
THE PHILIPPINES IN 2002

Playing Politics, Facing Deficits, and Embracing Uncle Sam

Michael J. Montesano

Abstract

Philippine politics in 2002 was characterized by early maneuvering for the presidential election of 2004, which President Arroyo will be eligible to contest, and by continuing violence in the country's troubled South. Economic indicators looked promising in the first half of the year. But the second half brought signs of a downturn on several fronts. Crippling revenue shortfalls contributed to a mounting fiscal deficit. As part of Washington's international war on terror, Manila welcomed American troops to the southern Philippines early in 2002. Renewed Philippine-American military ties seemed to reflect long-term U.S. priorities in the region.

Three issues shaped Philippine affairs in 2002: President Gloria Macapagal Arroyo's eligibility to contest the 2004 election, ever-greater government revenue shortfalls, and American determination to use the country as a venue for strategic posturing in Southeast Asia. The persistent problems of the Philippine South and continued economic sluggishness framed the ways in which these issues played out over the course of the year.

Politics

President Gloria Macapagal Arroyo focused her July 2002 State of the Nation Address (SONA) on the theme of a "strong republic."¹ Its serious concern with issues of governance and national security notwithstanding, the address also spoke to the strength of her own presidency. Arroyo came to Malacañang Palace from the vice presidency, following the ouster of her predecessor Joseph Estrada in early 2001. Uniquely

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1. Randy David, "Deconstructing the 'Strong Republic,'" *Philippine Daily Inquirer (PDI, Manila)*, July 28, 2002.

then, despite the terms of the Philippine Constitution of 1987 prohibiting presidential reelection, Arroyo may legally enter the 2004 polls. Not only did she have every incentive during the past year to govern with those polls in mind, but observers and potential opponents likewise showed every inclination to see her actions and decisions in intensely political terms.

In the weeks following the SONA, Arroyo's conduct reflected her determination to project a law-and-order image, above all through well-publicized appearances at crime scenes and staged confrontations with accused wrongdoers. In the short term, at least, this effort may well have backfired. Filipinos' mounting disgust with the unproductive shenanigans of their political class mounted during the year, and Arroyo ran the real risk of contributing to that disgust through her cultivation of an essentially gratuitous "hard-guy" pose.

Nor did developments within Arroyo's administration contribute to impressions either of strength or focus on governance rather than politics. Under extremely confusing circumstances, July saw Vice President Teofisto Guingona resign his concurrent post as secretary of foreign affairs. Though due above all to Guingona's principled objection to the deployment of American troops to Mindanao,² this resignation also pointed to the interference in matters of foreign policy of one of the president's numerous special advisors, Roberto Romulo. A former foreign affairs secretary himself, Romulo was widely seen to have brazenly and humiliatingly usurped Guingona's powers. Despite Arroyo's shabby treatment, Guingona remained vice president even after his resignation from her cabinet. Arroyo provoked little but scorn with her choice of a replacement for Guingona: Blas Ople, a discredited Marcos-era cabinet member whom she plucked out of the Senate, as much to effect a more favorable balance in the upper house as to meet the needs of Philippine diplomacy. Similarly, the president's appointment of a new Armed Forces of the Philippines (AFP) chief of staff for a term to last just over two months appeared to reflect an attempt to silence the officer's sister, outspoken Arroyo critic and former Senator Miriam Defensor-Santiago, far more than any serious interest in the effectiveness of the AFP or the quality of its leadership. Each of these events presented the opportunity, always exploited with gusto, for those who would replace Arroyo in Malacañang to attack her.

Along with such intense political maneuvering, the year brought a series of unnerving bombings both to two important centers on Mindanao and to the largest city in Metro Manila: explosions struck General Santos in April and Zamboanga and Quezon City in October. All were apparently related to

2. Following common Philippine usage, "Mindanao" refers here and elsewhere in the survey to the island of Mindanao proper and to the neighboring Basilan Island and Sulu Archipelago, unless otherwise explicitly indicated.

hemorrhaging problems of separatism and banditry in the Philippine South. Less spectacularly but also worryingly, the New People's Army (NPA)—the armed wing of the Communist Party of the Philippines (CPP)—kept up a steady pace of engagements with units of the AFP in many parts of the country during the year. Estimates suggested that the NPA fielded more than 11,000 armed guerrillas and operated on some 100 fronts.

Economy

Before opting to play hard guy, Gloria Macapagal Arroyo had long styled herself a policy wonk. Economic affairs in 2002 challenged her government in several areas: continued high poverty rates, a general downturn in the second half of the year, extremely bad publicity on the international scene, and above all deepening difficulties in the fiscal realm. At the same time, developments in a number of other areas proved unmistakably positive.

In winning the confirmation of respected banker Jose Camacho as her finance secretary in February, the president considerably strengthened her economic team. Having posted a year-on-year increase in gross domestic product (GDP) of 4.5% in the second quarter of the year, the Philippine economy seemed set to grow by an encouraging 4% in 2002 under a successful Arroyo-Camacho stewardship.³ Interest rates also fell, to less than half their levels at the end of 2000.⁴ They helped keep domestic demand, a key driver of the economy, strong. Similarly, inflation fell to its lowest year-on-year rate in over two years in June. Despite good rice harvests in the first half of the year, low rainfall due to the onset of the El Niño weather effect in late 2002 threatened to drive food prices and living costs up. Still, for 2002 as a whole, conservative projections pointed to an inflation rate of only 3.8%.⁵

Downturn after Mid-Year

Especially in the second half of the year, other indicators brought reminders of the Philippine economy's persistent doldrums and vulnerability to external shocks. In mid-October, the prospect of war in the Middle East and a related build-up of oil stocks helped push the country's currency to its lowest value in some 15 months, 53 pesos to the U.S. dollar.⁶ Led by textiles, leather goods, and tobacco products, manufacturing output showed solid growth in

3. James Hookway, "The Philippines: Manila Comes to the Rescue," *Far Eastern Economic Review* (hereafter, *FEER*), September 19, 2002, pp. 12–16; "The Philippines' Economy: 8/10," *Economist*, July 7, 2002, pp. 58–59.

4. Tom Holland, "Economic Monitor: Philippines: Budget Blow-Out," *FEER*, August 15, 2002, p. 45.

5. Economist Intelligence Unit, "Country Briefings: Philippines," August 2, 2002, <<http://www.economist.com/countries/Philippines/profile.cfm?folder=profile-Forecast>>.

6. "Peso Breaches P53:\$1 Level," *PDI*, October 14, 2002.

the second quarter of 2002. But July brought contraction and August, a precipitous downturn, in year-on-year terms. While foreign direct investment grew by some 40% in the first six months of the year, commitments of new funds to the crucial, export-oriented electronics sector demonstrated worrying declines.⁷ Overall export growth slowed from the middle of the year. A second source of foreign exchange earnings, remittances from between four and five million Filipinos employed overseas, went into free fall from as early as April. Expulsions of illegal workers from Italy, Israel, and Malaysia only exacerbated matters. One final indicator, foreign portfolio investment, likewise saw an upward trend in the first two quarters of 2002 turn into a decline as the third quarter began.⁸

Worries for Investors

Arroyo's taste for participation in Washington's war on terror did little to encourage investment in any of the economies of Southeast Asia. If her stance underlined the threat of terror in the region as a whole, it posed particular risk to the international image of her own country. Manila business interests, Filipino and foreign alike, nevertheless continued to argue that troubles in Mindanao had no effective bearing on business opportunities in the more dynamic parts of the country.

A number of additional factors diminished the Philippines's attractiveness to foreign capital and commerce. These included concerns about corruption, lack of respect for intellectual property rights, and persistent non-tariff barriers to trade. Worries about the continued deterioration of the country's educational system and unmistakable indications of the Arroyo administration's lukewarm commitment to tariff reduction only compounded these disadvantages. So, too, did the re-emergence in 2002 of electricity costs and supplies as a political and economic issue.

Yawning Revenue Gap

Aside from the nation's "peace and order" situation, nothing tested President Arroyo's vision of a strong republic or concerned foreign observers of the Philippines in 2002 as much as its fiscal problems. These problems fell on the revenue side of the equation rather than on the expenditure side. As a percentage of GDP, Philippine government revenues fail to match those in most of the country's East and Southeast Asian neighbors. Along with a complicated tax code and a narrow tax base, the Bureau of Internal Revenue (BIR) suffers from the closely linked problems of widespread corruption and

7. Gil C. Cabacungan, "Investments in Electronics 'Alarmingly' Down" and "Foreign Investments up 40%," *PDI*, August 5 and October 2, 2002.

8. Clarissa S. Batino, "Portfolio Investments up 748% in January-July," *ibid.*, August 8, 2002.

rampant evasion. One leading foreign investment bank has estimated that the Philippine treasury loses \$7.6 billion dollars to tax evasion annually.⁹

Manila's "target" fiscal deficit for all of 2002 was 130 billion pesos (about \$2.5 billion). By July, the deficit had exceeded that level.¹⁰ By October, some sources within the administration predicted a deficit of 190 billion pesos (about \$3.6 billion) by the end of the year.¹¹ Even more alarming, the government revised its target deficit for 2003 upward from 98 billion (about \$1.8 billion) to 142 billion pesos (about \$2.7 billion) in August.¹² And in October, Finance Secretary Camacho noted the possibility of still another upward revision; the goal of a balanced budget by 2006 seemed less and less realistic.¹³ Foreign-debt ratios become more and more of a concern.

August saw the resignation of Bureau of Internal Revenue Commissioner Rene Bañez following a revolt among the bureau's rank and file. His efforts to reform tax collection and to prepare the BIR for rechristening as a new, more independent Internal Revenue Management Authority threatened too many vested interests. At the end of October, concern over Philippine fiscal problems led Standard & Poor's to downgrade to "negative" its assessment of the nation's debt outlook.¹⁴ Analysts began to warn of higher government borrowing costs both at home and abroad, further weakening in the value of the peso, and a debilitating rise in domestic interest rates as consequences of the continuing revenue crisis.

For all her intense politicking, Arroyo's success during her term will depend heavily on her ability to deliver economic growth with some measure of equity. The Philippines's rapidly growing population passed 80 million in mid-2002; some 40% of that total remained below the official poverty line.¹⁵ In many ways, the natural constituency of her disgraced predecessor Joseph Estrada, the Filipino poor, are an electorate that Arroyo has yet to win over. Stalled land reform does not make her task any easier. Nor did squabbles during the year with her American ally in the war on terror over its proposals to give preferential access to tuna imports from Andean nations as part of its other war, on drugs. Employment in the Philippine tuna sector, centered on

9. Hookway, "The Philippines: Manila Comes to the Rescue," p. 14.

10. *Ibid.*, p. 14.

11. Clarissa S. Batino, "Treasury Says Gov't Can Fund P190-B Budget Deficit in '02," *PDI*, October 17, 2002.

12. "The Philippines: It's War," *Economist*, October 5, 2002, p. 72; Clarissa S. Batino, "Gov't Borrowing to Reach P190B in '02, Drop in '03," *PDI*, August 16, 2002.

13. Clarissa S. Batino, "Gov't Seen Raising Target for 2003 Budget Deficit," *ibid.*, October 22, 2002.

14. Enrico de la Cruz, "S&P Downgrades RP Credit Rating; Others Seen to Follow," *ibid.*, October 29, 2002.

15. Inquirer News Service, "Population Reaches 80M; 32M Are Considered Poor," *ibid.*, July 4, 2002.

General Santos City, had emerged as one of the bright spots in Mindanao's economy in recent years. Crippling fiscal shortfalls and troubling debt levels only serve to complicate Arroyo's need to nurture other such bright spots, both in Mindanao and elsewhere, between now and the 2004 election.

Foreign Affairs

The year brought a new, risky, and altogether astonishing chapter in the century-old Philippine-American romance. Egged on not least by self-proclaimed terrorism experts, Washington came after September 2001 to reimagine the long-running problems of violence and separatism in the Philippine South. It now saw these problems as local manifestations of global terror networks in action. For Arroyo, this reinterpretation of the troubles of Mindanao, the adjacent island of Basilan, and the nearby Sulu Archipelago had obvious appeal. The president was indebted to a miserably funded military for her rise to power, recognized the popularity of the "Fil-Am" relationship among many of her compatriots, and had made little headway in her efforts to crush a kidnapping gang called the Abu Sayyaf. Nevertheless, in November 2001 Arroyo seems to have refused the Bush administration's initial offer of direct military assistance in the South. By early 2002, she had changed her mind.

The withdrawal of U.S. forces from their Philippine bases in 1992 and the consequent reduction in American aid to the Philippine government had left military-to-military contacts between the two countries badly damaged. Though the 1951 Philippine-American Mutual Defense Treaty—intended to apply to external threats—has remained in force, it was the conclusion in 1999 of a Visiting Forces Agreement (VFA) that signaled the start of a process of repair to relations between the two countries' military establishments. The agreement's legal guarantees made possible the rapid acceleration of that process in 2002. A joint exercise, christened "Balikatan (Shoulder-to-Shoulder) 02-01," took American troops to Basilan Island, the Abu Sayyaf's key lair of the moment, for six months from February to July. Initially numbering some 700, including almost 200 members of the U.S. Special Forces, the force later grew to somewhere around 1,000 soldiers.

Prior to the arrival of American forces, elements of the AFP had been engaged in a large, futile operation on Basilan to track down the Abu Sayyaf. In addition to Filipino hostages, the gang held a husband-and-wife team of Protestant missionaries from Kansas with long service in the Philippines, Martin and Gracia Burnham. The brutality and maddening elusiveness of the Abu Sayyaf notwithstanding, it made for a curious target in the expansion of American anti-terror operations into Southeast Asia. International concern over Muslim terrorists' use of the Philippines as a safe haven and staging ground dates back almost 10 years. The past two years have brought wide-

spread recognition, first, that those terrorist elements were part of “the al-Qaeda network” centered on Osama Bin Laden and, second, that they had been in contact with Muslim separatist groups long active in Mindanao. Though originally a splinter group of the separatist movement, the Abu Sayyaf has actually devoted itself to criminal rather than political activity. It has shown no strong ideological or religious orientation. It never numbered more than 1,000 essentially untrained bandits. Its leadership has not demonstrated significant interest in the ostensible goals of international terrorism. By early 2001, the Abu Sayyaf, for up to a decade, had had no apparent direct contact with figures tied to al-Qaeda.¹⁶

In contrast, before its fall to the AFP during 2000, the separatist Moro Islamic Liberation Front’s (MILF) Camp Abubakar was very widely reported to have hosted numerous visitors with strong ties to and records of participation in international terrorism. Throughout 2002, the MILF continued to field armed forces in Mindanao numbering some 12,000 fighters. At the very least on historical grounds, it presented a far more plausible object of America’s global war on terror than the Abu Sayyaf. And yet the MILF kept or was kept away from operations related to Balikatan 02–01 for one or more of three reasons: its own survival instinct, President Arroyo’s resolve to engage it in negotiations, and American determination to keep the Philippine front in the anti-terror war small and manageable.

On very narrow grounds, the Philippine Supreme Court ruled that Balikatan 02–01 did not violate constitutional provisions banning the stationing of foreign forces on Philippine soil. Despite early speculation that Americans would accompany AFP units on their patrols in search of the Abu Sayyaf, the U.S. role remained confined largely to training and advising at the battalion level and to sophisticated aerial surveillance of Basilan and neighboring areas. Still, Washington and Manila chose to hold Balikatan 02–01, even if it was primarily a training exercise, in a combat zone.

American forces conducted a number of medical evacuations of AFP soldiers involved in encounters with the Abu Sayyaf. They also exchanged fire with members of the gang on at least one occasion.¹⁷ But the U.S. military’s only loss during the course of Balikatan 02–01 itself came when a helicopter crashed over water on its way from Zamboanga to Cebu; all 10 Americans on board perished. Another American death came in October, after the exercise’s formal conclusion, when a bombing in Zamboanga killed a soldier belonging to the units that remained in theater, reportedly to assist with public-works projects.

16. “Terror in South-East Asia: The Elusive Enemy,” *Economist*, August 3, 2002, pp. 45–46.

17. Julie S. Alipala and Norman Bordadora, “US Soldiers Clash with Abu Sayyaf,” *PDI*, June 19, 2002.

Locating the Burnham missionary couple in early June in a remote part of Zamboanga del Norte Province rather than on Basilan, the AFP succeeded in freeing the wife. Her husband and Ediborah Yap, a Filipina nurse also held by the Abu Sayyaf, died in the encounter. Later that same month, Philippine forces apparently tracked down and killed prominent Abu Sayyaf leader Abu Sabaya; his body, however, was never recovered. After the conclusion of Balikatan 02-01, units of the AFP continued to pursue elements of the gang on the island of Jolo in the Sulu Archipelago.

Balikatan 02-01 was only the most public dimension of intensified Philippine-American contacts during the year. In August, after attending the ASEAN Regional Forum meeting in Brunei, U.S. Secretary of State Colin Powell made a brief visit to the Philippines. Shortly thereafter, the U.S. included the Communist Party of the Philippines's New People's Army on its list of foreign terrorist organizations, while keeping the MILF conspicuously off that list. At the request of Washington, the Netherlands likewise moved to freeze the assets of the CPP-controlled National Democratic Front through which the party has maintained its effective headquarters in exile, and also those of party leaders long resident in the country. Though plans for a second joint Philippine-American exercise in the South starting in October were deferred, perhaps till early 2003, the U.S. military and the AFP did conduct a number of smaller trainings together on Philippine soil during the year.

The ultimate significance of Balikatan 02-01 and of the revival of AFP-Pentagon relations during 2002 will become clear only with time. The very real concerns of nationalistic Filipinos notwithstanding, President Arroyo certainly derived domestic political benefit from her embrace of Uncle Sam. Her armed forces also gained from a modicum of intensified training and enhanced financial support. American forces made considerable improvements to the neglected infrastructure of Basilan. But to cast joint Philippine-American operations directed at the Abu Sayyaf gang as a meaningful contribution to the global war on terror would be, at best, a very long stretch. What then did the U.S. seek to accomplish with this latest round of military intervention in the Philippines? A number of answers suggest themselves.

Freeing the Burnhams was certainly one. Though U.S. diplomats in Manila were careful not to present Balikatan 02-01 as *that* sort of police action, the Bush administration faced strong congressional pressure to rescue the American Protestant missionaries. A second answer is that Balikatan 02-01 represented Washington's attempt to show resolve in its fight against terrorism, without any particular concern for actual achievement. Exploiting a ready opportunity and a willing ally to broaden that fight into Southeast Asia, the U.S. could banish doubts about its determination aggressively to engage the forces of terror in this region as well as in Southwest Asia. Third is the possibility that—very, very early on, but not for long—some in the Pentagon

envisioned the southern Philippines as a jumping-off point for potential intervention into nearby reaches of Indonesia, a function that it had served during the Eisenhower administration.

Finally, and most importantly, the revival of Washington's military contacts with Manila during 2002 relates to the very broadest of America's strategic priorities in Asia. The year saw continuing discussion of a Philippine-American Mutual Logistics Support Arrangement. Once finalized, this arrangement will help give the Pentagon what it most wants in the region: not the reestablishment of permanent bases but rather, regular access to facilities. Along with stronger ties to Southeast Asian militaries, such access is basic to American determination to maintain its strategic relevance to the region in the face of the growing military and naval power of the People's Republic of China. President Arroyo enlisted in President Bush's war on terror for reasons of her own—reasons rooted in Philippine domestic realities. But she may well have signed up for more than she anticipated or understood.

Two additional matters of regional significance occupied Filipino diplomats in 2002. Malaysia's decision to expel illegal immigrants, including more than 60,000 of some 500,000 Filipinos resident in the East Malaysian state of Sabah,¹⁸ led Arroyo to make a surreal gesture. She revived a Ramos-era committee to study the Philippines's claim to the state, based on historical rights of the Sulu Sultanate not exercised even nominally since the 1870s. A second regional issue also related to competing claims of sovereignty, in this case over the Spratly Islands in the South China Sea. The arrest of several groups of Chinese fishermen for operating illegally in waters near the Philippine island of Palawan, and the acceleration of Philippine plans to settle civilians on an island in the Spratly chain on which the country already operated a naval station, raised tensions between Manila and Beijing. But an early November ASEAN-China meeting in Phnom Penh resulted in a rather vague agreement to behave better, among the various countries with interests in the South China Sea.

Conclusion

At the end of the year, Gloria Macapagal Arroyo stunned her country's citizens by using her annual Rizal Day (December 30) speech to announce that she would not contest the 2004 Philippine presidential election. Facing very low popularity ratings and noting her own role in the "divisive national events" of recent years, she pledged to dedicate her remaining year and a half in the presidency to governance rather than to politics. She alluded again to her vision of a strong Philippine republic and promised major new initiatives

18. Norman Bordadora and Cynthia D. Balana, "RP protests ill treatment of Filipinos by Malaysia," *PDI*, 28 August 2002.

early in 2003.¹⁹ A number of skeptics decried Arroyo's announcement as a political tactic rather than a binding commitment. Other observers praised her spirit of sacrifice. Whatever the case, this shocking news triggered immediate, intense speculation regarding possible entrants into the now transformed race to Malacañang. Political games had hardly been brought to an end.

The last two months of 2002 brought no improvement in the Philippines's fiscal situation. Late November saw the government revise the budget deficit target for the year to 223 billion pesos (about \$4.2 billion). Likewise, the target for 2003 was raised above 200 billion pesos (about \$3.8 billion), and prospects for a balanced budget receded ever farther into the future.²⁰

Manila and Washington finalized their Mutual Logistics Support Arrangement on November 21, 2002. While the arrangement takes the form of an executive agreement rather than a treaty, Vice President Guingona joined several members of the Philippine Senate in calling for that body to have the chance to review its terms and constitutionality. In the meantime, planning for an accelerated schedule of Philippine-American training exercises in 2003 continued. Reports suggested that the Pentagon and the AFP were considering the risky option of holding some of those exercises on the island of Jolo in the Sulu Archipelago to which leading elements of the Abu Sayyaf were thought to have retreated from Basilan.²¹

In mid-November, Philippine police arrested in Manila a man whom they characterized as the Abu Sayyaf's top explosives expert, Abdulmukim Edris. The arrest allegedly interrupted a plan to bomb the American embassy and other sites in the capital. Attributing to Edris responsibility for the October bombing that killed an American soldier in Zamboanga, authorities also claimed that he confessed to much more recent contact between al-Qaeda and the Abu Sayyaf than previously reported. Later in the same month, apparently specific, credible warnings of terrorist threats led to the closure of the Australian, Canadian, and European Union embassies; the latter two reopened for business in the final days of the year.

The last week of the year brought a series of murderous attacks on civilian targets in several provinces of Mindanao. The AFP was quick to blame the MILF despite that organization's denials. At the same time, Malacañang Palace reaffirmed its commitment to peace talks with the MILF, which President

19. "Text of Macapagal's Speech Saying She Won't Run in 2004," *ibid.*, December 31, 2002.

20. Agence France Presse, "Budget Deficit Worsens, Forces Revision of Targets," *ibid.*, November 21, 2002.

21. Eric Schmitt and Carlos H. Conde, "U.S. and Philippines May Start Training Mission," *New York Times*, December 1, 2002, p. 32, and Ellen Nakashima, "Island in Philippines Poses Counterterrorism Challenge; After Success on Basilan, U.S. Weighs Action on More Hostile Jolo," *Washington Post*, December 21, 2002, p. A16.

Arroyo continued successfully to urge Washington to keep off its list of foreign terrorist organizations.²²

The political skirmishes that marked Philippine affairs in 2002 doubtless offered a sample of battles yet to come, as prospective challengers position themselves for the 2004 presidential election. But the end of the year brought few certainties beyond that one. The economic downturn of the second half of 2002 and the ongoing Philippine rapprochement with the U.S. represented, above all, sources of future uncertainty and perhaps even insecurity for the country.

22. "Intelligence: Gloria's Powers of Persuasion," *FEER*, December 12, 2002, p. 10.