local currency (Montes, 1991; Intal and Power, 1990; Hutchcroft, 1998). Given the prominence of the landed oligarchy in Philippine politics and their heavy dependence on primary exports to the U.S. at the time, there was strong domestic pressure, especially from the powerful sugar bloc, to devalue the peso. Despite such domestic political dynamics, however, the overvalued peso was maintained and import controls were imposed, apparently due to U.S. dominance over economic policymaking. (Hutchcroft, 1989; Intal and Power, 1991). In this particular episode, external influence from the U.S. government weighed even heavier over policies, despite the overwhelming dominance of the landed oligarchy within the Philippine political arena. The system of import controls and an overvalued domestic currency — common ingredients of the ISI strategy — was initially introduced in the Philippines not as a conscious part of such a strategy, but rather as a response to the 1949 balance of payments crisis (Hutchcroft, 1998; Intal and Power, 1990; Alburo, 1993).

For many other developing countries, the explanation for the adoption of the ISI strategy could often be found in the prevailing political influence of a thin layer of mostly urban entrepreneurs over the rural population, as well as the rest of the urban population, “an uneasy alliance of sorts between the protected industries and the bureaucrats administering the protection” (Rodrik, 1996,12). In the case of the Philippines, however, we could argue that the main components of the ISI strategy were put in place before domestic interests for the industrial sector developed sufficiently. Instead, the ISI policies were instituted exogenously and domestic vested interests emerged in response to the new policy regime. This reflects the relative lack of competitive interest-group politics in economic policymaking, a defining characteristic of the Philippine political economy.

35. The roots of economic protectionism can be traced further back to at least as early as the idea of economic nationalism pursued by President Quezon in the late 1930s (Gopinath, 1986)
36. For example, focusing on Latin America, de Janvry (1981, p. 198) argues that the adoption of the ISI strategy was “a concerted effort of all the dominant classes — commercial bourgeoisie, agrarian oligarchy, and emerging national industrial bourgeoisie,” under the condition of relative autonomy of the ‘peripheral’ states from external forces (from the ‘center’).
Emerging vested interests under the ISI regime

The ISI strategy was the prevailing economic philosophy in many developing countries during the 1950s, and the Philippines was no exception. As we have shown, however, import controls were already in place and an overvalued domestic currency was maintained before the Philippines entered what is commonly known as the import-substitution industrialization (ISI) period. Most of the industrial infrastructure of the country was established during this period starting in the 1950s (Montes, 1991). Once instituted, ISI policies in turn induced the landed oligarchy to diversify their investment portfolios into industrial sectors that were protected under ISI policies.

For example, based on the description of the company history given by Yoshihara (1985), about 15 percent of the 250 largest manufacturing firms as of the late 1960s could be identified as originating from the landed oligarchy. If we restrict our attention to Filipino firms by excluding foreign firms, roughly one-third of the largest Filipino manufacturing sales was accounted for, at least initially, by land interests. If we further restrict our attention to the non-Chinese Filipino (i.e., mainly Spanish mestizos and Malay Filipinos) manufacturers, the share rises to more than one-half (56 percent).

A bloc of vested interests resulting in a powerful ‘enduring coalition’ to perpetuate the protectionist system was created (Hutchcroft,, 1998, p. 76; Intal and Power 1990; Alburo, 1993). As more of the landed oligarchy diversified their portfolios into ISI, conflict of interest over economic policy (e.g., exchange rates) between export agriculture (landed oligarch’s traditional sector) and the import substituting (IS) industry (landed oligarch’s new investment portfolio) became increasingly blurred, and possible policy conflicts were muted by family ties among the dominant economic elite. Thus a situation emerged where economic policymaking was characterized by a bias toward the rich and powerful, but interest group politics, such as agricultural versus non-agricultural, were conspicuously absent. As a result, it is no surprise that agricultural pricing policies of the past few decades cannot be explained in terms of interest groups based on any specific sub-sector or crop (Intal and Power, 1991)

Marcos regime and policy reform

In some aspects, the Marcos martial law regime broke from the traditional politics. By suspending the Congress, martial law limited access by the traditional oligarchy, now with fairly diversified economic interests, to state policymaking (Montes, 1991; Intal and Power, 1991). On the other hand, the relative importance of the government bureaucracy increased during martial law, allowing implementation of policy reforms advocated by technocrats (as well as prescribed by international financial institutions such as IMF and World Bank) independently of the interests of the traditional elite. In the end, however, such departure from traditional politics did not lead to significant policy reforms as had been hoped by some.

To the extent that systematic access by the traditional landed oligarchy was limited, its access was replaced by an increase in individual and ad hoc access by a new oligarchy or cronies closely associated with the Marcos family. The Marcos authoritarian government needed to create its own social base in order to sustain its political control and bureaucratic machinery. President Marcos relied on a group of new elite mainly
recruited from his own loyalists because they appeared to be the only reasonable constituency for his authoritarian regime (Montes, 1991). Creation of a new elite, in turn, required bending the rules by providing favors to specific individuals (Montes, 1991, p. 44). Furthermore, after 1978 President Marcos “became increasingly reliant upon courtiers to deliver the blocs of provincial votes that he would need for a new mandate” (McCoy, 1994, p. 18). As a result, the Marcos martial law regime “rested upon a coalition of rent-seeking families not unlike those that had dominated electoral politics before martial law” (McCoy, 1994, p. 17)

Despite initial hopes by some, authoritarian rule did not facilitate sweeping policy reforms. The survival imperative of the Marcos regime prevented implementation of sweeping and systematic policy reforms despite the apparent autonomy of the regime from interest groups. At least in the Philippines, authoritarianism (or other forms of concentrated executive power such as the initial Aquino presidency) proved to be no more conductive to policy reforms than were democratic regimes.37

**Restoration of democracy and return of the traditional oligarchy**

In 1986, the ‘people power revolution’ forced President Marcos into exile and a broad but shallow anti-Marcos coalition brought Mrs. Corazon Cojuangco Aquino to the presidency “with a revolutionary mandate for change and few debts to any of the prominent political families allied with Marcos” (McCoy, 1994, p. 18). A significant number of policy reform measures during the Aquino administration were implemented during the first year of her presidency prior to the restoration of Congress, including elimination of the monopolies for sugar, coconut, beef, wheat, and fertilizer; rehabilitation of the rural banking system; and tax reform (Tolentino, 1994).

Many observers contend, however, that the return to democracy under the Aquino presidency largely meant a return to pre-martial law politics dominated by the elite (Montes, 1991; Tolentino, 1994; Riedinger, 1995; McCoy, 1994). The protectionist interests of the traditional oligarchy were represented in the administration, for example, by the appointment of an entrepreneur in IS manufacturing as secretary of the Department of Trade and Industry (DTI), and more generally, access by the wealthy elite to policymaking was assured by a proliferation of government-private sector collaborative councils and other dialogue channels.38 The DTI secretary “did his best to delay the implementation of the TRP [tariff reform program] and the ILP [import liberalization program] . . . and was quite successful” (Tolentino, 1994, p. 100). Industries that could be affected by liberalization also mounted aggressive and successful

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37. Similarly, a global literature review by Rodrik (1996) also failed to find support for the hypothesis that economic policy reforms conducive to growth (or the types of policy reforms implemented by the East Asian tigers) require authoritarianism.

38. For example, according to Tolentino (1994, p. 143), “[organized farmers’ and peasants’] groups would request to see the President to discuss issues affecting agriculture and agrarian reform. They would need to go through all the formal channels of protocol and appointments, and if lucky, would get to see the President about four to six weeks later. In sharp contrast, it was common for prominent businessmen and the representatives of the business groups to request for meetings with the President and get to see her within a day or two.”
lobbying campaigns (Tolentino, 1994, p. 103-104). As a result, trade liberalization was slow, an overvalued exchange rate was maintained, and industry-specific exemptions (e.g., cars, phosphatic fertilizers, tinplate, appliances, etc.) were introduced. Recapturing the policymaking process by the landed oligarchy also manifested itself in relative inaction by President Aquino prior to reopening Congress and the substantial dilution of land reform in the legislature, as well as massive delay in its implementation (Hayami et al., 1990; Putzel, 1992; Riedinger, 1995).

**Delay in departing from the ISI strategy**

The ISI strategy was a popular development strategy in the 1950s (Rodrik, 1996), but powerful vested interests in the Philippines prevailed upon the government to maintain protectionist policies long after most other developing countries had abandoned them.

One possible explanation for this difference could be the absence of a political environment in which interest groups with distinct economic interests compete (Hara, 1994). After the landed oligarchy diversified its investments under an ISI regime, their economic interests were not clearly defined by economic sectors. Because the interests of the dominant elite encompassed a range of sectors, from export agriculture to IS manufacturing to banking, there were not many opportunities for a powerful and coherent economic interest group to emerge to challenge the dominance of the oligarchy. The enduring influence of vested interests in IS oriented policies can be partially attributed to the way the IS policies were initially introduced.

Unlike in countries where the adoption of an ISI strategy was mainly due to political pressures in competition with rural landlords, perhaps the (indigenous) pre-ISI industrial sector was not a strong political force behind the adoption of the IS policies in the Philippines. Instead, a powerful coalition of landed oligarchy who were also IS manufacturers emerged in response to the adoption of IS oriented policies that initially were externally imposed by U.S. economic interests. As a result, a social force distinct from the landed oligarchy never developed.

Rodrik (1996) suggests that the East Asian tigers managed to adopt IS oriented policies without inviting excessive rent-seeking because of the well-educated labor force (which leads to a competent bureaucracy), and more importantly, the relatively egalitarian distribution of wealth and income. Such a distribution prevents the emergence of powerful interest groups, which reduces the need for government redistribution policies. In addition, a low incidence of income and wealth inequality may encourage early adoption of policy reforms because it is easier for a government to convince its constituency that the burden of economic adjustment will be evenly distributed and thus build a consensus for reform among its constituency (Rodrik, 1996, p. 27).

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39. There was some indigenous development in IS manufacturing in the pre-war period (Yoshihara, 1985).

40. These are likely to be only partial answers. Rodrik (1996, p. 19) notes that we do not really know why “the East Asian governments [were] able to avoid the rent-seeking activities that typically accompanied microeconomic interventions.” Nor has the link between high inequality and delayed reform through political channels yet been empirically and directly tested in the literature. (Rodrik, 1996, p. 21)
Philippine example is apparently consistent with the general proposition that higher inequality hinders good governance and policy reform.

Comparing the Philippine political economy to its Southeast Asian neighbors, Hutchcroft (1998) argues that the Philippine state can be characterized as a “patrimonial oligarchic state” as opposed to its Indonesian (especially during the earlier Suharto period) and Thai (especially in the years 1932-1973) counterparts that are characterized as “patrimonial bureaucratic states.” In Hutchcroft’s terminology, a ‘patrimonial state’ is a polity where rent-seeking is rampant. Among such patrimonial states he makes a further distinction according to the relative strengths between the state apparatus (i.e., state bureaucracy, or ‘political aristocracy’) and private business interests. In a ‘patrimonial administrative state’ a bureaucratic elite tends to “extract privilege from a weak business class,” while in a ‘patrimonial oligarchic state’ “a powerful business class extracts privilege from a largely incoherent bureaucracy” (Hutchcroft, 1998, p. 20). He argues that in an ‘oligarchic patrimonial state’ such in the Philippines, it is difficult for policy reforms ‘from above’ to succeed given the relatively weak position of state bureaucracy vis-à-vis private business interests. The absence of social forces challenging control by the oligarchy led the ‘oligarchic patrimonial’ nature of the state to endure (Hutchcroft, 1998, pp. 52-54).

Political behavior and rationality — some remaining puzzles

Hutchcroft’s argument is not without controversy. Some observers maintain that the differences between the Philippine and Thai political economies may not be as large as Hutchcroft claims. A veteran scholar of Philippine politics argues that “the two political economies are converging — with Thai elections and political parties, for instance, becoming more like their Philippine counterparts — in turn affecting the role of private interests in state decisions on the economy, and thus reducing the strength of the bureaucracy” (Wurfel, 2000, p. 893). Furthermore, no explanation is offered as to how one type of the ‘patrimonial’ state emerges in some societies, but the other type emerges elsewhere. In addition, if the bureaucrats in a ‘patrimonial bureaucratic state’ are rational, it is not clear why they initiate policy reforms that eventually lead to the loss of their own economic advantages. As Rodrik (1996) notes, political explanations for policy changes often presume, implicitly or explicitly, myopic behavior by political actors. Economists, however, have a strong tendency not to give up the assumption of rational (thus non-myopic) agents “until they become older — wiser? — and distinguished” (Rodrik, 1996, p. 23). Without maintaining the rationality assumption at some level, any ‘explanation’ of past events would have little predictive power. Thus, such apparently collective irrational behavior would still need to be explained in terms of rational behavior of individual members.

Among the policy instruments commonly associated with the ISI strategy, a distinction can be made between unsustainable macroeconomic policies (such as overvalued domestic currency or large fiscal deficits) and microeconomic policies that lead to inefficient resource allocation but induce relatively limited effects on macroeconomic stability (such as trade restrictions or industry-specific subsidies/taxes). This distinction is often lost in policy discussions (Rodrik, 1996). In the Philippines, both sets of policies have tended to be maintained under the long-sustained ISI regime (at least
prior to the 1990s). By definition, maintaining unsustainable macroeconomic policies will eventually lead to macroeconomic instability that sets off costly adjustment processes for everyone, and “the longer they [unsustainable macroeconomic policies] are pursued the more drastic their eventual reversal must be” (Rodrik, 1996, p. 21) If the vested interest groups (landed oligarchy-cum-industrial manufacturers) are rational, it would appear that they have a good reason to sustain the distortionary microeconomic policies (such as trade restrictions and industry-specific taxes or subsidies) but not sustain the macro components of the ISI strategy (such as overvalued exchange rates) that would eventually hurt them as well as others. Explaining the maintenance of the whole ISI package in terms of ‘vested interest’ groups may also contain an element of collective myopia/irrationality that would need to be further explained, an area that needs further exploration in the literature.41

Rural organizations and local politics — potential for changes?42

Much of the literature on Philippine politics focuses on the persistent dominance of the landed oligarchy. As we have seen, such a view can explain maintenance of development strategies that ran counter to rural development and poverty reduction. Domination of political processes by the landed oligarchy can also explain the slow and prolonged pace of land reform (Riedinger, 1995; Putzel, 1992; Fuwa, 2000). In contrast, small farmers and landless laborers, who comprise the overwhelming majority of the rural poor, have relatively little influence over the policies that very much determine their livelihood. They are large in number and dispersed geographically, thus it is particularly difficult for them to organize against the well-organized landed oligarchy.

Against such a general picture, the political influence of peasants and the landless could to some extent be enhanced in local political dynamics by the efforts of grassroots organizations. Case studies in local implementation of land reform programs, for example, indicate that small-scale farmers and landless labors who organize and build coalitions mediated by NGOs and POs could make a significant difference at the local level. Under the Comprehensive Agrarian Reform Program (CARP), the Ramos administration redistributed a far larger amount of land than any of its predecessors, although it still fell short of the initial targets stipulated by the program (Fig. 5). Some observers attribute this redistribution to some changes in civil society originating in the late 1980s.

According to these accounts, the ‘people power revolution’ of February 1986 that ousted President Marcos not only returned the landed oligarchy to the center stage of national politics, but also led to the emergence of various peasant organizations (Borras,

41. It is interesting to note that the Philippine example is a total reversal of the wholesale adoption of both macro- and microeconomic policy reforms in Latin America during the 1980s. This is in marked contrast to the earlier policy reforms by East Asian tigers where reforms were limited to macro stabilization policies while maintaining selective microeconomic interventions, as illustrated by Rodrik (1996).

42. This section draws heavily on Fuwa (2000).
There have been some reported cases (in areas such as Nueva Ecija, Davao del Norte, Pampanga, Quizon, and Laguna) of increasingly active involvement in land redistribution by local and national NGOs. Linking local peasant groups to pro-reform officials within the national agrarian reform bureaucracy, linking peasant groups from different regions, and media campaigns contributed to successful land redistribution despite strong resistance from local landowners (Borras, 1999). Such actions suggest a potential for a political force to counteract the traditionally powerful landed oligarchy.

Summary and Conclusions

In this paper we have reviewed overall rural development and government policies that had major effects on rural development over the past four decades in the Philippines. We then explored the dynamics of the political economy behind some of those policies. While there was sustained growth in national income during the 1960s through the 1970s, the rate of growth was lower than that in Indonesia or Thailand. Furthermore, there has been relatively little transformation of the economic structure compared to its neighbors — the share of agriculture in GDP in the Philippines, for example, was much smaller than that of Indonesia or Thailand as of 1960, but the subsequent decline of agriculture’s share was much slower in the Philippines than in its Southeast Asian neighbors. As a result, as of 1997 the share of agriculture in GDP was higher in the Philippines than in Indonesia or Thailand.

More importantly, the pace of poverty reduction in the past few decades was much slower in the Philippines than it was in its neighbors. Poverty incidence (headcount ratios) in Indonesia fell from a level nearly twice that in the Philippines in 1975 to less than one-half the level in the Philippines in 1995. The incidence of poverty in Thailand, on the other hand, was already less than one-quarter that in the Philippines in 1975, and then subsequently dropped to near zero by 1993 (Table 1). Such a disappointing performance by the Philippine economy compared to its neighbors is among the most notable observations emerging from our comparative study.

Focusing on the agriculture or rural sector in the Philippines, the aggregate growth in agricultural production during the 1960s and 1970s was quite substantial and comparable to the pace of agricultural growth in Indonesia or Thailand. Much of the agricultural growth during this period resulted from increased productivity as new technology was introduced (especially high-yielding varieties and increased use of fertilizer) and public investment (especially irrigation) expanded. Despite the impressive growth in total agricultural production up to the early 1980s, the effect of such aggregate growth on reduction of rural poverty was not very impressive. While the incidence of rural poverty generally declined over the past four decades, the pace of poverty reduction in the

43. Such a diversified mode of mobilization included organized attempts at land occupation that peaked in 1987-88 when the Comprehensive Agrarian Reform Law was being debated in Congress.
44. Other potential involvement by local and national NGOs includes providing legal advice to counter the common landowner tactic of bringing legal cases against land reform beneficiaries, supporting peasant demonstrations and picketing, providing logistical support for lobbying in the national capital, and providing links to international NGOs.
Philippines (measured by income or expenditure or by non-income dimensions) has been quite disappointing compared to its neighbors.

One of the main reasons for such weak effects of aggregate growth in reducing rural poverty can be attributed to the historical processes leading to the social structure of the rural Philippines and the growing incidence of landlessness during the period (Hayami, this volume). Additional reasons can be found in a layer of policy measures that were ‘anti-small-scale farmer’ and thus ‘anti-poor.’ It has been well documented that economy-wide policies comprising the import-substitution industrialization (overvalued exchange rates, industrial protection) during the 1960s and 1970s depressed the relative price of agricultural products and encouraged capital-intensive patterns of industrialization, thereby hampering the absorptive capacity of economic growth and industrialization for labor. Furthermore, critics have argued that policy interventions targeted to the agriculture sector appear to have had a bias against small-scale farmers. For example, the subsidized credit program reached relatively few small-scale farmers and fertilizer subsidies were largely ineffective.

Growth in agricultural production stagnated in the 1980s as a result of several factors, including price declines in world markets, stagnation in public investments (especially rural roads, irrigation, and research), and high-yielding varieties exhausting their potential. In addition, the slow process and uncertainty surrounding the land reform program (CARP) in the late 1980s appears to have had negative effects on private investments and encouraged non-planting and premature land conversion as a means of avoiding land redistribution. In the meantime, unlike in the neighboring countries, despite a series of policy reforms, an import substitution orientation was maintained throughout the 1980s, and as a result the magnitude of negative indirect protection on the agriculture sector remained relatively high.

Policy measures biased against small-scale farmers that were introduced in the 1970s were reformed in the 1980s. Meanwhile, despite the substantial slow-down in agricultural growth in the 1980s, rural poverty continued to decline, albeit very slowly, through the 1980s and 1990s. A main factor that contributed to the increased responsiveness of poverty reduction to economic growth during this period appears to be expanded opportunities for non-farm income in rural areas (Hayami and Kikuchi, 2000). In addition, the policy reforms of the 1980s and 1990s may have made the effect of aggregate growth more ‘pro-poor’ compared to the earlier period (Balisacan, 1998b; Balisacan, 1999a). In the 1990s, however, there were both accelerated policy reforms (liberalization of foreign exchange markets, trade liberalization, privatization in the service sector) and increased protection for the agriculture sector (introduction of high tariffs). As a result, the effective rate of protection for the agriculture sector became roughly equal to that of the manufacturing sector in the 1990s, a major policy shift from the previous several decades when the effective protection for agriculture was substantially less than that for manufacturing.

Many observers have argued that policies based on import-substitution industrialization (indirect negative protection) hindered rural development, and that such policies encouraged a capital-intensive pattern of industrialization. This pattern hampered the growth of labor-intensive industries that could further reduce rural poverty.
Despite such negative consequences for rural development and the rural poor, an import substitution orientation persisted in the Philippines through the 1980s, a much longer period than in other developing countries. The lack of competitive interest groups that could influence policies contributed to this persistence.

The historical dominance of the landed oligarchy, which originated during the Spanish colonial period, has consistently characterized Philippine politics and the introduction of an import-substitution industrialization orientation. Such an orientation induced the landed oligarchy to diversify into the newly protected industrial sector, thus creating a formidable vested interest group. With the absence of any counter-balancing group to challenge the dominance of the oligarchy, such a policy orientation persisted. Neither the introduction of authoritarianism in the 1970s nor the restoration of democracy in 1986, altered such a basic structure of the Philippine politics.

While definitive quantitative evidence is scarce, the Philippines is well known for highly unequal wealth distribution (especially land ownership), which also originates in the colonial period (Hayami, this volume). The effects of economic growth on poverty reduction are likely to be smaller when income inequality is high. Empirical evidence shows a negative relationship between initial inequality and subsequent growth, although the exact mechanisms for such correlation are not entirely clear (Pearsson and Tabellini, 1994). Many government policies during the past three decades apparently contributed to the disappointing performance in Philippine development. The political processes behind these policies, in turn, could also be a result of high initial inequality in wealth distribution. Some have argued that high inequality hinders the emergence of a political process with competitive interest groups and may encourage a political process with rampant rent-seeking (Binswanger and Deininger, 1998; Rodrik, 1996). Philippine development during the past few decades appears to be a prototypical example of the thesis that initial inequality hurts subsequent economic development through the adoption of poor policies through a political process without competitive lobbying. Lack of such competition is a result of the high inequality in wealth distribution, a lingering legacy of the colonial era.

References


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54 Revised Final

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Is the Rural-Urban Migration Story a Statistical Illusion?

Judging only by statistics, it appears that there have been few improvements in the Philippine countryside over the last few decades. Indeed, looking at official estimates, the poverty incidence in rural areas has fallen very sluggishly (from 56 percent in 1985 to 51 percent in 1997). Despite substantial economic growth, the distribution of wealth seems to have hardly changed. The rural poor still account for about 70 percent of all poor people nationwide and their numbers appear to be growing (from 18.7 million in 1985 to 19.6 million in 1997).

These numbers are in stark contrast to the apparent ‘success’ of urban areas in terms of poverty alleviation. As shown in earlier studies, poverty reduction in urban areas has been quite substantial (Balisacan, 1999c). The poverty head count, for example, fell by 13.5 percentage points from 1991 to 1997, which is in sharp contrast to the 3.6 percentage point reduction in rural areas.

Two caveats are necessary. First, rural estimates may not be strictly comparable, because changes in rural-urban classifications over time create a downward bias on the usual indicators of rural development performance. Second, even if examining roughly comparable estimates (e.g., for the 1990s), problems still emerge because of the phenomenon of ‘shifting physical areas’ as rural areas become increasingly urbanized, again dampening rural performance as reflected in the statistics.

Changing Definitions

The definition of ‘urban areas’ in the Family Income and Expenditures Survey (FIES), the main source of data for rural household indicators over time, has changed substantially through the years. In the 1961 FIES, urban areas included Metro Manila (plus its adjacent cities and municipalities), chartered cities, provincial capitals, and all town centers of municipalities.

The 1965 FIES added population density as a criterion for the urban classification, including as urban all town centers of municipalities with a density of at least 500 persons per square km as well as villages contiguous to these centers having at least 2,500 inhabitants. Since 1971, any district with at least six establishments (commercial, manufacturing, recreational, and/or personal services) can also qualify as an urban area, regardless of population density. As classifications change, a statistical migration has been added to the human migration.
Shifting Physical Areas

In addition to changing definitions, the physical area of the ‘rural’ sector is shifting over time. As population grows and/or economic activity expands, an initially rural area will sooner or later be classified as urban. While this may not pose a problem in measuring, for example, urbanization trends, it tends to depress rural performance indicators.

Suppose that rapid agricultural growth in some regions leads to a similarly rapid expansion of non-farm employment and income. This change induces urbanization, thereby reducing the physical size of ‘rural’ areas. Poverty incidence in urbanizing areas tends to fall relative to that in shrinking rural areas because household income rises faster in the former. This is particularly true if there are constraints to labor movement from slow to rapidly growing areas, or if there are considerable lags to such movement.

Although growth stimulus is initially rural-based, gains in poverty reduction appear to happen in urban areas. The data in population censuses would then suggest that rural development programs, even if they spur rural income growth and reduce rural poverty, do not matter much.

Rural-Urban Migration Trends — An Exaggeration?

The reclassification of physical areas over time has a particularly important implication on rural-urban migration stories. High urban population growth in less-developed countries is, for example, commonly attributed to rapid rural-urban migration, with evidence of such migration based mainly on published population censuses. If reclassification of physical areas is driving the commonly observed high urban population growth, then the rural-urban story in the development literature can be vastly exaggerated.

For the country as a whole, it is the reclassification of physical areas — not physical movement of population from rural to urban areas — that mainly accounts for the growing share of urban areas in the total population. This is easy to demonstrate. Table A1 highlights rural and urban population counts based on published population censuses, as well as population estimates for fixed physical rural and urban areas (which involves reclassifying geographic areas in various population censuses according to their urban-rural classification in the 1970 census of population). Estimates based on fixed areas indicate that ‘rural’ areas had a population share of nearly 69 percent that dipped to 64 percent in 1990. In contrast, the census report shows the population share of ‘rural’ areas falling from nearly 69 percent to 51 percent during the same period.

Comparability Problems

Reclassification obviously reduces the comparability of rural poverty indicators. It has been demonstrated that a failure to consider ‘shifting physical areas’ arising from reclassification of villages can distort the overall picture of actual performance. We can return to the example of (extremely slow) rural development in the late 1980s and the early 1990s as an illustration. Sampling for the 1985 and 1988 FIES was based on the 1980 population census, while that for the 1991 FIES was based on the 1990 census.
(Note that both censuses applied the same set of criteria in classifying villages into ‘urban’ and ‘rural’ areas.)

A large number of rural areas in 1980 became urban areas in 1990 when they were found to satisfy the necessary criteria. This reclassification, in addition to net migration from rural to urban areas, reduced the population share of FIES rural areas from 62 percent in 1988 to 50 percent in 1991. In contrast, the estimated rural population share based on fixed physical areas was virtually the same — 64 percent. More importantly, it was estimated that in FIES rural areas, poverty incidence increased from 50 percent in 1988 to 52 percent in 1991. In the ‘fixed’ rural areas, the count actually fell, from 48 percent to 41 percent.

Clearly, much can be explained by construction of statistics alone, and other convoluted explanations might not be required. Viewed in this perspective, the rural sector might not be as lethargic as often pictured, and may have even been a source of considerable dynamism.

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<th>Table A1. Urban-rural population changes in the Philippines, 1960 to 1990</th>
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<td>Fixed rural areas</td>
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a. Based on 1970 urban-rural classification of villages.
b. Urban-rural growth difference.