WORKING PAPER

Costing Populist Policies

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1. Introduction

There is a populist tsunami sweeping across the world right now. And this is not new – the Thaksins in Thailand, Chavez in Venezuela, and Erdogan in Turkey, among others, signaled its arrival in many developing countries some years back. Most recently, even the industrialized economies were not spared, with the election of President Donald Trump in the US and the Brexit vote in the UK. Some would argue that Xi Jinping in China and President Duterte could also be considered populist leaders (Chen, 2016).

While there are several conceptions of populism, there are at least two ways to describe this phenomenon. One approach, popular in political science, describes populism as an ideology separating society into two antagonistic groups—the vast majority of people and a corrupt elite (Mudde, 2004). On the other hand, among the economists, populism has sometimes been described as an economic strategy emphasizing growth and redistribution, with rising risks linked to higher inflation and deficits later on. Populism is often seen as an unsustainable strategy, as growth eventually sputters and the costs associated with populist policies lead to debt related challenges (Dornbusch & Edwards, 1991).

In many cases, populist waves end in crises, as redistribution policies appealing to large numbers of citizens often impose unsustainable fiscal burdens. In the worst cases, redistribution policies also often come at the cost of deep structural reforms, including those that make the economy much more competitive and inclusive. Deeper reforms are often delayed while the country lingers in a populist euphoria.

Populist leaders could come from the political left or the conservative right, often leveraging social discontent, as well as either racial or economic anxieties brewing in society. Often, they leverage deep social, political, and economic divides in society, separating a large mass of voters from an elite portrayed to be unnecessarily and unfairly advantaged.

Trump's rise to power, for example, has been accompanied by strong anti-immigrant and protectionist rhetoric, which might actually be embedded in deep economic divides. Researchers from Brookings Institution, for example, found evidence that Hillary Clinton won in 472 counties which nevertheless accounted for over 60 percent of US economic output. Trump, on the other hand, won in over 2500 counties accounting for a mere 36 percent of US GDP. Brookings therefore attributes part of the election divide as having to do with the differences across "high output America" and "low output America".

Table 1. Number of US Counties Won by Candidates and their Share of GDP in 2000 and 2016

Year	Candidates	# of Counties won	Aggregate share of GDP
2000	Al Gore	659	54%
	George W. Bush	2397	46%
2016	Hillary Clinton	472	64%
	Donald Trump	2584	36%

Source: Muro & Liu, (2016), Brookings Institution

In the Philippines, it seems that a mix of factors could be contributing to the tendency towards some populist politics. One of these factors is the rising inequality which seems to favor a "high output Philippines", which may have benefited relatively more from greater economic integration in the last several decades.

On the other hand, sectors which may have benefited less—or may even have been harmed—could then be targeted for redistributive policies: farmers with no means to invest in irrigation, young people aspiring for better jobs through higher education, small firms marginalized by the formal financial sector despite the benign credit environment, and an urban lower middle class feeling the pinch from rising transport and other costs, combined with job uncertainty.

In urban areas, growing concerns over the challenges and risks associated with rapid urbanization—including the threat of crime and illegal drugs, rising transport costs and traffic, as well as economic uncertainty—could be contributing to the strong support for policies that cater specifically to these issues. That in itself does not necessarily make those policies populist—it's the focus on quicker yet ultimately unsustainable policy shortcuts, which may give rise to the canonical populism that has led to policy failure and crises in many countries where populism has taken hold. In Latin American countries affected by populist waves, for example, spendthrift populist leaders failed to address structural inequality as their policies merely triggered inflation, which in turn triggered wage increases and macroeconomic instability. In these countries, populist policies were exposed for their lack of sustainability, and for missing out on deeper structural reforms (The Economist, 2016).

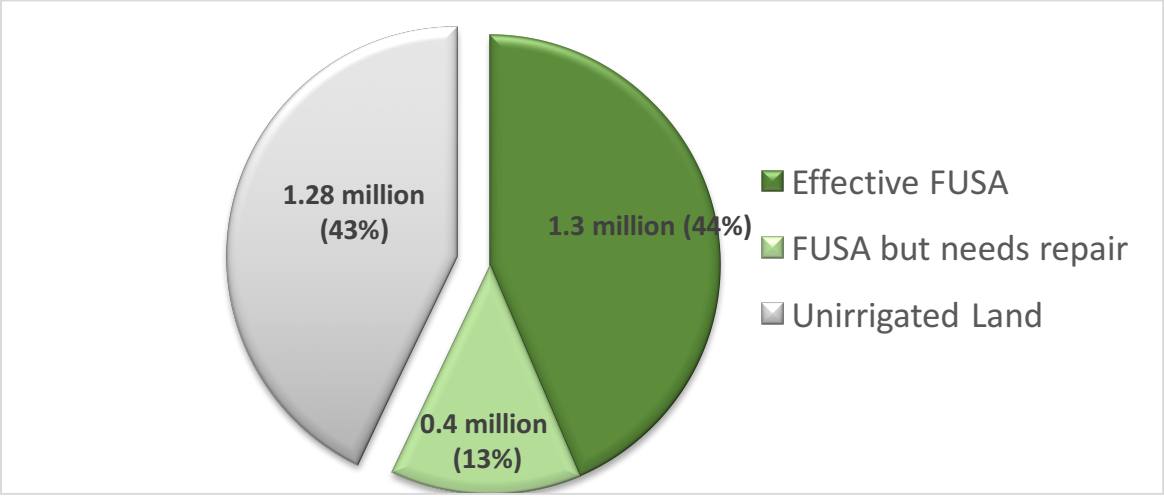
In what follows, we analyze three policy cases which appear to reflect populist tendencies, defined simply by its redistributive yet potentially unsustainable characteristics. The objective here is to reveal not simply the cost of these policies, but also the need to think of structural and institutional reforms that address the root causes of these challenges. Ultimately, populism appears to be trumped by evidence on policies that actually work more effectively.

1. Case 1: Free Irrigation

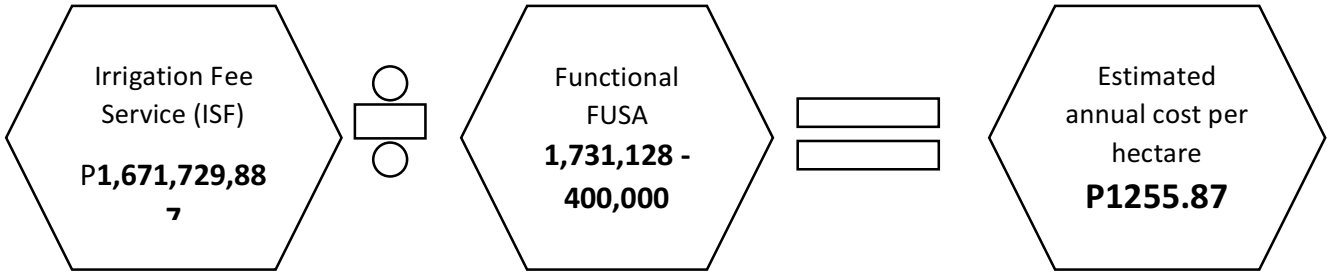
Access to irrigation remains to be one of the main challenges of agriculture in the Philippines. With the country having one of the highest irrigation fees in Asia (Quiros, 2016), irrigation continues to be a burden for farmers. With this, President Rodrigo Duterte advocated for free irrigation (along with land distribution) during the campaign period. In an attempt to fulfill this campaign promise, P2.3 billion was added to the budget of the National Irrigation Administration (NIA) to cover the irrigation services fees (ISF), which used to be paid by farmers, increasing the total budget to P38.7 billion (Philippine Information Agency, 2016). But is this enough to provide free irrigation for all?

According to NIA's Annual Report, a total of P1,671,729,887 was allocated for ISF in 2015 (National Irrigation Commission, 2015). From this, it would seem that the additional P2.3 billion is already enough to cover the ISF. However, according to NIA, the total firmed-up service area (FUSA) or the service area to be covered by irrigation facilities as of December 2015 is 1.7 million hectares, covering only about 57% of irrigable land (National Irrigation Commission, 2015). Of the remaining 1.3 million hectares, NIA is targeting to cover 75% over a period 10 years, which is 96,636 hectares per year (Pasion, 2016). Moreover, of the total FUSA, there are still about 400,000 hectares that need repair.[Error! Bookmark not defined.] (See figure below.)

Figure 1. Distribution of Irrigable Lands (in Hectares)



To obtain an estimate of how much NIA charges per hectare of irrigated land, we divide the ISF by the land area (in hectares) of functional irrigated land:



The computation below shows the estimate of the actual needed variable cost for 2017, assuming the 400,000 hectares FUSA for repair will be functional.

FUSA	1,731,128
Additional areas to be irrigated	96,636
Total area	**1,827,892**
2017 Variable cost	Total area*Estimated annual cost per hectare = P2,295,594,726

The total cost is P2.3 B, which matches the additional allocation. However, to comprehensively provide free irrigation, the government will have to pay a total of **P3.8 billion** every year to cover the ISF of the entire 3 million hectares.

In addition, the above computation has not yet accounted for the cost of expanding the FUSA. Unless the government builds the necessary infrastructure, it will remain "a challenge to bring water to farmlands" (Julio, 2017). According to a study of the Philippine Institute for Development Studies (PIDS) on irrigation development, NIA in 1995 estimated the average cost per hectare of constructing a gravity irrigation system to be P100,000 (David, 2000). Note, however, that this is still underestimated if we are to consider the current cost. The computation below illustrates the estimated cost to be incurred in constructing the additional target irrigation systems:

Additional areas to be irrigated in 2017	96,636
Cost per hectare	P100,000
Estimated additional cost	96,636*100,000=P9,663,600,000

Adding 96,636 hectares per year to the FUSA then costs additional **P9.6 billion** per year, in the 1995 price. In comparison, the NIA budget in 2017 increased only by P3.6 billion from the 2016 budget. In other words, the increase in budget from 2016 to 2017 will have to be more than doubled for the government to reach its target for the year.

In summary, adding P2.3 B is enough to subsidize irrigation services for the current FUSA. However, implementing a comprehensive program that will fully provide a free and sustainable irrigation system for Filipino farmers will require a much more expensive effort to repair and expand the existing system.

Other Points to Consider

- Under the current charter, NIA exists as a government-owned-and-controlled corporation. Agriculture Secretary Piñol calls for the amendment of the NIA charter to transform it into a service agency rather than a revenue-generating body. Amending the charter is necessary to ensure that the agency would no longer have to ask Congress for additional subsidy to provide free irrigation to farmers (Arcalas, 2016).

- Lowering of production costs in agriculture should be pursued. Benefits include food security and improvement of income especially those of small farmers. DA will provide aid (loans and technology) to farmers tilling over 1 million hectares of irrigated land (Masaganang Ani Project), which would increase productivity among farmers and decrease production cost.

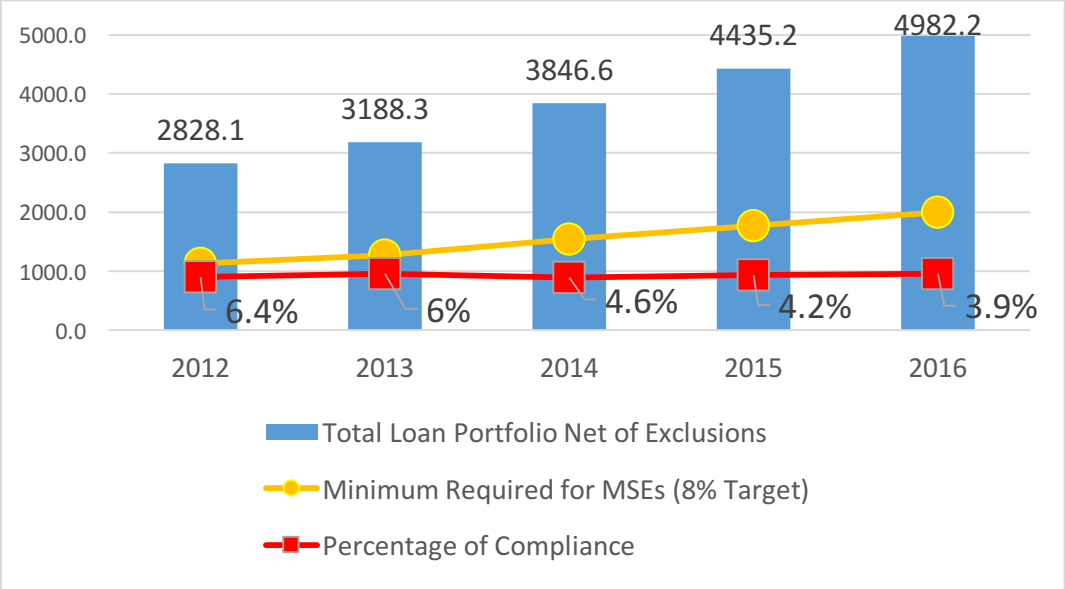
2. **Case 2: Enhanced Access to Credit by SMEs and Farmers**

Micro and small enterprises are drivers of local growth and job creation. This reflects on the Duterte administration's economic agenda, particularly on promoting and increasing agricultural and rural enterprise productivity. In order to achieve this, there has been a push to provide greater access to credit among small enterprises and poor farmers.

2.1. Easier Access to Credit for MSEs

During the campaign, Duterte proposed a P1 billion budget per region for credit to micro and small entrepreneurs (MSEs) (Quiros, 2016). This sums up to a total of P18 billion budget for MSEs. Under the Magna Carta for Small, Micro and Medium Enterprises, banks are mandated to allocate 10% of their loan portfolio to micro, small, and medium enterprises (MSMEs) where 8% will be apportioned for micro and small businesses (MSEs) and 2% for medium enterprises (Bangko Sentral ng Pilipinas, 2008). However, in the last five years, the compliance ratio of the Philippine banking system did not even reach the target mandate of 8% loan portfolio for MSEs (see figure below).

Figure 2. Compliance Ratio of Loanable Funds to MSEs of Philippine Banks, 2012 to 2016



Source: Bangko Sentral Pilipinas (2015)

Suppose the average minimum required loanable funds to MSEs in the past 5 years is used as an approximation for the amount that must be raised to at least meet the 8% compliance ratio by 2017, it can be seen in the table below that the minimum loanable amount must be P308.5 billion from the total loan portfolio of P3,856.1 billion.

Table 2. Detailed summary of the banks' loanable funds for MSEs

Year	Total Loan Portfolio Net of Exclusions	Minimum Required for MSEs (8% Target)	Compliance for MSEs	Percentage of Compliance
2012	2828.1	226.3	181	6.4
2013	3188.3	255.1	191.3	6.0
2014	3846.6	307.7	178.2	4.6
2015	4435.2	354.8	186.2	4.2
2016	4982.2	398.6	192.2	3.9
Average	**3856.1**	**308.5**	**185.8**	**4.8**

Assuming that the allotted P 18 billion budget is completely loaned to MSEs, a computation of its effect in the compliance ratio is presented below.

Allocation to MSEs (in B pesos)	
Total Loan Portfolio Net of Exclusions	3856.1
Minimum amount required:	
MSEs Credit (8%)	308.5
Compliance:	
Total Compliance for MSMEs (185.1 + 18)	203.4
Percentage (%)	**5%**

It can be seen that this will not significantly change the percentage of credit access. Even with the increase of loans to lend out, it still falls short of the minimum compliance ratio requirement for credit to MSEs. The government's allocated subsidy should be at least **123.4 billion pesos** in order to reach the target loan compliance ratio (8%) of banks' loan portfolio to MSEs.

2.2. Greater Access to Agricultural Credit for Farmers

Secretary Piñol of the Department of Agriculture has released a statement that the Duterte government will allot another P1 billion budget for each region (a total of P18 billion) to provide easier financing access of farmers (GMA News, 2016). The Republic Act 10000 or the Agri-Agra Reform Credit Act of 2009 mandates all banking institutions to set aside at least 25% of their loanable funds: 15% for agricultural credit and 10% for agrarian reform credit (Bangko Sentral ng Pilipinas, 2009). A summary of the compliance ratio for agricultural credit in the last 2 years is presented below.

Table 3. Loanable Funds for Agricultural Credit

Year	Total Loanable Funds Generated	Minimum Required for AGRI 15% Target)	Compliance for AGRI	Percentage of Compliance
2015	2577.3	386.6	371.1	14.4
2016	2977.5	446.6	402	13.5
Average	**2777.4**	**416.6**	**386.6**	**13.9%**

Using the average values in the past two years as estimates for the 2017 allocation, percentage compliance will still not at least reach the minimum required to banks (see summary of the computation below) even with the P18B increase in the budget.

Allocation to Agriculture (in B pesos)

Total Loanable Funds Generated	2777.4
Minimum amount required:	
Agricultural Credit (AGRI, 15%)	416.6
Compliance:	
Total Compliance for AGRI (386.6 + 18)	404.6
Percentage (%)	**14.6%**

With this, the government needs to subsidize at least **P30 billion** to be at par with the mandated compliance ration of agricultural credit.

Additional Notes

- "About 30 percent (or 11 million) employed in agriculture out of the 37 million total employed have very little access to financial institutions (Ordoñez, 2016).
- Jefferson A. Arapoc, an economist from the University of the Philippines-Los Baños (UPLB) campus, cited two reasons for the relatively small share of loans going to agriculture and to micro, small, and medium enterprises (MSMEs): they do not have

backup, unlike the manufacturing sector; and they are volatile in that they are sensitive to inclement weather (Gonzales, 2016).

- Farmers and fisher folk prefer less structured institutions like cooperatives or the "5-6" method due to their flexibility of payments and simplicity of conditions (Gonzales, 2016).

3. Case 3: Free College Tuition

Senate has ratified an additional P8.3 billion pesos of funding to State Universities and Colleges (SUCs) (Geronimo, 2016). This aims to provide tuition-free education among undergraduate students who cannot afford the education cost of private institutions. In the past, there have been efforts to institutionalize a free tuition policy. Some lawmakers have even attempted to estimate its cost. To name some, Sen. Win Gatchalian (Geronimo, 2016) suggested a P15 billion budget and Sen. Bam Aquino (Senate of the Philippines, 2017) proposed P16 billion. But how much does a free tuition policy really cost? In this short note, we attempt to present some estimates and illustrate the possible implications of implementing the policy.

It is important to take note that a sound policy goes beyond the present and considers possible future circumstances. The current population of college enrollees is lower than usual, due to the K-to-12 program taking into effect starting AY 2016-2017. According to Philippine Association of State Universities and Colleges (PASUC), a total of 917, 884 undergraduate students were enrolled in the said school year (Philippine Association of State Colleges and Universities, 2016). On the other hand, CHED's Students' Grants-in-Aid Program for Poverty Alleviation (SGP-PA) gives qualified Pantawid Pamilyang Pilipino Program (4Ps) beneficiaries 60,000 pesos annually for a wide range of expenses for schooling: tuition fees and other fees (P20,000), textbooks (P5,000), board and lodging, transportation, clothing, health/medical needs, and other related costs (P35,000) (Commission on Higher Education, 2012). We now consider these figures as the government's estimated cost of college education. Multiplying this amount by the population size gives an estimate as to how much the government would have to spend to provide truly free higher education for all. Below is a summary of the full year computation.

Estimate of the Number of enrollees (N)	917, 884
Tuition Fee and other fees cost (P20,000*N)	P18.4 B
Living allowance and books expenses (P40,000*N)	P36.7 B

2017 estimated free education cost	**P55.1 B**

We see here that for the tuition fee alone, amounting to P18.4 billion, the additional budget of P8.3 billion will not be enough to support the existing enrollees, even if we add the financial assistance grants provided by CHED, which is P5.7 billion (Senate of the Philippines, 2016).

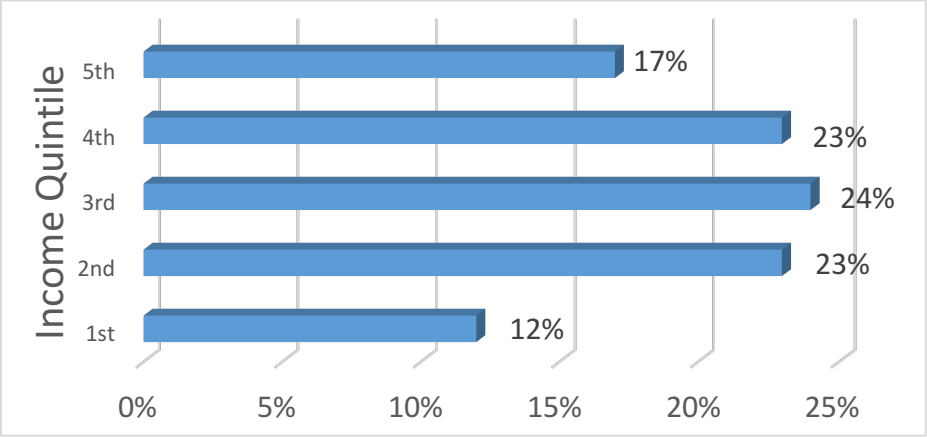
We now look at the sustainability of the policy. How much will the government need when the college enrollment returns to normal (after K-12 transition period in 2021)? Using the AY 2015-2016 data (N=1,387,599) on the number of enrollees to reflect how the numbers after the K-12 transition period, we summarize the computations as follows.

Estimate of the Number of enrollees (N)	1,387,599
Tuition Fee and other fees cost (P20,000*N)	P27.7 B
Living allowance and books expenses (P40,000*N)	P55.5 B
2021 estimated free education cost	**P83.2 B**

Based on the computation, 51% increase (from P18.4 B to P27.7 B) in the 2017 computed tuition will be needed to sustain the free tuition fee alone.

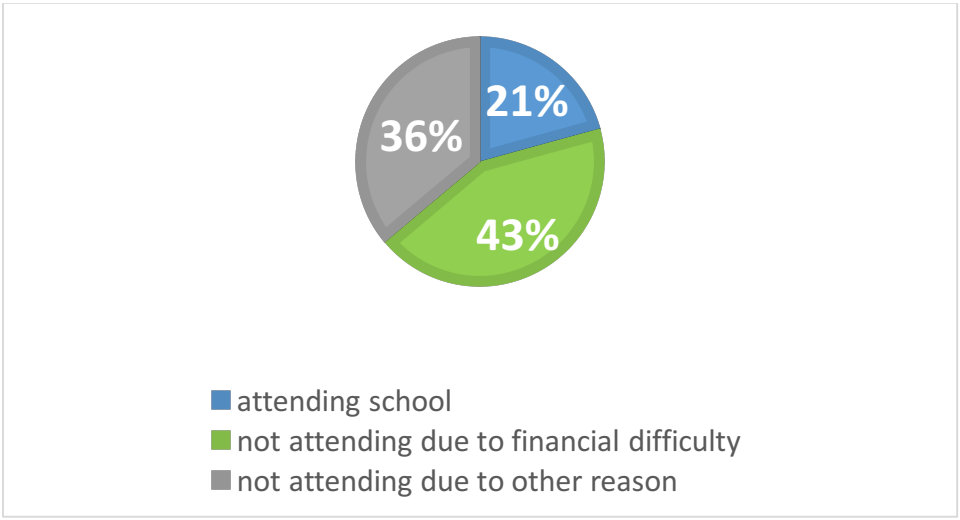
Note that these computations would suffice only for the currently enrolled undergraduate students in SUCs. If the government wants to target the poor, it seems that the proposed free tuition fee policy would be biased towards middle and high income undergraduate students. As shown in the figure below, only 12% of the currently enrolled undergraduate students in SUCs are poor or in the lowest quintile. This is based on the 2014 Annual Poverty Indicators Survey (APIS) as cited in Orbeta Jr. and Paqueo's policy note (Orbeta & Paqueo, 2017). The distribution of the benefits of tertiary education in the country is regressive across income groups (Manasan, Cuence and Villanueva, 2007). Consequently, the poorest 10% of the population receive less than 10% of the tertiary education subsidies that are being provided by the state, while higher income group capture larger portion of the benefits.

Figure 3. Distribution of students who enrolled in SUCs by Income Quintile in 2014



In our next case, we will estimate the cost if college dropouts are to return to school because of the free tuition fee offer. Based on our calculations from the 2013 Functional Literacy, Education, and Mass Media survey (FLEMMS) (Philippine Statistics Authority, 2013), as many as 43% of the Filipino college-aged population are not attending school particularly due to financial difficulties (see the figure below). These dropouts may want to return in light of free tuition.

Figure 4. Distribution of population aged 16-24 bracket by school attendance and reason in 2013



The estimate of the size of undergraduate students in private Higher Education Institutions (HEIs) for AY 2016-2017 would be 1,358,202. Summing the private HEI and SUC populations yields 2,276,386 students. Based on the 2013 FLEMMS (Philippine Statistics Authority, 2013), only 20.7% of the Filipino college-aged population is attending school. We can then estimate the number of dropouts due to financial constraints by appropriately scaling up (roughly doubling) the combined enrolled population, which yields 4,735,313 students. Adding this to the AY 2016-2017 enrollees in SUCs would yield a population of 5,653,197 students. Summarized below are the details of the estimates assuming dropouts due to financial constraints will return to college.

Estimate of the number of enrollees (N)	5,653,197
Tuition Fee and other fees cost (P20,000*N)	P113.0 B
Living allowance and books expenses (P40,000*N)	P226.1 B
Estimated free education cost (inclusive of dropouts)	**P339.2 B**

If dropouts are to return to college, the government would need 6 times the supposed budget. However, it's important to note that the inclusion of such dropouts would raise the country's college participation to 64% and would potentially even higher with that of Thailand (51.4%), the country with the highest in ASEAN (excluding Singapore) as of 2012 (Commission on Higher Education, 2016).

To sum it up, SUCs have a total fund of **P14.05 billion pesos** to relieve students of the cost of tuition. From the calculations above, in considering tuition fee alone, the fund is already not enough to cover for the enrolled SUC population as estimated cost is at **P18.4 B** even more when it returns to normal after the K-to-12 transition. Furthermore, if we include the full cost of education for undergraduate students, the cost for the current SUC undergraduate population alone is **55.1 billion pesos** and even six times this amount (**339.2 billion pesos)** if dropouts due to financial difficulties are included. Proper and careful planning of the program then is essential if the government targets an inclusive free education.

Additional Notes

- Another aspect of the issue that must be taken into consideration is the possible exodus of undergraduate students from private universities to SUCs. With free tuition in place for SUCs, some students in private HEIs may transfer to SUCs to avoid paying tuition. Without state support and with dwindling enrollment, the free tuition policy could kill many private HEIs. SUCs do not yet have the capacity to exclusively provide higher education, as private HEIs currently outnumber them 1708 to 60 (Geronimo, 2016). If an exodus does occur, then both SUCs and private HEIs will have a problem.
- President Duterte has called for a "conditional implementation" of the free tuition policy (Diaz, 2016). The rationale is to "safeguard" its implementation and to prioritize poor but academically qualified students (Diaz, 2016).
- An alternative recommendation is the full funding of the UniFAST law – proposes to unify all modalities of publicly funded student scholarships, grant-in-aid and student loans for college education (Orbeta & Paqueo, 2017).

4. Synthesis

The policies outlined in this note carry high risk of unsustainability. Based on our calculations, the following points need to be considered.

Free Irrigation:

- The additional P2.3 billion budget is enough to subsidize irrigation service fees using current irrigation facilities but this will only cover 57% of the irrigable lands.
- To provide free irrigation service fee for all, the government must allocate at least P3.8 billion (65% increase from the current budget) to cover 100% (3 million hectares) of irrigable lands.
- This, however, does not include the construction of irrigation facilities that will cover the remaining 43% unirrigated areas. Construction of the irrigation facilities for the remaining unirrigated areas itself will cost at least P130 billion.
- Therefore, the total budget needed to provide free irrigation for all irrigable lands will amount to at least **P133.8 billion**.

Easier Access to Credit for MSEs:

- The proposed P18 billion budget for credit to micro and small entrepreneurs (MSEs) will not significantly change the percentage of compliance for credit access (5%) because even with this additional amount, it still falls short of the minimum compliance ratio requirement for banks (8%).
- The government's allocated subsidy should at least be **123.4 billion pesos** in order to achieve the target loan compliance ratio (8%) of banks' loan portfolio to MSEs.

Greater Access to Agricultural Credit for Farmers

- The proposed P18 billion budget for credit to farmers is not enough to support the banks' minimum compliance ratio requirement of 15%, though it would approximately increase the compliance ratio by 0.7% (from 13.9% to 14.65).
- The government needs to subsidize at least **P30 billion** to at least be at par with the mandated compliance ratio of banks to agricultural credit, which is 15%.

Free tuition for SUC undergraduates:

- The government's additional P8.3 billion budget for free tuition will not be enough to support the existing enrollees in SUCs, even if financial assistance grants of P5.7 billion provided by CHED is added.
- The government needs at least P18.4 billion to subsidize the current tuition fee of all students in SUCs.
- If the full cost of education is considered, the government will have to spend at least P55.1 billion to give free education to the currently enrolled SUC students.
- The country has a low net enrollment ratio for tertiary education at 21%. The possibility that dropouts due to financial constraints will return to college will entail larger budget for the government, at least 6 times the estimated cost (P113 B versus P18.4 B at least for the tuition fee).
- The proposed free tuition fee policy will be more beneficial for middle and high income undergraduate students who constitutes approximately 64% of the total enrollees in SUCs. Only 12% are considered as poor among the current enrollees.

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