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An Overview

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INTRODUCTION

Urbanization is a well-known stylized feature of economic development, reflecting a shift in the economy's dynamic comparative advantage from one initially based on agriculture to one based on industry and services. The urbanization pattern in the Philippines, however, does not appear to fit the stylized mold. The country recorded a relatively high level of urbanization, rising from 30% in 1960 to 38% in 1980 and 49% in 1990, but this has not been matched by an equally high level of per capita income as well as by a significant shift of labor employment from low to high-productivity areas. The country's gross domestic product (GDP) per capita in the early 1990s was not much different from that in the mid-1970s. The share of the industrial sector in total employment remained virtually unchanged at about 16% during the last three-and-a-half decades. The employment share of the manufacturing sector, the hub of dynamic growth in fast-growing neighboring countries, even contracted from 12% in the mid-1950s to 10% in the early 1990s.

The urban sector is a dominant source of growth in a dynamically growing economy. The presence of scale and agglomeration economies in urban centers constitutes powerful stimuli to regional and national development. Unfortunately, the policy environment has weakened these stimuli and engendered development imbalances between urban and rural areas, between cities of different sizes, and between regions of the country. In particular, urban development strategies and policies have evolved in isolation from rural development concerns. And, on the other hand, policy proposals for rural development have also been suggested in isolation from the requirements of urban growth and development. Conflicts among the various sectors have been the unintended outcome.

Nowhere is this conflict more apparent than in land use. Some sectors believe agrarian land reform and restrictive land conversion policies are standing in the way of urban growth and industrial development. Propo-

nents of agrarian reform, on the other hand, see the conversion of agricultural lands to urban and industrial uses as an impediment to rural development and a sign of the government's weak resolve to get agriculture and the rural sector in the forefront of national economic development.

This research aims to provide a deeper understanding of the interrelationships among spatial development, employment generation, land use, and urban-rural growth linkages. The results of the study are expected to provide a better-informed basis for the discussion of urbanization and spatial development policy for the Philippines.

The study has four interrelated modules. The first looks at spatial aspects of development and interregional imbalances, including migration patterns and its determinants. The second module analyzes economic issues affecting land use, land conversion, and land taxation, as well as efficiency and equity considerations in the design of land use policy. The third module focuses on employment generation, and the constraints on the structural transformation of employment. Lastly, the fourth module empirically reexamines the spatial and intertemporal aspects of inequality and poverty in the Philippines, especially within and between population subgroups. An overall summary precedes the presentation of individual modules.

SPATIAL DEVELOPMENT, URBANIZATION, AND MIGRATION PATTERNS

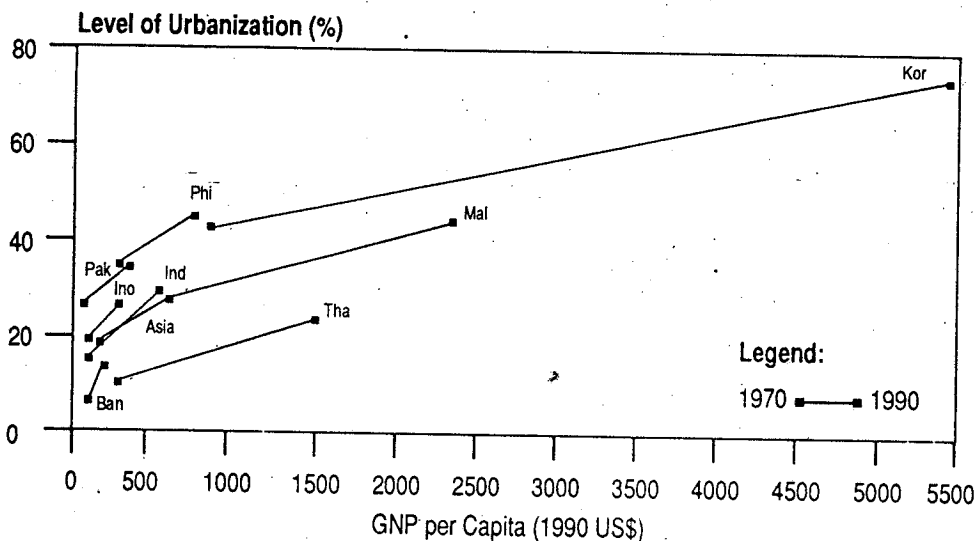
The issue of urbanization and spatial development is an old one which, like other issues, surfaces periodically as a function of the prevailing popular mood and political temperament. A revisit to this old issue is now timely owing to recent developments in the field (like the sharp acceleration in the pace of urbanization in the 1980s — a period of sluggish economic growth) which necessitate a continuing search for policy guidance on more balanced urbanization and regional development.

In developing Asia, the Philippines had the highest level of urbanization in the early postwar period, owing partly to the Spanish colonial policy of *reducción* and partly to the economic headstart it enjoyed. The pace of urbanization during the 1950s and 1960s was relatively slow, however, mainly because of the economy's sluggish structural change. Moreover, capital-intensive industrialization meant limited employment growth in cities. Fortunately, rural areas could still absorb a large part of the increase in labor force through the expansion of farm lands.

But with continuing rapid population growth and diminishing agricultural frontiers, rural-urban migration accelerated in the 1970s and picked up further in the 1980s. By 1990, the level of urbanization had risen to nearly 50%, the highest in Southeast Asia and next only to South Korea (Figure 1.1).

This rapid urbanization had not been supported by a robust economic growth and transformation. It appears to have been driven largely by

Figure 1.1
Level of Urbanization Against GNP
per Capita Across Countries



Ban - Bangladesh Pak - Pakistan Ind - India Ino - Indonesia
 Kor - Korea, Rep. Tha - Thailand Mal - Malaysia Phi - Philippines

population growth through rural-urban migration (and rural-to-urban reclassification of barangays) on the supply side, and the growth of the service sector particularly the informal service sector on the demand side. Urbanization continued to be concentrated in the National Capital Region (NCR) because of its huge informal service sector; the formal service sector had been largely capital-intensive.

However, there are signs of nascent deconcentration. Some regional and subregional centers such as Cebu, Davao, General Santos, Cagayan de Oro, Olongapo (Subic), and Baguio have been picking up and attracting considerable migration. Secondary and tertiary cities, which are found in most of the regions, tend to serve as intermediate points of destination, as can be gleaned from their outmigration character.

Interregional disparities in industrial (manufacturing) and service sector production and employment, as well as in physical and social infrastructure, have resulted in persistent migration from the lagging regions. Outmigration is heaviest in the Cagayan Valley, Bicol, East Visayas, and Western Mindanao regions. On the other hand, the NCR, Southern Tagalog, Central Luzon, and Northern and Southern Mindanao lead in terms of immigration.

Migration is not only a consequence of underdevelopment, as it is triggered by high unemployment and the inadequacy of basic infrastructure at the place of origin, but also seems to be a cause of it. This is implied by the migrant stock (i.e., earlier migrants at the destination area from the same region of origin) which is the most consistently robust variable. If the

migrant stock continues to draw migrants from the same places of origin, these areas are likely to be drained of critical human capital, given the positive selectivity of the migration process. An important effect of the migrant stock, thus, is that of preventing migration from being an equilibrating process.

Philippine urbanization in recent decades has been paradoxical: it has been simultaneously weak and rapid. Its weakness is attributable to the exceedingly slow transformation of the economy which, in turn, has been caused by decades of inward-looking, capital-intensive industrialization strategy. At the same time, given high fertility, stagnant regional economies (which also became seats of insurgency) have spurred rapid migration into the cities, particularly those with large service sectors that seemingly provided ample opportunities for informal activities. In short, it may be said that the link between urbanization and economic development had weakened in the 1970s, and more so in the 1980s, compared with the earlier decades.

Balanced regional development or, more precisely, reduction of interregional disparities in terms of economic growth and well-being, has been a policy goal in the Philippines since at least the mid-1960s. Despite policies and programs redressing interregional imbalances, however, the problem has persisted. And the social costs have become increasingly palpable. These include, *inter alia*, congestion and environmental degradation, deepening poverty in many regions, inequity in access to basic infrastructure and social services, and fragile social cohesion. To the extent that regional imbalances are also caused by market failures, redressing them could result in efficiency and equity gains.

Taken together, these conditions constitute a compelling rationale for a well-thought-out and more determined regional and urban policy as an integral part of, not separate from, overall development strategy.

Recent policy reforms may hasten economic transformation and sustain economic growth. But there is much catching-up to do as urbanization (or sheer demographic overhang) appears to have far overtaken economic growth. Sustained economic growth must be broad-based with respect to both socioeconomic classes and regions. In addition to policy reforms that emphasize the economy's comparative advantages and endowments, with the likely effect of reducing the NCR bias, there must be a deliberate effort to attend to the needs of the regions. Clear and consistent policies and procedures must be in place, but these cannot be paralleled by concrete efforts to improve access to basic infrastructure, education and health services. These can certainly be delivered by the existing government agencies; there is no need to create new ones. Reasonably adequate basic infrastructure (not piecemeal measures such as rent control and frequent legislated increases in minimum wages) are an important key to encouraging investments in and improving the performance of regional economies, as suggested by the recent showing of General Santos, Cagayan de Oro, and

the Subic Bay area. It is curious, though, that these particular developments were not really special intentions *ex ante* of official regional development planning.

URBANIZATION, LAND USE, AND LAND CONVERSION

Since production and population are expected to grow faster in urban areas than in rural areas, the market value of peri-urban agricultural land (which has high nonagricultural potential) would be higher than the capitalized value of its agricultural income. If owners of peri-urban agricultural land are secure about their property rights, they may not convert their land to nonagricultural use until such time that the nonagricultural income from the land is high enough to cover not only the foregone agricultural output but also the cost of capital needed to convert the use of the land. However, if the government wants to acquire the land for distribution to tenants, and offers a price closer to its agricultural value than to its market value, owners of peri-urban agricultural land may be inclined to offer their land to developers sooner. For their part, poor tenants who have high discount rates may find landowners' offers of disturbance compensation irresistible. It is therefore quite possible that agricultural land would be converted prematurely (from the point of view of society) with no one (not the tenants and certainly not the owner) objecting to the conversion.

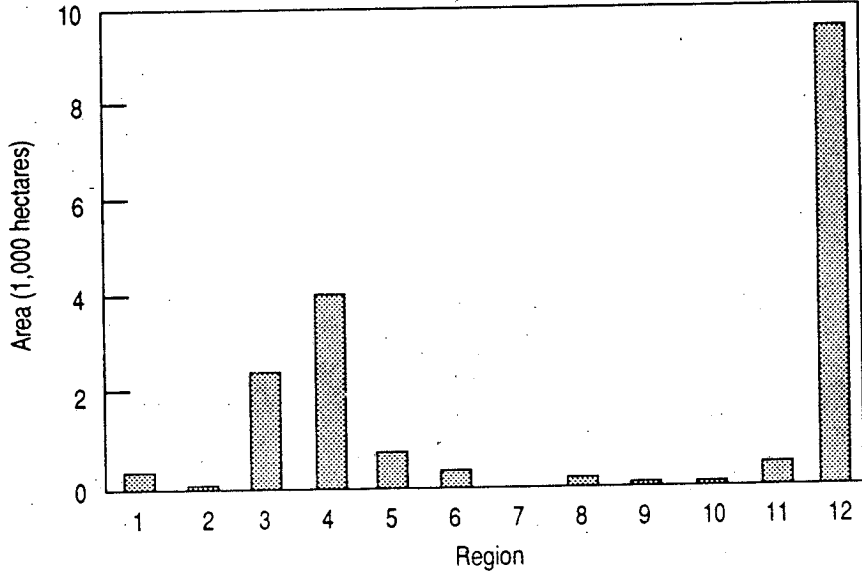
Available data support the hypothesis that the rising incidence of premature land conversions is the joint effect of land reform and urbanization. For the ten-year period ending in 1981, applications for conversion totalled less than 10,000 hectares (Figure 1.2). Within six years after the effectivity of the Comprehensive Agrarian Reform Law (CARL), the Department of Agrarian Reform (DAR) had received applications for the conversion of more than 40,000 hectares, with more than three-fourths of the applications coming from Regions III and IV. And these conversions, which went through the government-prescribed process, probably represent only a fraction of all conversions. Details of the applications for conversion also support the above hypothesis. Some lands are applied for conversion even though many lots in adjacent developed subdivisions are unsold. There are even cases where owners apply for conversion only after they have received notices of acquisition.

Until the issuance of Administrative Order No. 20 (AO No. 20), applications for land conversion were generally approved provided the owner could convince his tenants to waive their rights and the necessary environmental and zoning clearances could be obtained. At that time, these conditions were thought sufficient enough to ensure that conversions would not happen prematurely.

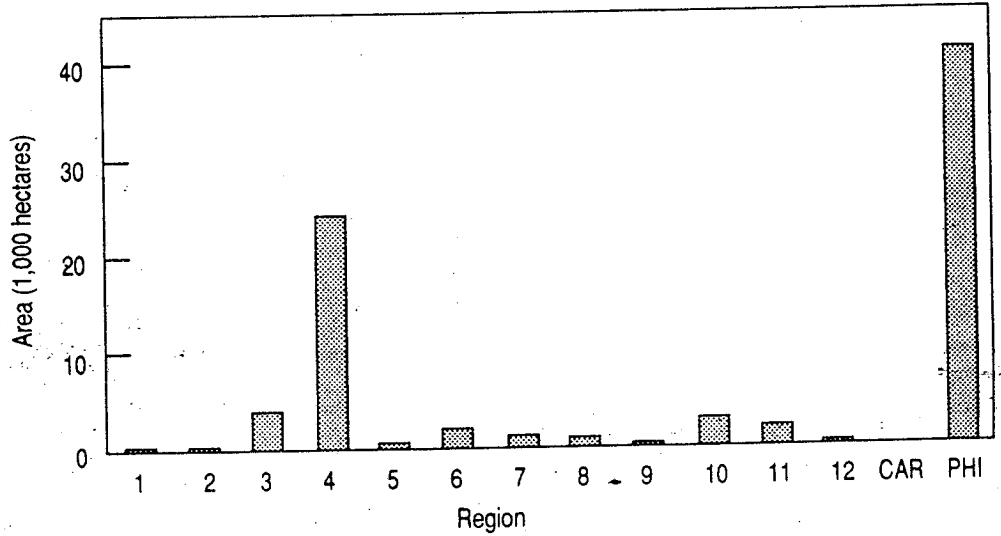
AO No. 20 provided an added control to land conversion: irrigated and irrigable land may no longer be converted even if tenants consent to the conversion and other necessary clearances can be obtained.

Figure 1.2
Land Conversion

(A) Approved for Conversion
(1972 to 1991)



(B) Applied for Conversion
(June 1988 to May 1994)



Although the current interim policy seems to be better than the previous policy, it also has its own limitations. In the first place, there is no reason to believe that the incidence of premature conversions is higher in irrigated areas than in non-irrigated areas. Although the agricultural output that is lost due to premature conversion is smaller when the land is unirrigated, it is rather likely that the incidence of premature conversion is more correlated with the nonagricultural value of the land than with the availability of irrigation.

There may also be cases where the social benefits from conversion exceed the costs even if the land is irrigated. In short, the current interim policy may prevent both premature and well-timed conversions.

Out of the applications submitted to DAR, those disapproved as of April 1994 cover only slightly more than a thousand hectares. Even assuming that the number of applications that will be disapproved will increase dramatically, the data already point to two possible conclusions. One is that land conversion is not primarily a food security issue but essentially an agrarian reform issue, which may or may not have significant effects on food security. The other possible conclusion is that government cannot process enough applications and a lot of land conversion will simply happen outside the prescribed system. Furthermore, it may be virtually impossible to decongest or speed up the processing of applications since government, as shown by its own directives and issuances, does not seem to trust its own people in its municipal, provincial and regional field offices.

Can the present system be improved? One approach is simply to fine-tune it. Keep nearly all the restrictions but allow conversion of a limited number of hectares of irrigated and irrigable land for housing and industrial use (and other priority programs) provided the total irrigated or irrigable areas that would be issued permits by the relevant government agencies (e.g., HLRB and DTI) do not exceed certain quotas for each priority sector, and the projects to be undertaken would meet certain socioeconomic criteria. This approach would be consistent with the assumption that until the Comprehensive Agrarian Reform Program (CARP) is completed, most new proposed conversions would be premature, and the few that are not will be subjected to the quotas given to the appropriate agencies. Moreover, if these quotas are quite small (certainly not millions of hectares), conversion would not pose a major threat to national food security.

Another approach is to rely more on taxation to regulate and slow down conversion. A sufficiently high conversion tax, if it can be widely enforced, raises the cost of conversion. This would make conversion unprofitable except in cases where the urban value of the land is really much higher than its agricultural value in the long run (in which case conversion may even be socially desirable). One advantage of relying on a conversion tax is that more revenues can be raised for land reform, the slow implementation of which is partly to blame for the conversion problem. Moreover, by sharing a substantial portion of the tax with local governments, the national govern-

ment can expect more cooperation from local governments, which are in a better position to monitor conversion, in reducing the number of conversions that bypass the government's prescribed process.

Finally, it should be recognized that the long time it is taking to complete the agrarian reform program is putting added pressure on owners of agricultural land to convert their land. CARL is the only law that says prime or irrigated agricultural land should remain agricultural simply because they are prime or irrigated. Indeed, CARL and the expectation of future economic and urban population growth are the twin forces driving the premature conversions. One without the other would not be enough to make land conversion a major issue. Thus, it is probably not wise to pass laws that would restrict land conversion independently of the status of the land reform program. Put in another way, restrictions on the conversion of agricultural land to nonagricultural use should be coterminous with CARP, unless a new land reform program is again launched by the state.

EMPLOYMENT AND URBAN GROWTH

Employment generation in the Philippines is poor in relation to the standards of the newly industrializing economies of East Asia and many other countries at similar income levels. This is significant considering that the lack of high-paying job opportunities is at the core of the poverty problem in the Philippines. In large part, public policies have created distortions that have not only been inimical to sustainable growth but have likewise been adverse to the employment content of growth. The heavily capital-intensive, import-substituting development strategy which the country adhered to for several decades engendered inefficient industries, effectively penalized agriculture and labor-intensive exports, impeded backward integration, promoted growth-retarding rent-seeking activities, and stifled the country's competitiveness in the world market.

The industrial sector — particularly manufacturing, the hub of growth in the rapidly industrializing economies of East Asia — has failed miserably in absorbing labor despite the rapid expansion of its share in national income. This means that services, mainly in the informal sector, and agriculture have been the major sources of employment for the rapidly expanding labor force. Unfortunately, in these sectors, labor productivity and wages are relatively low.

The low productivity of labor in agriculture compared to the rest of the economy reflects sectoral differences in the nature of the production function, rate of technological change, and mobility of resources. The productivity gap may even increase from the early to the middle stage of development. Thus, the transfer of labor from agriculture to more productive sectors — in both rural nonfarm and urban areas — would be interpreted as an improvement in average employment situation and living standards of the employed population. Once migration and capital accumulation have

significantly reduced labor surplus, productivity and wages in agriculture rise, eventually reducing the productivity gap between this sector and the other sectors.

The economic welfare of the population can be secured only by a policy reform aimed at correcting the disincentives against the production (and consumption) of labor-intensive goods, particularly labor-intensive exports, and at promoting backward integration and balanced urban-rural growth. In particular, the reform has to allow for a rapid, sustained growth of employment outside the agricultural sector and the urban informal sector. It must also permit infrastructure and institutional development outside major urban centers (particularly Metro Manila).

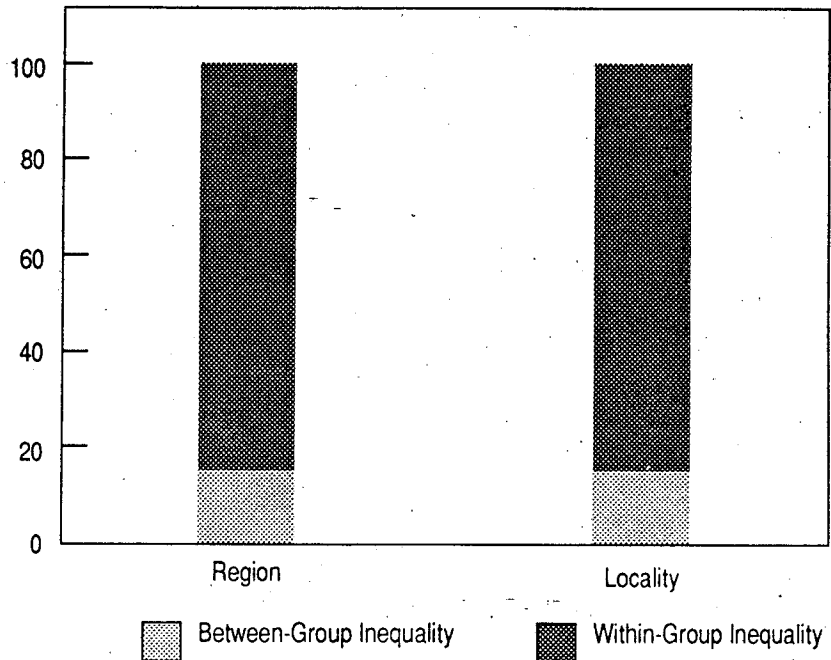
INEQUALITY, POVERTY, AND URBAN-RURAL GROWTH LINKAGES

Recent public policy discussions have called attention to the need for reducing the high interregional inequality in the distribution of income and wealth, as well as other aspects of well-being, in the Philippines. Large income disparities have been noted both among regions and between urban and rural areas. Moreover, the poor performance of the Philippine economy over the last three decades has been blamed partly on the large variation in access to infrastructure and social services between the major urban centers and the rural areas. Regional income and expenditure data attest to the existence of such a disparity. Indicators of access to infrastructure, health and sanitation, and education also reveal glaring spatial disparities between urban and rural areas especially between Metro Manila and the rest of the country.

However, analysis of household expenditure data shows that interregional or rural-urban inequality accounts for only a small proportion of the total (national) inequality (Figure 1.3). Hence, redistributing income away from economically advanced regions to lagging regions may not reduce overall income inequality and poverty very substantially. This is because more than three fourths of the observed inequality in any given year comes from inequality within regions or locations. Within-region inequality arises from differences in possession of both physical and human assets. Unfortunately, while the distribution of these assets is within the influence of government policy, public investments have fallen short of creating a highly favorable environment for human capital formation, especially among the poor.

The recent changes in overall inequality and poverty, albeit small, are also accounted for largely by changes in intraregional or intralocal inequality. The observed rise in poverty from 1988 to 1991 is attributable mainly to increased intraregional differences in living standards, not so much to changing relative fortunes (or misfortunes) of regions or locations. This observation suggests a crucial point: It is how the economic and

Figure 1.3
Sources of National Income Inequality
(Percent share in total)



institutional environment affects the rewards to owners of the factors of production, which are distributed highly unevenly within a region or location, that largely determines the country's performance in poverty and inequality reduction. In recent years, efforts to reduce rural poverty have centered on reforming agrarian relations, specifically land redistribution and tenancy. Theoretically, redistribution should increase the farmer-recipient's income and hence reduce rural poverty and overall income inequality. However, even if land redistribution were to level off the landholding inequality in regions above the national mean, and rural household incomes increase as expected, the increases are not likely to substantially alter the picture of aggregate poverty and inequality. The results are not much different for cases involving a proportionate reduction in landholding inequality across all rural regions.

The same thing can be said about tenancy reform. The observations in this study and recent empirical and theoretical studies suggest that tenancy by itself is not as important a correlate of poverty and inequality as expected: the variation in incomes within tenure classes (reflecting the effect of farm size, yield, cropping intensity, land quality, and access to technology and markets) has been found to be much greater than the variation between classes.

There are, however, very promising areas for poverty alleviation in infrastructure development and human capital formation. Improvement in

access to infrastructure in relatively infrastructure-deprived regions substantially reduces poverty without seriously aggravating inequality. This is one of perhaps only a few cases where a move to equalize access to public resources across regions or locations clearly helps poverty reduction.

In the case of human capital formation, the average level of formal education in the Philippines is low—the average adult is barely an elementary graduate—and differences in mean years of schooling across regions are small. Thus intraregional improvement in access to education is highly desirable. The present analysis suggests that raising the educational level of the population in every region to at least high school graduate will reduce aggregate poverty incidence by about 11 percentage points, all other things remaining the same. Because incomes of rural households respond to the increase almost as well as those of urban households, improvement in intraregional access to high education does not aggravate inequality.

A major lesson one can draw from this study is that policymakers need not form new agencies or go far in search of “new” models to effectively alleviate poverty, reduce inequality, and promote balanced urban-rural growth. Much can be achieved simply by improving performance in traditional areas of development management: the financing and public-sector coordination of investments in social and physical infrastructure, promotion of rules ensuring incentive compatibility in government and in the private sector, maintenance of macroeconomic stability, and pursuit of peace and order. The state must not only institute and enforce the long-term rules of the game that empower and constrain economic actors, but also provide complementary public goods for the efficient operation of markets.

Spatial and sectoral movements of population need to be seen not only as responses to changing economic and social opportunities but also as an essential component of economic transformation. Severely constraining spatial movement and employment choices will disproportionately hurt the poor in the long term; it will also inhibit equality-promoting transformation of employment from low-productivity to high-productivity areas. The policy proposal, for example, to prohibit the conversion of agricultural lands into otherwise productive, nonagricultural uses is inimical to long-term poverty alleviation, rural industrialization, and economic development.

The maintenance of a robust economic growth is crucial to the reduction of poverty. But even with economic growth sustained at the rate targeted in the Medium-Term Philippine Development Plan, i.e., an average GDP per capita growth of about 4%, it will take many years for the average poor to cross over the poverty line. Assuming that income distribution remains essentially unchanged, as it has over the last three decades, it will take about 12 years for the average poor person to cross over the poverty line. A lower GDP per capita growth of 2%—the average for the 1960s and 1970s—will substantially lengthen the crossover time to about 22 years. Thus, even with growth, it takes a long time—and, for some groups in society, some pain—

to win the war on poverty. But there is no easy alternative. Efforts aimed at promoting and sustaining economic growth still help reduce poverty more than any of the direct, untargeted intervention schemes proposed in recent years (e.g., food and credit subsidies).

The positive effect of growth on poverty is even stronger if it is accompanied by a proportionate improvement in access of low-income groups to social services. The provision of these services needs to be properly directed, ensuring that the benefits of social programs intended for the poor are not pre-empted by the nonpoor. As a general rule, targeting approaches that least contradict household behavior are most likely to be successful in achieving income transfer or nutrition goals. The legislated minimum wages are not, for example, efficient means of providing safety nets to the poor during a period of macroeconomic adjustment (e.g., during an episode of devaluation). In contrast, public works programs that offer wages lower than the legislated or prevailing market rates are likely to attract only poor workers who need work the most.