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Will the Philippine Development Plan 2023-2028 targets be met?

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Will the Philippine Development Plan 2023-2028 targets be met?

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EARLY THIS YEAR, President Ferdinand Marcos, Jr. signed the Philippine Development Plan 2023-2028 (PDP). The document contains hundreds of targets. Some of the key targets to be attained by 2028 are as follows (in fact, the Plan provides yearly targets):

1.) an annual growth rate of 6.5-8% (since 2024); 2.) a gross national income per capita of $6,044-$6,571 (50% higher than that in 2023); 3.) inflation between 2%-4% (from 2.5%-4.5% in 2023); 4.) a government fiscal deficit of 3% (from 6.1% in 2023); 5.) a debt-to-GDP ratio of 48%-53% (from 60%-62% in 2023); 6.) an unemployment rate of 4%-5% (from 5.3%-6.4% in 2023); and, 7.) poverty incidence of 8.8%-9% (from 16.4% in 2023).

Will these targets be met?

To assess this question, I have used the De La Salle University model of the Philippine economy (called Animo). The model is a set of about 1,000 statistical relationships that describe how the Philippine economy (consumption, investment, employment, interest rates, etc.) works. For example, in the model, consumption depends on households' disposable income, remittances, prices, and the short-term interest rate. Likewise, underemployment (percentage of workers who want to work additional hours) depends on the wage rate and prices. A third example is the average wage rate, which depends on prices, productivity, and the share of employment in agriculture in total employment. Using statistical methods, we estimate the numerical impact of disposable income, remittances, prices, and interest rates on consumption (and similarly for the other relationships in the model).

By making some assumptions (about variables such as the US or China's growth rates), the model produces forecasts and allows us to generate scenarios. Results indicate that most of the PDP targets mentioned above will not, strictly speaking (that is, by the National Economic and Development Authority's own numerical targets), be met. Only inflation and unemployment will be within the projected ranges. Inflation will return to the 2%-4% Bangko Sentral ng Pilipinas target and unemployment is on track to decline to the 4%-5% range.

The Animo model tells us that the Philippine economy will not be able to attain an annual growth rate of 6.5%-8%. Growth will oscillate between 5.5% and 5.7% until 2027, then decline to 4.9% in 2028. As a consequence, gross national income per capita in 2028 will fall short of the 50% target increase with respect to the 2023 value. We think income per capita will be just about 33% higher than that in 2023. We will need another three years (to 2031) to achieve the PDP target. This is the result of the employment structure: most workers are in sectors of low productivity (agriculture) and are moving into other sectors of not much higher productivity (wholesale and retail trade). Sectors of high productivity (real estate, electricity, finance) employ a very small portion of the Filipino labor force.

The poverty incidence rate in 2028 will be 12.5%. Even in 2030, it will be about 10.8%. Poverty is definitely coming down, but it will take maybe until 2032 to bring it down to 9%. Poverty was coming down until 2019 but COVID-19 reversed the trend in 2020 and 2021. Poverty is a phenomenon associated with the countryside, the rural, agricultural areas. The reduction in poverty depends on how fast the share of employment in agriculture falls, as well as on remittances and prices. The share of agricultural employment is declining as fast as it can, close to a percentage point per annum. This is fast by historical standards, but it will still be a high 17% in 2028 and 15% in 2030.

Despite these outcomes, our assessment is not negative. The Philippine economy is moving in the right direction but at a slower pace than that projected in the PDP. The problem does not lie in the underperformance of the economy but in having set overly ambitious targets and a poor understanding of the constraints of the Philippine economy. These two aspects are related. While a government has to send positive messages to its constituency, unrealistic targets end up doing more harm than good.

To wit: if policymakers had understood the most important constraints of the Philippine economy, they would not have set a growth target of 6.5%-8%. The key constraint on growth is the need to avoid current account deficits. This implies that we need to export to earn foreign currency to pay for imports. The Philippines has a significant deficit in the trade account that is compensated by the service account (BPO exports) and also by remittances. The latter requires maintaining the flow of OFWs. This is not a great development model. We run a significant trade deficit because our exports concentrate on electronics (assembly) and agriculture. This trade structure reflects what the country manufactures (virtually nothing as the country did not industrialize), its lack of international competitiveness, and its low wages. With this trade structure and employment moving out of agriculture into activities of low productivity growth in services, the Philippine economy cannot grow sustainably by more the 6%-6.5%. To progress (have faster growth), the country's production and trade structures need to shift toward the production and export of more complex manufactures and services. This is our major constraint — not corruption, digitization, higher taxes/sound fiscal management, or improving the ranking in the World Competitiveness Report. It is the economic structure of the economy… duh! The economy (private sector) needs to create jobs in activities that pay higher wages. This is not so simple as this is a low-productivity (non-tradable) service economy.

Also, the growth rate of a small open economy like the Philippines' depends on that of the rest of the world. The latter is projected to grow this year and the next by about 3% (there are lots of headwinds). It is next to impossible for the Philippines to maintain (not just one year) a growth rate twice as high as that of its trading partners.

I have left for the end the most misunderstood targets: our estimates indicate that it will be difficult to bring the fiscal deficit below 6% of GDP during the next few years; and the debt-to-GDP ratio in 2028 will be about 55%. The latter will reach the PDP target only in 2029-2030. These two targets, however, are unnecessary and meaningless, even dangerous.

It is annoying that our economic managers think in terms of models of the gold standard era that naturally do not apply to the Philippine economy. They do not seem to understand that because today we use fiat money (government-issued money backed by the power of the state to enforce payments in it; and not backed by any commodity such as gold), the Philippine economy (the Department of Finance) does not face a financial constraint like those of a family or a company (the Government will never go broke); that government spending increases non-government's (private sector) income (government deficits are peso for peso private sector surpluses); that the fiscal balance is not a discretionary outcome of the government (it is the result of policy choices taken by the government and the spending and saving behavior of the private sector); that government debt provides a risk-free financial asset to strengthen the non-government portfolios; or that the 60% debt ceiling that some economic managers flag as dangerous, is a lie. Simulations with our model clearly show that a decrease in the budget deficit leads to a lower growth rate of the Philippine economy.

Summing up: the Philippine economy is moving forward but perhaps not as projected in the PDP. It is just a bit behind in the key targets. I would urge economic managers to focus on the structure of the economy. Unless this changes, it will be very difficult to sustain a high growth rate and see productivity, wages, and income per capita increase. Second, forcing the economy to reduce the fiscal deficit to 3% of GDP, will have a negative impact on the economy.

*This article was published also in Business World on November 17, 2023.
https://www.bworldonline.com/opinion/2023/11/17/558007/will-the-philippine-development-plan-2023-2028-targets-be-met/