

PASCN Discussion Paper No. 99-10

**Social Impact of the Asian Financial Crisis in the  
Philippines: Preliminary Survey**

*Gloria Pasadilla*



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## **Social Impact of the Asian Crisis in the Philippines: Preliminary Survey**

**Gloria O. Pasadilla\***

The Philippines fought hard to be considered part of Asia because for many years since the 1980s, she had somehow been lumped together with Latin countries. Partly because of the same historical Spanish root, partly because while other Asian countries enjoyed robust growth for two decades, the Philippines had muddled through its economic development as many Latin American economies did. To join the ranks of the Asian tigers, starting in the late 1980s, the country vigorously pursued economic and financial liberalization, privatized government corporations, hinged its development strategy on exports, etc., resulting in a relatively modest success. Confidence on the economy rose and large capital inflows diverted themselves to the Philippines. But when the country finally seemed poised for tigerhood and was increasingly being recognized as yet another emerging 'Asian country', with the supposed prestige that comes with the name, the crisis spotlighted the inherent weaknesses in the erstwhile tigers. For better or worse, the Philippines is, indeed, now more recognized as 'Asian', not Latin American, and therefore was not immune from the Thai bubble bursting contagion.

At the outbreak of the crisis, the Philippines had already created a small property and financial bubbles that was ripe for bursting. The reason can be traced to the same ones that created the bubbles in Thailand, Korea, and Indonesia, that is, to huge capital inflows, which led to bank increased lending to sectors like real estate and stockmarkets, and which caused asset prices to soar. So, when the Thai bubble collapsed and foreign funds scampered out of other Asian countries, Philippine asset prices plunged, construction activity declined, and property prices dropped. These effects are similar to those of the tiger countries, albeit the difference is one of degree.

The fact is that, even as the Philippines suffer through the same large exchange rate devaluation, skyrocketing interest rates, stockmarket volatility and decline, the real economy has shown to be resilient. In 1997, it posted one of its highest historical GNP growth of 5.8%, amidst low inflation, in contrast to the collapsing growth rates of neighboring countries. In 1998, the economy is expected to decelerate to less than 1% growth, a still remarkable performance in contrast to sharp declines in economic growth in Indonesia, Malaysia, Korea, and Thailand. Yet, even this slow growth is largely attributed to the El Nino phenomenon, and less on the Asian crisis contagion.

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## **A. Tale of Two Crises**

Perhaps one reason why the present turmoil seems to be relatively painless for the Philippine economy is that the country has seen worse times in the period 1983-1985. The rise in world interest rates in the early 1980s, along with the spectre of an ailing president, led to moratorium on Philippine foreign debt, massive capital outflows, bank closedowns, and labor layoffs. There were a spate of mass street protests and threats of communist-inspired violence that exacerbated the plunging confidence on the economy. Thus, to a certain extent, the present Indonesian situation is reminiscent of what the Philippines went through during the early 1980s.

The present crisis, in contrast, occurred at a time of political stability, relative financial sector strength, and high confidence on the economy that even if there were short term capital outflows at the onset of the crisis, it was nowhere near the level seen in the 1980s. Besides, the Philippines had hardly recovered from the two oil shocks of the 1970s when another external shock hit it in 1981-82, while in the 1990s, the economy has consistently posted respectable performance before the Thai crisis hit, thus providing an inertia for growth.

At its nadir, the GNP contracted by more than 9% in 1984 and another 7% the year after. This makes the slowdown in 1998 hardly comparable to the severe recession in 1984-85, not to mention the strong growth chalked up in 1997. From the expenditure side, the 1984 slowdown was largely accounted by a drop in government consumption of minus 12%, and decline in investments of 37%. The 1998 slowdown is similarly largely caused by 14% drop in investments, and a slowdown, though still positive growth, in real consumption. Real exports have gone down in 1998 too, but that is largely because the 1985 survey basket for the GDP does not include new and high growth export industries like semiconductor which today actually takes more than 50% of export earnings. Hence, the real exports data from the National Income Accounts (NIA) is severely underestimated (see table 1).

Average exchange rates depreciated more than 50% in 1984. The 1998 depreciation closely follows at 46%, from P29.47/\$ in 1997 to an average of P41.17/\$ up to October 1998, yet its effect has not been as dramatic as the exchange rate depreciation in 1983-84. The reason is that the past exchange rate market turbulence was cast within a problematic structural and political scenario that affected the financial and institutional support for the economic system. Thus, industry output suffered a greater toll, dipping by 12% and 16% in 1984 and 1985, respectively. This is not the case in 1998 which see a minimal drop of 0.2% in industry output, but a very large decline of more than 6% in agricultural output. Since the agricultural sector is not highly dependent on imports, its significantly negative performance can hardly be attributed to the exchange rate depreciation, rather it is more likely due to the El Nino weather phenomenon.

**Table 1. Two Crises Compared**

	Crisis in the 1980's		Asian Crisis		
	1983	1984	1985	1997	1998
Real GNP Growth	1.65	-9.11	-6.96	5.30	0.8
Real GDP Growth	1.87	-7.32	-7.31	5.17	0.02
Growth in Real Consumption	0.61	0.27	-1.16	4.99	3.9
Growth in Government Consn	-4.73	-11.80	-1.03	1.56	0.6
Growth in Capital Formation	6.40	-36.99	-31.85	11.73	-13.8
Growth in Real Exports	3.45	4.54	-16.07	17.54	-7.7
Growth in Real Imports	-3.06	-17.48	-14.20	14.38	-10.2
Agriculture Growth	-3.38	-0.93	-1.88	2.93	-6.2
Industry Growth	1.52	-11.51	-15.75	6.14	-0.2
Services Growth	5.56	-6.53	-2.08	5.46	3.5
Per capita GNP (in P)	12,640	11,245	10,201	12,625	9058
Per capita GDP (in P)	12,828	11,601	10,491	12,108	8621
Interbank Call Loan Rate /a	16.49	28.29	20.16	15.70	15.1
Change in Interbank Rate	34.72	71.55	-28.73	21.88	-3
Treasury Bill Rates (91 days) /a	14.26	28.24	25.87	12.89	15.31
Change in TBR	3.48	98.04	-8.39	4.50	26
Exchange Rate /a	11.11	16.70	18.61	29.47	41.14
Change in Exchange Rate	30.13	50.27	11.43	12.42	46.02
Inflation (IPIGDP 1985=100)	14.24	53.79	17.29	6.01	10.4
Unemployed (thousands) /b	2053	2388.4	2544.5	2702.2	3507.7
Change in Unemployed /b		16.34	6.54	7.19	20.2
Unemployment Rate /b	10.27	11.61	12.18	8.85	11.1

1998 figures are based on data up to the third quarter

/a Data based on Jan-Oct 1998

/b Data based on 1st to 2nd Quarter 1998.

In fact, the crisis even freed the economy from an overvalued peso mindset, and displayed its resilience to sharp exchange rate changes. Significantly, the past stability of overvalued exchange rates as well as high domestic interest rates actually encouraged unhedged dollar-denominated borrowings<sup>1</sup> that proved fatal when exchange rates pegs collapsed. At the onset of the crisis, unhedged dollar borrowers panicked by buying dollars to cover their open positions, thus exacerbating the downward pressure on the peso. This also explains why, unlike in Thailand where speculation was mostly faulted on foreign institutions, most speculation on the peso was largely made by local players.

<sup>1</sup> This possibly explains the fact that most of the increase in total inflows have been due to growth in foreign loans, and less on portfolio and direct investment flows. Foreign currency loans was the fastest growing item since 1988 and constituted between 60-80% of total foreign net inflows.

The sharp depreciation of the peso not only dampened borrowings in dollars, but also helped turn the trade deficit into a surplus. Exports, based on the Central Bank's Balance of Payments data, increased by 19% as a result of the cheaper peso. The reduced manufacturing and export capacity of other Asian countries also helped divert demand on Philippine products. Imports, on the other hand, dropped by 14%.<sup>2</sup> In spite of the depreciation, inflation in 1998 is still manageable at more than 10%, albeit back at two-digit levels. Majority of the increase in inflation, however, is due to food prices increases resulting from the low agricultural produce. In contrast, inflation in 1984 reached an all-time high of 54% as a result of exchange rate depreciation and depressed industrial output, resulting to incidents of panic buying, in turn fueling more the spiralling price increases.

High interest rates policy was pursued during both crises. But the interest rate level reached even at the peak of the Asian crisis still does not compare with the level attained in the early 1980s. At some point at the onset of the contagion, lending rates were more than 35% per annum, fueling concerns for the stability of the banking system. But Central Bank bills in the 1980s were being issued at a much higher rate of more than 50% interest per annum, causing a spate of small bank bankruptcies. Period averages of 91-day Treasury Bill Rates, the bellwether of other interest rates, record 15.3% p.a. in 1998, about 26% change from the previous year. During the 1980s crisis, in contrast, TBR increased by more than 70% in 1983-84.

The 1980s recession dealt a permanent effect on the Philippine economy that it took almost 15 years for real per capita GNP to return to its pre crisis level. Of course, in between were other episodes of smaller crisis like the 1991-92 world recession, or the early post-Marcos economic transition difficulties that also contributed to delays in the recovery of 1982 per capita income. The Asian crisis, on the other hand, is expected to affect the economy relatively more quickly for reasons discussed in the succeeding section. Rapid annual growth of about 5-6% is expected to return in about two years.

### **Why is the Philippines Different?**

The fact that the Philippines is faring relatively better than other Asian countries does not mean, however, that all is well. In the first place, high growth in the 1990s occurred against the backdrop of large trade deficit, financed by rapid increase in remittances of Filipino overseas workers as well as large investments inflows. In 1995 and 1996, for instance, trade deficits were 12.5 and 13.5% of GDP, respectively, while non-merchandise receipts which include foreign remittances were 20 and 22.7%. Inflows from loans consisted of an average of 7% of GDP, and foreign direct investment, 4%, thereby allowing an overall positive balance of payments position (Table 2). This situation, as the Asian experience attests, render the country extremely vulnerable to adverse shifts in sentiments.

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<sup>2</sup> These export and import figures are for January to July 1998.

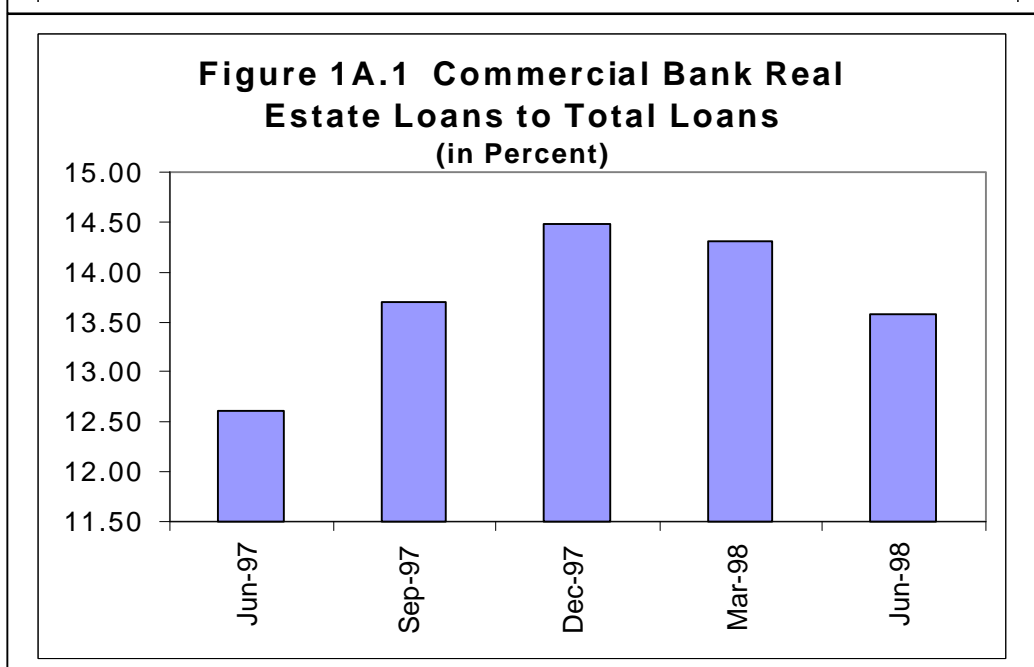
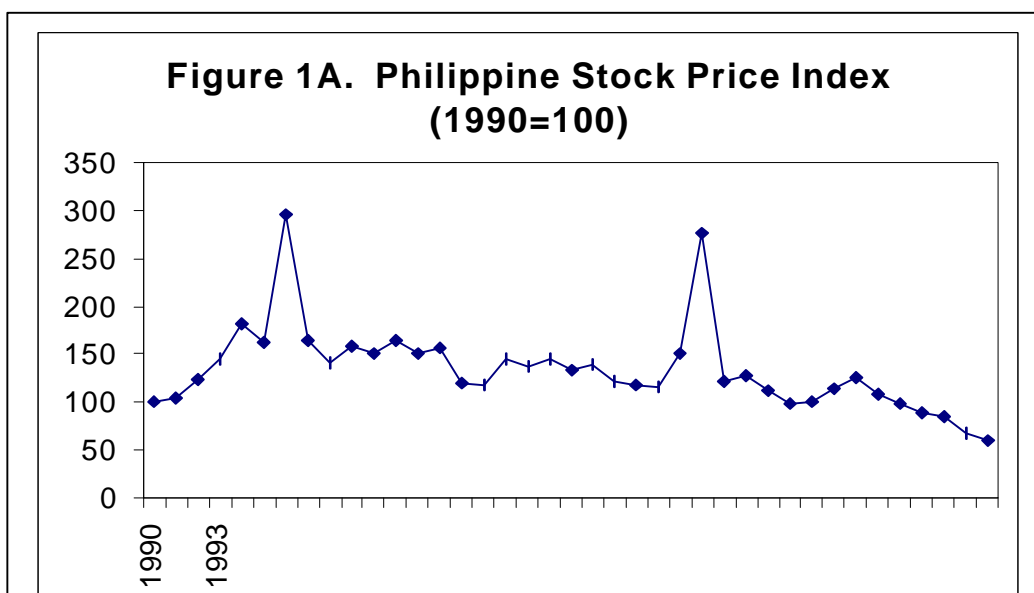
**Table 2. Philippine Balance of Payments  
1995 -1998 (selected items)  
(in % of GDP)**

	1995	1996	1997	1998
Merchandise Trade	-12.53	-13.54	-6.55	-4.39
Exports	24.45	24.52	30.68	45.60
Imports	36.98	38.05	44.21	49.99
Non Merchandise Trade	6.68	8.16	6.98	3.29
Receipts	20.14	22.68	27.77	25.49
Current Account	-4.62	-4.67	-5.23	-0.03
Medium and LT Loans	1.79	3.21	5.69	6.57
Inflow	5.5	7.55	9.03	10.12
Outflow	3.71	4.34	3.34	3.55
Non-res. Investments	4.13	4.32	1.03	2.91
Overall BOP	0.88	4.9	-4.09	5.11

1998 data is from 1st to 2nd quarter  
Exchange rate used for 1998 GDP conversion: P41.17/\$

Moreover, significant inflows of foreign capital plus financial liberalization were already leading to an overborrowing syndrome and causing an incipient bubble in property and asset markets (figure 1A). In a sense, it was lucky for the Philippines for the crisis to have struck while it was early, that is, while the bubble has not yet reached the same proportion as those in Thailand and elsewhere. For, two years hence, the bursting of a bigger bubble would have caused much more severe damage.

Structurally, however, there are certain differences between the Philippines and its Asian neighbors that bade well this time for the economy. First, its early bout with cronyism during the Marcos regime taught it enough about the dangerous links between vested interests sanctioned by the government and financial and economic mismanagement. This lesson is just now being learned by Thailand, Indonesia, and Korea. In a government clean up, the Aquino administration in the latter half of 1980s did away with many crony-controlled government monopolies which, besides being notorious for inefficiency and corruption, were a significant drain to government coffers. Thus, unlike the most afflicted economies in Asia, at the crisis onset the government had no big bailout commitments that compromise its credibility.



Second, the financial system crisis in 1983-85 led to a reinvigorated and relatively more stable banking sector and more prudent central bank supervision. The entire banking system actual exposure to real estate, for instance, is significantly less than the Central Bank mandated maximum of 20% of total loans. Banks are also required to set aside foreign currency assets in liquid instruments equivalent to 30% of their foreign exchange liabilities. Likewise, capital adequacy ratios requirement by the authorities is actually even higher than the ratio established by the BIS. Further, total bank loans to total assets have been considerably less than the ratios of other Asian countries which typically exceed 100%, reflecting the absence of overleveraging that characterized the afflicted economies in the Asian crisis. Finally, non-performing loans, though increasing, are still at manageable ratios to total loans (table 3). These selected indicators suggest that overall financial system management has been relatively sound.



**Table 3. Philippine Banking System: Selected Ratios**

	<b>NPL/Loans</b>	<b>Loans/Assets</b>	<b>Loss Provisions to Total Loans</b>
	<b>(in percent)</b>		
1990	7.86	49.84	4.42
1991	7.31	49.98	3.83
1992	7.21	51.00	3.27
1993	6.00	55.64	2.55
1994	5.41	57.58	2.03
1995	4.93	61.45	1.72
1996	3.51	65.28	1.39
1997	4.54	57.26	1.64
1998	9.34 /a	56.75 /b	2.75 /a

/a Monthly average (Mar-Jun)

/b Average up to September 1998

Source: Annual Data (BSP Selected Indicators)

Monthly Data (BSP Statistical Bulletin - prelim. data)

Third, while in the past it might have been disadvantageous to link exports very closely to the US economy because output can fluctuate wildly according to US economic growth, this time it proved to be a boon rather than a bane, since the US and Western Europe are now the only ones fueling world demand. Philippine exports to the US and Europe comprise more than 50% of total exports, with the US alone taking more than 30%, which explains the relatively remarkable Philippine export growth in 1998. Unlike the Asian tigers, the Philippines have a comparatively low export links with the other ASEAN countries, which given the present situation, is a blessing in disguise which allows its export performance be untrammelled by the Asian turmoil.

Finally, but not least, after almost two decades under dictatorship, the Philippine political succession is now much better established under the system of democratic election. The contribution of political stability that comes with clear electoral mandate cannot be underestimated since through it, a credible economic policy can be designed and made to work.

### **Vulnerable Economic Sectors**

The succeeding sections of the paper attempt to present a preliminary survey of the social impact of the Asian crisis on the Philippines. While the crisis is not as severe in the Philippines as in Thailand, Korea, and Indonesia, nevertheless the demand contraction, increased inflation, and reduced employment opportunities are expected to impact on certain vulnerable groups, particularly the low income families. Since strong economic growth is a prerequisite for raising incomes and living standards, the slow growth prospects is most unwelcome, especially considering that barely has the Philippines begun to enjoy robust economic recovery. The economic sluggishness

will most likely lead to worsening income distribution and slow poverty alleviation in the country.

In the next section, the income inequality profile in the Philippines is briefly explored to derive implications on the relative vulnerability of different income groups to economic shocks. The data can help shed some answers on questions like: What will be the effect of price increases on expenditures of the poor? Which group would suffer the most from high interest rates and unemployment spells? The third section describes currently known impact of the crisis on employment, prices, some social indicators, as well as historical impact of policy responses on income distribution. The last section discusses some lessons from the Asian crisis, particularly on the desirability of social safety nets to cushion the adverse impact of economic downturns on lower income groups.

### ***Profile of Poverty in the Philippines***

This section describes the income distribution in the Philippines, regional patterns and characteristics of the Philippine poor in order to determine points of vulnerability to economic shocks of low-income groups.

Cross-country comparison of poverty incidence is not straightforward<sup>3</sup>. But income inequality is relatively easier to see, and in the case of the Philippines, the enormous gap between the rich and poor is way too obvious for argument. In 1997, for instance, the poorest 20% of the population earned only 4.4 % share of total income, while the richest 20% captured 56 %, 13 times the share of the bottom quintile (see table 4). Over a decade, such relative income distribution with the wealthiest taking more than 50% of national income, roughly 10-12 times the share of the poor, has not changed much.

The share of the lowest two deciles to total expenditures is slightly higher at 6% in 1997, but the dominance of the top two deciles remains, consuming almost 9 times the expenditures share of the bottom group. Compared to Indonesia, where the richest 20% accounted for 41% of income in 1993, about 4.7 times the share of the poorest 20%, the Philippine income distribution profile is clearly heavily tilted in favor of the rich.

Yet, the low-income groups constitute the largest block of Philippine population. More than a third of Filipino families live below the poverty threshold as of the 1997 latest survey.<sup>4</sup> Poverty incidence has slightly improved from 44.2% of families living below poverty line in 1985 to 32.1% in 1997, the largest rate of improvement being in the 1990s when the country experienced relatively stable

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<sup>3</sup> Countries usually differ in the way subsistence threshold is calculated. Even if the caloric consumption threshold is identical, the composition of the basket of goods to translate calories into incomes may vary. The Philippines, for instance, has a comparatively large share of nongrain items in the basket than other countries resulting in higher subsistence income. If its share were reduced to the same level as, say in China, subsistence poverty would be reduced by two-thirds (Gerson, 1998).

<sup>4</sup> Using an internationally comparable poverty line of one US dollar per capita per day (at 1985 purchasing power parity), poverty incidence for the Philippines is only 20%, lower than the rate derived from using consumption threshold.

political environment, and undertook economic deregulations and institutional reforms. Based on poverty threshold including only foodstuffs instead of total basic expenditures, poverty incidence is significantly smaller at 17% in 1997, down from 24% in 1985.

**Table 4. Indicators of Income Inequality in the Philippines.**

	1985	1988	1991	1994	1997
<b>Share to Total Income</b>					
<i>Lowest 20%</i>	5.20	5.20	4.70	4.90	4.40
<i>Top 20%</i>	52.10	51.80	53.90	51.90	55.80
<i>Ratio, Top/Bottom</i>	10.00	10.00	11.50	10.60	12.70
<b>Share to Total Expenditure</b>					
<i>Lowest 20%</i>	-	6.71	6.18	6.08	5.71
<i>Top 20%</i>	-	46.06	48.63	47.54	50.18
<i>Ratio, Top/Bottom</i>	-	6.90	7.90	7.80	8.80
Per Capita Poverty Threshold (pesos)	3,744.00	4,777.00	7,302.00	8,885.00	11,388.00
Number of Families Below Threshold ('000)	4,355.00	4,230.00	4,781.00	4,531.00	4,553.00
Poverty Incidence 1/	44.20	40.20	39.90	35.50	32.10
Poverty Incidence 2/	24.40	20.30	20.40	18.10	16.50
<b>Gini Ratio</b>	0.4466	0.4446	0.468	0.4507	0.496
<b>Mean per capita Expenditure</b>	-	-	51,991.00	67,661.00	-

Notes: 1/ Based on total basic expenditure

2/ Based on subsistence food consumption

**Source:** NSCB, Philippine Statistical Yearbook

NSCB, Family Income and Expenditure Survey (FIES), various issues

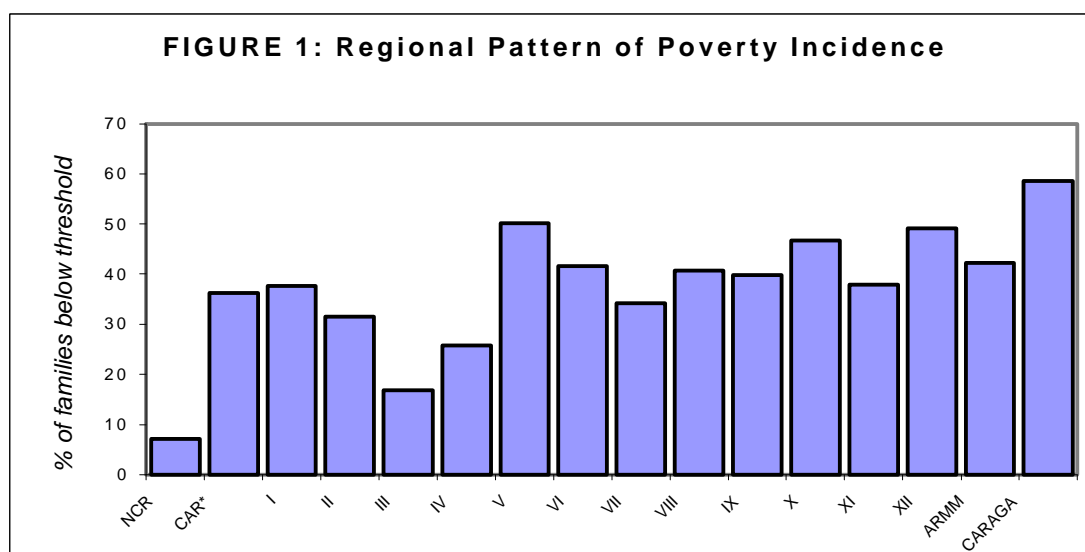
The latter improvement in poverty incidence suggests that growth in the 1990s was consistent with poverty alleviation and equity objectives.<sup>5</sup> It also suggests that one important route to lessen income distribution is economic growth. Conversely, economic stagnation foreseen over the next few years as a result of the crisis is certain to worsen poverty incidence.

The Gini ratio, however, shows very little improvement in income distribution. It even apparently points to a deterioration, with the ratio increasing from 0.45 in 1985 to 0.5 in 1997. Comparison with other ASEAN countries' Gini ratios show that their numbers have not shown much change either in a span of a decade, which suggests that other countries have not also successfully altered relative shares of national income even though their average incomes may have grown more rapidly than the Philippines'.

<sup>5</sup> Balisacan (1997).

## ***Regional Patterns of Income Inequality***

Among the different regions, a significant and persistent difference in poverty levels is evident. The incidence of poverty is lowest in the National Capital Region with only 7% of the population below the poverty line. In contrast, region 5 (Bicol region) exhibits the largest incidence of poverty at 50% (see figure 1). From 1985 to 1997, some regions significantly lowered the income disparity, while others merely maintained its poverty incidence.<sup>6</sup> While this reflects certain structural characteristics of the different regions – region 5, for instance, is noted for its frequent typhoon visits; and region 12 have had years of religious conflict - the persistence of the gap between the richest and poorest regions suggests that the benefits of economic recovery seemed to have been concentrated in specific regions.



## ***Income Source and Expenditure Profile***

For the entire Philippines, lower income groups depend on agriculture-based entrepreneurial activities for income, while higher income groups depend mainly on non-agriculture-based wages and salaries (see table 5). This implies that a severe unemployment spell will not only affect the poor income groups but also the middle to high income families. However, because of higher educational attainment, these groups tend to be more resilient and possess sufficient capital to start off business ventures in case of employment downturns. The fact that more affluent families have more capital to start and maintain business than do poor people is suggested by the fact that a great part of rich families' income also come from entrepreneurial non-agricultural activities.

<sup>6</sup> Region 3 (Central Luzon region) dropped its number of poor people from 28% in 1985 to 17% in 1997. Region 5, in contrast, while also lowering poverty incidence to 50% in 1997 from 60% in 1985, still maintains a huge number of families below poverty line. The National Capital Region rapidly decreased its poverty levels from 23% in 1985 to 7.1% in 1997.

It is also significant to note that a greater number of families in the middle to upper income echelon depend on remittances from abroad than lower-income families. This may be because the rich have assets kept abroad, or that those in the middle-to-high income groups have had better education and therefore possess the human capital necessary for overseas employment.<sup>7</sup> This has implication on education and skills development training needs for the economically disadvantaged. This also implies that the impending contraction of foreign demand for Filipino workers will actually bear more on the middle income families, instead of the poorest group.

**Table 5. Percent Distribution of Families by Main Source of Income in the Philippines, 1994 (in percent)**

Main Source of Income	Total No. of family	Under 20,000	20,000-29,999	30,000-39,999	40,000-49,999	50,000-59,999	60,000-79,999	80,000-99,999	100,000-249,999	250,000 and over
<b>Number of Families</b>	6,407,653	852,873	1,220,028	1,125,236	842,674	607,701	743,527	356,256	601,357	58,002
<b>Percent</b>	100	100	100	100	100	100	100	100	100	100
<b>Wages and Salaries</b>	45.45	20.23	31.87	37.12	41.69	47.76	55.62	60.83	57.83	46.49
<i>Agricultural</i>	8.35	12.75	15.97	14.69	10.78	8.68	5.31	3.63	1.59	0.66
<i>Non-Agricultural</i>	37.10	7.48	15.91	22.42	30.91	39.08	50.31	57.20	56.24	45.83
<b>Entrepreneurial Activities</b>	36.71	48.45	51.64	50.71	44.51	38.02	30.15	24.26	20.30	24.76
<i>Agricultural</i>	24.48	42.76	43.57	40.70	32.51	24.65	16.52	9.35	5.49	3.21
<i>Non-Agricultural</i>	12.24	5.69	8.07	10.01	12.00	13.37	13.62	14.90	14.81	21.55
<b>Other Sources of Income</b>	17.84	31.33	16.49	12.17	13.80	14.22	14.23	14.92	21.86	28.75
<i>Rental from Non-Agricultural</i>	0.45	0.00	0.13	0.09	0.20	0.46	0.34	0.60	1.01	1.60
<i>Interest from Deposits &amp; Loans</i>	0.05	0.14	-	0.02	0.06	0.04	0.04	-	0.06	0.10
<i>Receipts from abroad</i>	6.75	1.44	1.87	2.28	3.80	6.41	6.77	9.20	13.69	16.93
<i>Receipts from domestic source</i>	3.43	11.63	6.28	3.66	3.19	1.88	2.33	0.76	1.11	1.08

Source: FIES 1994.

In the urban areas, most families depend on non-agricultural wages and salaries for their main income which suggests that during unemployment spells, the urban areas would suffer a greater hit than rural areas thereby leading, in theory, to more urban to rural migration. Receipts from abroad, likewise, constitute a bigger share in total urban income than in rural income, again suggesting that since presumably the urban areas have better schools and possibilities for greater exposures, most overseas workers must have had relatively higher human capital to land to jobs abroad. Besides, there are informational advantages in being located in urban areas: placement agencies, embassies, government agencies that announce job possibilities abroad, are all located in the urban areas.

<sup>7</sup>This is attested by the fact that even those who end up as domestic helpers in foreign countries have reportedly been school teachers in the Philippines.

As in most developing economies, the large majority of the poor are located in rural areas, and are mostly dependent on low-productivity agriculture-based income activities.<sup>8,9</sup> Table 6 illustrates that income from entrepreneurial activities constitute more than a third of rural income but has relatively less share in urban income. But of these, earnings from agricultural activities take the greatest percentage share.

**Table 6. Percent of Income Received from Different Sources**

Income Source	Philippines		Urban		Rural	
	1994	1997p	1994	1997p	1994	1997p
<b>Wage and Salaries</b>	44	45.2	47.3	48.2	36.9	38.5
Agricultural	4	3	2	1.1	8.1	7.4
Non-Agricultural	40	42.1	45.3	47.1	28.8	31.1
<b>Entrepreneurial Activities</b>	27.7	26.7	23	22.8	37.6	35.3
Farming and Poultry Raising	8.6	6.9	2.9	1.7	20.6	18.5
Livestock and Poultry Raising	1.1	0.9	0.6	0.4	2.1	2
Wholesale and Retail Trade	9.1	8.8	10.8	9.9	5.8	6.3
Manufacturing	2	2	2.2	2.2	1.6	1.6
Other Entrepreneurial Activities	6.9	8.1	6.5	8.6	7.5	6.9
<b>Other Sources of Income</b>	28.3	28.1	29.7	29	25.5	26.2
Net Share of Crops	1.1	0.9	0.8	0.6	1.8	1.6
Receipts from Abroad	8	6.7	9	7.1	5.8	5.9
Rental Value of Occupied DU	9.4	10.4	10.8	11.8	6.3	7.2
Family Sustenance Activities	1.8	1.3	0.7	0.4	4	3.3
Other Sources	8	8.8	8.4	9.1	7.6	8.2

Note: p = preliminary

Source: (Preliminary Results) FIES 1997.

In Metro Manila, of the total number of families dependent on non-agricultural wages and salaries, almost 80% belong to higher income groups. While this share is slightly lower for other parts of the country, the majority of wage earners likewise belong to the upper income brackets, presumably suggesting that the higher income groups possess the necessary qualifications (i.e., education, skills) for inclusion in the non-agricultural labor force. Again, this points to a need for large investments to improve human capital particularly of the lower income bracket. However, it is likely that the non-agricultural sector in the rural areas is qualitatively different from that in the urban areas which presumably gives out better pay.

<sup>8</sup> For example, in region 5, more than 50% of families in the lowest income groups depend mainly on entrepreneurial activities, almost all of which are agriculture based. Only about 13% depend on wages and salaries, reflecting the relative lack of outside employment opportunities in the area. Majority in the highest income group, on the other hand, source their income from wages and salaries, most of which are non-agriculture related. A similar picture can be seen for region 3.

<sup>9</sup> Balisacan (1997) shows that agriculture has the highest poverty incidence – its share in national poverty is staggering at 80%, due to the high level of poverty in the sector and to its high share in total population. He therefore suggests that anti poverty programs be focused on the rural areas.

In terms of expenditures, almost two-thirds of income of poor families is spent on food. Other types of expenditures, like house rentals and bills for utilities pale in significance relative to food in the family budget. Significantly, among the richest group, while food still takes a lion share of family income, it is reduced to only about a third of the budget, while expenditures for house rentals almost compete with food share. Unlike low-and middle-income groups, budgets for education is higher, about 5% of total income, suggesting that the rich invest a great deal on quality education for their children.

**Table 7. Distribution of total family expenditures by expenditure group and income class, Philippines, 1994.**

	Total no of families	Under 20,000	20,000- 29,999	30,000- 39,999	40,000- 49,999	50,000- 59,999	60,000- 79,999	80,000- 99,999	100,000- 249,999	250,000 and over
Total Family Expenditures (in billion pesos)	863,008.3	17	41	54	57	55	102	82	301	155
%	100	100	100	100	100	100	100	100	100	100
Food	47.8	66.9	65.3	62.9	59.5	57.6	53.9	50.8	43.7	30.2
Alcoholic Beverages	0.9	1.3	1.2	1.4	1.3	1.2	1.1	1	0.8	0.5
Fuel, Light and Water	5.5	6.6	6	5.6	5.5	5.6	5.6	5.7	5.6	5
Transportation & Communication	4.7	2.3	2.5	2.7	3.1	3.2	3.6	3.9	4.7	8.3
Personal Care and Effects	3.2	2.4	2.9	3.2	3.4	3.4	3.6	3.6	3.4	2.7
Clothing, Footwear, and Other Wear	3.5	2.7	3.2	3.5	3.7	3.7	3.8	3.7	3.6	3.2
Education	3.7	0.7	1.1	1.5	2.1	2.4	2.9	3.6	4.7	5.3
Medical Care	2.3	1.4	1.5	1.7	1.98	1.8	2	1.9	2.6	2.8
Non-Durable Furnishings	0.4	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4
Durable Furniture and Equipment	2.7	0.4	0.4	0.7	1.2	1.6	2.4	2.8	3.2	4.6
Rent/Rental Value of Occupied Dwelling Unit	13.1	6.9	6.8	7.2	8.2	9	10.4	11.7	14.4	20.8

Source: FIES 1994

### **Social Impact of the Crisis**

There are several reasons why poverty incidence tends to rise with economic crises. One, since lower income group is mostly composed of unskilled workers, they are more easily dispensed with because of an almost infinite elasticity of labor supply. Second, unlike the rich, the poor usually have no properties whose asset returns (like interest or rental income) can go up with inflation. Another reason is, since their consumption basket is already at a threshold level, they can afford very little room for adjustment when inflation rises as a result of economic disturbances. This section surveys these different channels through which the Asian crisis affects the poor.

### *Effects on Employment*

The employment effect of the crisis actually cuts across different income groups. In fact, considering the middle- to high-income group's high participation in the formal labor force relative to low-income group (shown in table 5), a serious economic downturn and massive business closures will more likely have greater effect of income loss on them. But since, it can be surmised that the poor- particularly the urban poor involved in the formal sector - have little alternative source of income unlike other sectors of the population, job losses would have more severe effect, both economically and psychologically.<sup>10</sup>

Though official statistics do not yet show a convincing trend of increasing unemployment, news stories cite anecdotal evidence of business closures and insolvency as a result of the crisis. Some companies decreased the number of new hires, others completely froze hiring for some positions. Some other companies cut training budgets, postponed or reduced salary increases, and increased the workload of retained workers. The lack of job experience for new graduates, and the lack of training at the workplace implies a diminishing of workers' human capital which, in the Philippines, often compensates for the inadequate quality of education at the secondary and tertiary levels.<sup>11</sup>

Another effect of the crisis which official statistics does not reflect is that overall slump in economic activity also drags down income in the informal sector, either because of low market demand or because of more intense competition from displaced workers in the formal sector.

Although foreign remittances from overseas contract workers posted a 33% increase in 1997 (from \$4.31 to \$5.74 billion) and up to most recent months, demand for Filipino workers abroad is clearly slowing down. Unsurprisingly, much of the decline in foreign demand is coming from the other afflicted Asian countries (see table 8). Since almost 7% of families in the Philippines, most of which are middle-income and from urban areas, depend on foreign income (table 5), the slowdown in foreign workers deployment will definitely reduce total family income and possibly lead to reclassification from middle to lower income groups.

### *Effects on Prices*

Low-income groups tend to be fixed wage earners. Thus, a general increase in prices, particularly of staple food items, will reduce the purchasing power of the poor. Moreover, since they tend to already consume at the minimum threshold, reduced income exert greater pressure on lower income groups.

Fortunately, even with the large peso devaluation, no run-away inflation has yet been evident as a result of the crisis. In theory, peso devaluation increases prices

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<sup>10</sup> Currently available employment figures, however, do not yet compellingly show labor demand contraction as a result of the Asian crisis. Though unemployment rates increased to 13.3 % in April 1998, the July unemployment figure of 8.9 is back close to historical average. Besides, it is not clear how much of the economic downturn can be attributed to the crisis, and how much to El Nino.

<sup>11</sup> Lim (1998).



of imported items and of tradable goods, thus pushing general price level upwards. Year-to-date average inflation, however, remains at a manageable 9.5 %, largely due to lower world commodity prices, particularly of oil, as well as price controls on specific commodities.

**Table 8. Deployed Contract Workers (growth rates)**

	1994-97	1998
<b>Total</b>	1.7	-47.2
Land-based	0.3	-46.8
Sea-based	6.9	-48.4
 <i>By Destination</i>		
Indonesia	30.3	-50.2
Malaysia	5.3	-79.9
Thailand	43.4	-48.8
Korea	-7.5	-71.2

Data is Jan.-June average

Food inflation, however, has increased by 9.9% in October, due to higher prices of fruits and vegetables presumably due more to El Nino than to the financial crisis. This implies that to date, there is already a budget crunch on low-income households thus leading to consumption substitution to cheaper but less nutritious food items. Even considering that, particularly in the rural areas, most of family income come from agriculture and that therefore they also stand to benefit from increase in prices of food items, the net effect is likely going to be negative because the low-income group are net consumers of staple items.

The price deflation from the crisis reduced property prices, particularly in most urban areas. But since low-income groups do not possess such assets, much of the effect of the bust in asset prices falls on the highest income families.

A preliminary conclusion that can be derived from the Asian crisis, therefore, is that most of the adverse (first-round) economic consequences would be borne by the middle- to high-income groups. In marginal terms, the poor has relatively little to lose as a result of the crisis (not to include, of course, the psychological, health, and other impact of the crisis which is discussed next). In a sense, this may, paradoxically, improve income distribution - not because everybody is better off but because some of the rich- and middle-income families have become poorer.

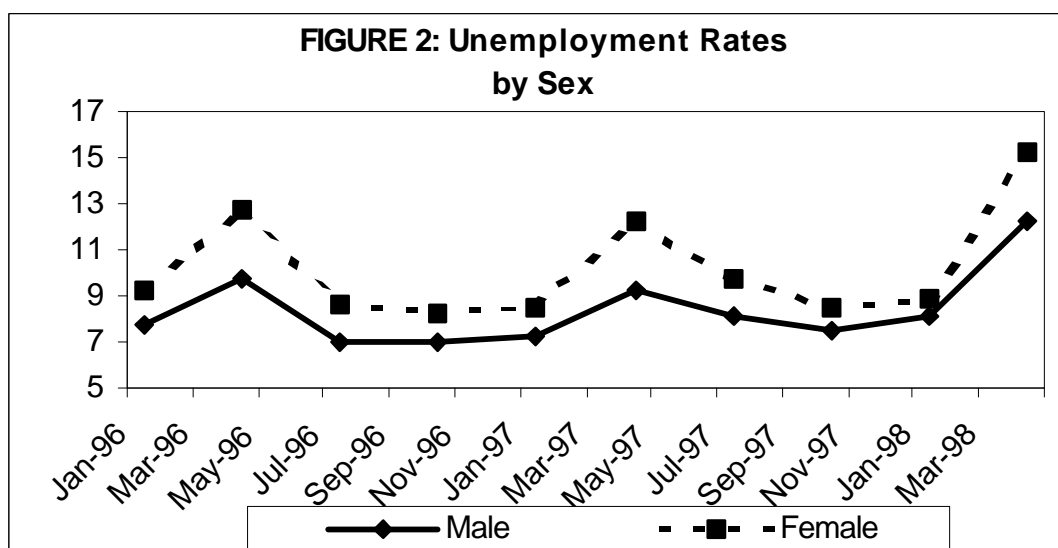
### ***Effect on Social Indicators***

Lower growth prospects from the Asian crisis will have an effect on various social concerns. While no hard data of social indicators can be shown, it is not difficult to establish a theoretically acceptable correlation of low economic growth due to the crisis and various social issues. For instance, lower per-capita GNP has been found to be highly correlated with education, in particular with enrolment rates

at all levels. Unlike in other countries, no serious cases of child labor in the Philippines as a result of the crisis have been reported. But the possibility of increased dropout rates especially in secondary levels for families to augment income using their children's labor is quite real if the economic situation gets worse.

Such effects like decline in education imply that transitory economic contractions can translate to longer term social problems, and eventually to persistently low economic performance. In particular, the diminished human capital from school dropouts will affect future earnings and productivity of the future labor force.

The decline in employment opportunities also affects women participation in the labor sector, which the improved economic condition in the 1990s already helped improve. During times of crisis, 'theory' goes that women are the first to go out of work, presumably because men are given more consideration as main family breadwinners.<sup>12</sup> Besides, firms can cut costs more by reducing maternity leaves and other benefits of women workers. This probably explains why unemployment rates are consistently higher for women than for men (figure 2). It probably also explains why in the first quarter of 1998, the rate of increase in women unemployment was sharper than that for men.



Other social effects of the crisis pertain to health, environment, and extended family systems. With regards to health, higher unemployment and inflation are correlated with increased malnutrition at crucial stages of childhood, affecting physical and mental development of children, which again, has long term implications. They are also correlated with infant and, indeed, overall mortality rate.

One explanation is that government health budgets tend to be limited under crisis. In particular, the financial resolution cost in many afflicted Asian countries will definitely divert much of government expenditures from socio-economic programs. In the Philippines, the decreased budget for health is due more to the

<sup>12</sup> On the other hand, Filipino women also tend to be very enterprising in undertaking activities outside of the formal labor sector thus lessening their opportunity cost of leaving work.

shrinking of government revenue resulting from poor economic performance. On top of this, the cost of drugs, mostly imported, has increased as a result of the large devaluation, leading to decrease in its supply.

Since the social security system in the Philippines is limited, retrenchments add pressure on extended family systems to provide some security. Close family ties help prevent social discord that can arise from financial difficulties, but mothers face more pressure to supplement family income by joining the labor force or the informal sector. The increased pressure for family members to look for additional source of income also somehow affects the care for the elderly in the homes.

### ***Impact of Crisis Responses***

In most affected economies, currencies depreciated by exorbitant magnitudes, prompting monetary authorities to allow interest rates to soar. As a result of economic downturn and shortfalls in government revenues, fiscal expenditures were also cut across the board.<sup>13</sup> How do these policy responses to the crisis affect income distribution?

Several empirical studies have tried to assess the effects of macroeconomic adjustment in the 1980s on income distribution. Though clearly the magnitudes of the changes in exchange rates and interest rates are not the same in the 1980s and in the present crisis, the effects found in those studies can give indication on the likely effects of the present crisis on current income distribution. Unfortunately, these studies conflict in their implications.

Blejer and Guerrero (1990), for instance, found that high labor productivity, depreciated exchange rates, and high real interest rates tend to improve income equality, presumably because it makes agriculture – on which many poor people depend for income – become more competitive in the world market. The positive impact of high interest rates is presumably due to the fact that poor people, farmers in particular, have less access to formal credit and therefore are less affected by high interest rates.<sup>14</sup>

Balisacan (1995), however, argues that exchange rate depreciation (and its corresponding effect on prices) and tight monetary policies do not, on balance, help poverty in the agricultural sector because families dependent on agriculture income are net buyers of staples. Instead, the overall net impact of price increase in the sector is an increase in the average poverty gap.

The adverse effect of high interest rates is via credit squeeze particularly on small and medium-sized enterprises. In the final analysis, however, the distributional effect of interest rates changes depends on how segmented the credit market is. If it is highly integrated, monetary policy tightening translates to higher interest rates across

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<sup>13</sup> In the Philippines, the fiscal authorities directed a 25% mandatory reserve on all non-personnel related expenditures on all government departments, except Education Department.

<sup>14</sup> Philippine farmers tend to prefer informal credit sources even though they charge higher rates to circumvent the requirements on collateral.

the board. Government programs that help different groups gain access to credit can therefore alleviate the effect of tight money on income distribution.

## **Policy Lessons**

The Asian crisis is essentially a banking crisis. For economies in Asia to start growing again, the banking system has to be nourished back to health, which may imply bailing out some banks. But since it may appear that the financial problems of the rich are being mitigated at the expense of the poor in the sense that everybody pays for the bailout through taxation and government funds are diverted from other socio-economic programs, such bailout has an equity consideration. Expenditures on safety nets can help diminish this perception and thereby help gain democratic support for necessary structural reforms in the financial sector. Besides, barring wasteful expenditures or corruption, social spending can be an effective way to engineer a fiscal expansion.<sup>15</sup>

These safety nets must aim at ensuring food security<sup>16</sup> and maintaining purchasing power of vulnerable households through the promotion of well-targeted public works, expansion of unemployment insurance system that ease their transition into future jobs, targeted subsidies, and retraining for retrenched public sector employees.

Admittedly, safety nets do not come without a problem. Its administration tends to be plagued with inefficient bureaucracies and relatively high levels of corruption leading to beneficiaries other than the targeted group. In particular, the experience of many countries shows that the urban middle class tend to capture the benefits. This is not too bad if this were to happen in the Philippines, however, because as discussed above, the primary casualties from the Asian crisis appear to be the middle income families, more than the lowest income groups.

Long-run solutions, however, must go beyond safety nets but should address the problem of low levels of human capital. High levels of human capital is important for low-income families to get better jobs, which are the best means for inclusion in society and for someone to feel productive. Also, human capital development is the best means to bridge the widening wage gap between skilled and unskilled workers that is even more highlighted by increased globalization. This problem needs to be addressed, crisis or no crisis.

To a certain extent, the equity effects of investment in human capital is fool-proof. While the impact of other structural reforms – take for instance, the agrarian reform program in the Philippines – on equity is open to question, the effect of increased expenditure on education, health, as well as infrastructure in rural areas in reducing poverty and improving income distribution is well documented.<sup>17</sup>

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<sup>15</sup> Stiglitz (1998).

<sup>16</sup> This may be better addressed by keeping prices of essential staple foods low, like rice, while ensuring that distribution network remains effective.

<sup>17</sup> Balisacan (1995) shows that college graduates tend to earn much higher wages than those with lower levels of education.

Investment in human capital and regional development can boost economic growth, and strong growth is a necessary condition for raising incomes and living standards, and ultimately for solving income inequality.

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