

Challenges for a Post-Election Philippines

Issues for U.S. Policy

A Council on Foreign Relations Special Report

**Catharin E. Dalpino
May 11, 2004**

**SPONSORED BY THE COUNCIL ON FOREIGN RELATIONS
CENTER FOR PREVENTIVE ACTION**

Founded in 1921, the Council on Foreign on Foreign Relations is an independent, national membership organization and a nonpartisan center for scholars dedicated to producing and disseminating ideas so that individual and corporate members, as well as policymakers, journalists, students, and interested citizens in the United States and other countries, can better understand the world and the foreign policy choices facing the United States and other governments. The Council does this by convening meetings; conducting a wide-ranging Studies program; publishing *Foreign Affairs*, the preeminent journal covering international affairs and U.S. foreign policy; maintaining a diverse membership; sponsoring Independent Task Forces; and providing up-to-date information about the world and U.S. foreign policy on the Council's website, www.cfr.org.

THE COUNCIL TAKES NO INSTITUTIONAL POSITION ON POLICY ISSUES AND HAS NO AFFILIATION WITH THE U.S. GOVERNMENT. ALL STATEMENTS OF FACT AND EXPRESSIONS OF OPINION CONTAINED IN ITS PUBLICATIONS ARE THE SOLE RESPONSIBILITY OF THE AUTHOR OR AUTHORS.

For further information about the Council or this report, please write to the Council on Foreign Relations, 58 East 68th Street, New York, NY 10021, or call the Director of Communications at 212-434-9400. Visit the Council's website at www.cfr.org.

Copyright © 2004 by the Council on Foreign Relations®, Inc.

All rights reserved.

Printed in the United States of America.

This report may not be reproduced in whole or in part, in any form (beyond the reproduction permitted by Sections 107 or 108 of the U.S. Copyright Law Act and excerpts by reviewers for the public press), without written permission from the publisher. For information, write the Publications Office, Council on Foreign Relations, 58 East 68th Street, New York, NY 10021.

CONTENTS

| | |
|--|----|
| Acronyms | iv |
| Acknowledgments | v |
| Report | 1 |
| Introduction | 1 |
| Why the Philippines and Why Now? | 2 |
| Boosting the Economy and Improving Competitiveness | 4 |
| Strengthening Governance and Curbing Corruption | 9 |
| Bringing Peace and Prosperity to Muslim Mindanao | 13 |
| Strengthening Security | 18 |
| CPA Mission Statement | 22 |
| CPA Advisory Committee | 23 |

ACRONYMS

| | |
|---------|--|
| AFP | Armed Forces of the Philippines |
| APEC | Asia Pacific Economic Cooperation |
| ARMM | Autonomous Region of Muslim Mindanao |
| ASEAN | Association of Southeast Asian Nations |
| ASG | Abu Sayyaf Group |
| CPA | Center for Preventive Action |
| FDI | Foreign direct investment |
| FTA | Free Trade Agreement |
| GDP | gross domestic product |
| JDA | Joint Defense Assessment |
| JI | Jemaah Islamiyah |
| MCA | Millennium Challenge Account |
| MILF | Moro Islamic Liberation Front |
| MNLF | Moro National Liberation Front |
| NAMFREL | National Movement for Free Elections |
| NGO | Nongovernmental organization |
| OIC | Organization of the Islamic Conference |
| USAID | United States Agency for International Development |
| UNDP | United Nations Development Programme |
| WTO | World Trade Organization |

ACKNOWLEDGMENTS

The Center for Preventive Action (CPA) is grateful to those who contributed their perspective and expertise to this report. The report does not necessarily reflect the views of these individuals or their affiliated institutions. The CPA convened an advisory group to aid in the formulation of the report. The Center thanks the following individuals for their participation in this group: Stephen Bosworth, Tufts University; Jonathan E. Colby, The Carlyle Group; William W. Ferguson, Citibank; Maurice R. Greenberg, American International Group, Inc.; Richard W. Kessler, Senate Committee on Governmental Affairs; Richard W. Murphy, Council on Foreign Relations; Marcus Noland, Institute for International Economics; Nicholas Platt, Asia Society; Victor Raphael, U.S. Department of State; Eunice S. Reddick, U.S. Department of State; Richard H. Solomon, U.S. Institute of Peace; Astrid S. Tuminez, U.S. Institute of Peace; and Frank G. Wisner, American International Group, Inc.

The CPA is also grateful to Steven Rood of The Asia Foundation in Manila and to officials of the Republic of the Philippines for their views. Lastly, the author wishes to thank Richard N. Haass, James M. Lindsay, William L. Nash, and Amelia Branczik of the Council on Foreign Relations for their guidance and support.

Catharin E. Dalpino

REPORT

INTRODUCTION

The outcome of national elections in the Philippines on May 10 is still to be determined. For the past three years, President Gloria Macapagal-Arroyo has governed as an appointed head of state in the wake of President Joseph Estrada's forced resignation on corruption charges. Her administration inherited a country in crisis, and it began the critical process of economic stabilization and growth. Economic indicators in the past two years have shown modest progress. In this interim period, the Philippines has been a steadfast ally of the United States in the war against terrorism. These fragile gains could be imperiled if the Philippines does not complete the electoral process in an expeditious and credible manner. Whatever the outcome of the polls, the winner will have little time to lose in addressing a number of short- and long-term problems in the Philippines.

Although the upswing in recent economic indicators is encouraging, the Philippines faces serious challenges on several fronts: long-term economic viability and social stability; competitiveness in the global economy; internal security; and ability to defend against growing transnational threats. Meeting these challenges will require a major effort on the part of the government, political and economic elites, the business community, the nongovernmental sector, and the Philippines' major international partners, including the United States. For the new president and the legislature, these six years will be decisive. During this time, it is crucial that the Philippines accomplish three major tasks. The new administration must move quickly to avert a fiscal crisis and to halt the influx of foreign extremists and the radicalization of Philippine Muslims that threatens to turn the southern province of Mindanao into a terrorist hub. In addition, the administration must make significant progress on improving governance and curbing widespread corruption.

This Council Special Report, sponsored by the Center for Preventive Action (CPA) of the Council on Foreign Relations, examines these three challenges, focusing on the underlying conditions that have brought the Philippines to the brink of multiple crises

while considering steps to address them. The Philippines is not failing, but it is flailing. The most serious problems facing it today are some of the oldest: profound discrepancies in income and economic development within the country; endemic graft; and a minority population that has never been fully integrated into the broader society and economy. Some more recent problems, such as a daunting budget deficit, are equally difficult.

These problems cannot be resolved overnight, but a strong, clear national plan can improve both the fiscal and security situations in the short term. Moreover, it can give the Philippines needed traction in three broad areas. First, it can increase the confidence of Filipinos in their leaders' ability to govern. Second, it can strengthen the country's appeal as an international investment site. Lastly, it can improve economic and social conditions among the Philippine Muslim population and undercut the appeal of foreign and indigenous extremists.

The United States and the Philippines have had a close and special relationship since the Philippines achieved independence in 1946. The U.S. devoted substantial attention to the country during the Cold War and for some years after the "People's Power" revolution of 1986 ousted President Ferdinand Marcos. However, with the end of the Cold War and the closure of Clark Air Base and Subic Bay Naval Station, U.S. interest in the Philippines waned. It revived with the war on terrorism, but that interest is narrow. The United States needs to broaden and deepen its attention to the Philippines.

WHY THE PHILIPPINES AND WHY NOW?

Since September 11, the Philippines has become more significant to the security of the United States. Among the Association of Southeast Asian Nations (ASEAN) governments, Manila has been the strongest supporter of U.S. policy and has spearheaded regional initiatives to encourage Southeast Asian nations to cooperate on counter-terrorism. The Balikatan exercises are the only joint military activities of the United States and an Asian ally that have focused on an indigenous terrorist threat.

At the same time, violent separatist movements in the south have targeted U.S. as well as Philippine interests. Al Qaeda links to the separatist Abu Sayyaf Group (ASG)

were the source of threats against Western, and particularly American, interests in the 1990s. In recent years, the group was assumed to have degenerated into a kidnap-for-ransom criminal gang without a political agenda. However, in early 2004 the interdiction of Abu Sayyaf plans to attack American targets in the Philippines has raised concern that the ASG has become the anti-Western terrorist group its Al Qaeda founders intended it to be.

Of equal if not greater concern are links between the Jemaah Islamiyah (JI), Southeast Asia's homegrown terrorist network, and the separatist Moro Islamic Liberation Front (MILF). The International Crisis Group has documented the JI's use of MILF territory in Mindanao as a "new Afghanistan," a training ground for regional terrorists. Despite the Philippine government's strong stand against terrorism, the presence of these camps is turning the southern Philippines into an exporter of terrorists. The JI's anti-Western and anti-American agenda, evidenced by the 2002 Bali bombings and the 2003 attack against the Marriott Hotel in Jakarta, make it a direct threat to the United States. Until it severs all ties to the Jemaah Islamiyah, the MILF is a threat as well.

As one of America's five treaty allies in Asia, the Philippines' importance to American security is not confined to terrorism, however central that is. Power dynamics are rapidly changing in Asia. In the past decade, China has made remarkable inroads in its diplomatic and economic relations in both Northeast and Southeast Asia. Southeast Asia's fastest-growing trade is now with China, and Beijing has recently concluded agreements in principle for both a free trade area and a "strategic partnership" with ASEAN. U.S. security analysts have noted Seoul's growing closeness to Beijing, at a time when anti-American sentiment in South Korea is running high. Tensions in America's relations with Japan are heightened over the issue of U.S. forces in Okinawa.

As the United States moves to a more flexible force structure in the region, with stronger provisions for visiting troops and the use of facilities, the Philippines could host a proportionately larger U.S. presence. This could be politically difficult, if not impossible, without a stronger underlying relationship between the United States and the Philippines.

As a result of these new concerns, it is in the U.S. interest to encourage greater political stability and economic prosperity in the Philippines, as well as a stronger bond between the two countries. These goals will not be achieved with a business-as-usual approach. The U.S. government and the American business and nongovernmental communities need to support the new administration in Manila in making a strong start in addressing these problems. Ultimately, however, the success or failure of that effort will belong to the Philippines itself.

BOOSTING THE ECONOMY AND IMPROVING COMPETITIVENESS

Touted in the 1950s as a prime candidate to lead Southeast Asia, the Philippines has failed to live up to its potential. Rapacious politics and multiple internal conflicts prevented the country from participating in the Asian “economic miracle.” In the 1980s, when some Southeast Asian economies had double-digit growth rates, the Philippines’ annual growth in gross domestic product (GDP) averaged 1.6 percent.

This sluggish rate made it difficult for the Philippines to address important tasks such as poverty alleviation and building or strengthening infrastructure. At present, 46 percent of the population of 80 million lives on \$2 per day or less. In some southern provinces, such as Sulu, the poverty rate is over 60 percent. The World Bank judges both the education system and the level of investment in education in the Philippines to be below those of Malaysia, Thailand, and Indonesia, and well below the international average. This has obvious implications for the labor force and suggests that the Philippines is losing its educational advantage in the region. For example, a decline in English-language instruction will reduce the Philippines’ ability to compete in the international economy, although literacy levels are still relatively high at present.

High population growth, currently at 2.36 percent per year, affects economic progress. Per capita growth in the Philippines was 86 percent between 1975 and 2001. Over the same period, Indonesia’s total growth per capita was 423 percent, Thailand’s 261 percent, Malaysia’s 169 percent, and China’s 235 percent. Longstanding levels of unemployment and underemployment, combined with population increases, create an

imbalance which is all but guaranteed to widen in the short term. Simply put, the labor force is growing faster than the number of jobs.

Recent history has shown that some progress is possible in a short time with government reform. During the administration of President Fidel Ramos, growth went from .05 percent in 1991 to 7 percent in 1998. The 1990s also demonstrated that reformist policies can help protect an economy from negative contagions. Although the Asian economic crisis of 1997–98 slowed economic progress in the Philippines, financial sector reforms cushioned it, preventing the degree of damage suffered by Thailand, Indonesia, and South Korea.

The Arroyo administration made commendable strides in raising some economic indicators over the past two years. For example, economic growth in 2003 was 4.5 percent, the fifth highest in Asia. However, recent growth has been in consumption rather than investment, which suggests that it may not be sustainable. Economists estimate that several years of good progress will be needed to create a strong fiscal position, rebuild market confidence, and generate the revenues needed for investment in social and physical infrastructure.

The Philippines faces three challenges in strengthening its economic position: reducing the budget deficit, improving competitiveness, and trade liberalization.

Reducing the Budget Deficit

The Philippines is struggling under crippling debt. The current deficit is estimated to exceed 3 trillion pesos (\$53.8 billion, based on the May 11, 2004, exchange rate); the national government debt represents 70 percent of GDP. Standard and Poor's rates the Philippines' sovereign debt two notches below investment grade. More than 31 percent of the 2004 national budget is allocated to servicing of foreign debt. The greatest single danger this debt creates is the possibility that a rise in foreign interest rates would make repayment even more difficult, leading to increasing cuts in foreign credit. Many economists fear such a scenario would thrust the Philippines into a financial crisis of Argentinean proportions.

Under a schedule devised by the International Monetary Fund (IMF), the government aims to balance the budget by 2009. As with economic growth, some

progress was made in 2003 in reducing the deficit, but most analysts believe that the government will not reach the 2009 target unless it accelerates the annual rate of reduction. More to the point, economists increasingly fear that even a successful five-year deficit reduction plan will not head off fiscal disaster. They give the Philippines three years at most to balance the budget to avert a crisis.

Several factors account for the large deficit. The Philippines has the lowest tax revenue-to-GDP ratio in ASEAN. From 1997 to 2002, that ratio fell from 16 to 12 percent. The World Bank estimates that the tax-to-GDP ratio needs to be raised by at least half a percentage point each year for several years in order to provide a more solid revenue base. Tax collection and other aspects of tax administration in the Philippines are weak. In response to high corruption levels and poorly chosen funding priorities, the middle and upper classes in the Philippines have staged a tacit tax revolt. The tax structure is widely considered to be flawed and in need of reform. Inefficient and poorly targeted government spending is also attributed to the deficit. More than 80 percent of the national budget is allocated for debt service, allotment of local government units, and the salaries of government employees. This leaves very little for social development or investment in infrastructure.

Improving Competitiveness

In 2007 the ASEAN chair will rotate to Manila. This responsibility draws attention to the growing economic divide between the Philippines and the other four original ASEAN members. Indeed, the Philippines lags behind most of Southeast Asia economically: for example, it is being outdistanced by Vietnam, which has been a market economy only twenty years. The IMD World Competitiveness scale ranks the Philippines behind Singapore, Malaysia, Thailand, and Vietnam, and only slightly ahead of Indonesia.

World Bank statistics on foreign direct investment (FDI) flows are also sobering. From 2001 to 2003, annual FDI inflows to the Philippines were \$900 million, while Vietnam received almost double that and Thailand nearly three times that. This figure was down from a Philippines average of \$1.2 billion in the 1998–2000 period.

The Philippines is not alone in this. With the exception of Vietnam, whose FDI percentage is rising because of recent “catch-up” reforms, most Southeast Asian countries have lost FDI in the last few years. There are a number of reasons for this, but a significant factor is the increasing competitiveness of China. Entry into the WTO, strong growth rates, and the potential for enormous economies of scale have given China the advantage. Recovering from the Asian economic crisis and confronting the threat of terrorism, Southeast Asia is at a growing disadvantage. It is not just that China is leaping ahead, but also that Southeast Asia is lagging behind. Within ASEAN, however, the upper tier—Singapore, Malaysia, and Thailand—is pulling away from the pack.

These gaps only promise to worsen in the short term. For example, the middle- and lower-tier Southeast Asian countries expect to lose a significant portion of their garment export trade to China when textile quotas are abolished for WTO members on January 1, 2005. Of the Philippines’ 3 million manufacturing jobs, 400,000 textile workers could be affected. These jobs are important for less educated urban workers, particularly women. As a source of revenue, integrated technology goods eclipsed textiles long ago in many Southeast Asian countries, including the Philippines. Textiles account for a tenth of the Philippines’ export revenue, down from a sixth in 1995. However, since the industry is very labor-intensive, the social and political value of clothing production is still significant.

Over time, Southeast Asia hopes to make up for this disadvantage with increased trade to China. This trend is evident in nearly every country in the region, including the Philippines. In 2003, Philippines exports to China rose 56 percent. In the near term, however, Southeast Asian countries expect to feel the pain of competition with China.

Trade Liberalization

“Free trade fever” is moving through Asia, as it is in other parts of the world. In Asia, a network of bilateral free trade agreements (FTAs) is building, and interest is growing in regional free trade arrangements. Much of this is still rhetorical, but most of the regional powers in Asia are negotiating FTAs with ASEAN. The United States favors a hub-and-spoke arrangement of FTAs which parallels its security alliances. The U.S.-ASEAN Enterprise Initiative provides for bilateral FTAs as a follow-on to Trade and

Investment Facilitation Agreements. The United States has concluded an FTA with Singapore and is negotiating one with Thailand. The U.S. business community is presently lobbying to put Malaysia next on the list. No plans are under discussion at present for a U.S.-Philippines FTA, even in principle. In practice, Manila could find it difficult to meet some of the intellectual property rights, labor, and other standards in recently negotiated U.S. FTAs.

In general, the Philippines is cautious in its approach to free trade agreements and is reluctant to consider further liberalization with Asian countries other than Japan, with which it is now in negotiations. This reluctance is understandable. In the new ASEAN free trade framework with China, for example, the Philippines will not reap benefits as immediately as the upper tier of ASEAN economies, while its per capita income is too high to qualify for the “early harvest” payments that China has made to Vietnam, Laos, Cambodia, and Burma. Beyond these concerns, liberalization may threaten the Philippines’ least competitive industries. However, to avoid falling further behind, the country should begin preparing for greater trade liberalization now.

These issues, and others such as poor governance and corruption, influence international perceptions of the Philippines as an investment destination. The criteria for investment in the Philippines put forward by some foreign investment groups that focus on Asia is revealing. The Philippines scores well for peaceful changes of government through fair elections; the conduct of this election will greatly influence that impression. However, at present the Philippines is rated below par for anti-corruption practices, corporate governance and shareholder minority rights, modern institutional financial frameworks for the financial sector (such as bankruptcy laws, bank lending, and stock exchange operations), and free trade agreements with key existing and potential export markets, such as China, Japan, Korea, and the United States.

Recommendations

- 1) The new Philippine administration should conduct a rigorous review of the tax code aimed at improving collection, and a tough screening of spending priorities.

- 2) To support deficit reduction, the Philippine government should set clear social development targets for the duration of the administration and retarget budget priorities. Priorities might include the creation of jobs; expansion of health care and property rights; improvements in education; an increase in the availability of clean water; and the construction of affordable housing. These measures will help cushion the pain of rapid economic reform felt by the Philippine middle and lower classes.
- 3) The Philippine administration and business community should take a cooperative approach to development. In the run-up to the election, the Makati Business Club pledged to provide funds through a Guaranty Pool for Poverty Alleviation and other projects to provide microcredit, medical care, and other essentials to impoverished areas. Such projects should be coordinated carefully with government efforts to maximize the benefits of both.
- 4) The IMF and the new administration should revise the deficit reduction schedule and shorten the timeline to avert a fiscal crisis.
- 5) The United States and the Philippines should take an incremental approach to negotiating a free trade agreement. They should initially seek a “fast track” agreement for trade in services. This would open U.S. markets to the Philippines’ educated workforce and the Philippine market to U.S. retail, financial, and professional services. A broader agreement covering manufacturing and agriculture would logically come at a later time.

STRENGTHENING GOVERNANCE AND CURBING CORRUPTION

Although the Philippines’ restoration of democracy is nearly twenty years old, a generation in human terms, its democracy has yet to be fully consolidated. There is nothing unusual in this; long periods are normally required for genuine democratic

consolidation. Despite occasional setbacks, democratic rule has been sustained in the Philippines, and the commitment to democracy is broader in Philippine society than in some other new Asian democracies. However, periodic military insurrections and mass civil society demonstrations, some of them violent, suggest that the formal system does not accommodate and resolve major disagreements within Philippine society. Increasingly, Filipinos appear to see their government as unable or unwilling to curb corruption and provide efficient, accountable governance.

Dissatisfaction with the present political system has created momentum in the Philippines for constitutional reform that would shift from a highly centralized government with clear separation of powers to a unicameral parliamentary form of government under a federal system. If elected, President Arroyo intends to convene a commission to study the advantages and drawbacks of the proposal.

Proponents argue that a more decentralized system would bring much-needed attention to poorer provinces. At the federal level, they believe a parliamentary system would promote cooperation between the executive and legislative branches and, by shortening the length of electoral campaigns, reduce political corruption.

Opponents argue that the present Philippine political system does not have the party discipline necessary to make a parliamentary system work (a problem often observed in those Asian democracies that do have parliamentary systems). This argument underscores the greatest short-term disadvantage to constitutional reform at this time. The Philippines' tradition of contentious and confrontational politics could destabilize government in the early years of a new parliamentary system with frequent opposition calls for no-confidence votes. As in other Southeast Asian democracies, the concept of a loyal opposition is still weak in the Philippines.

Related to this problem is public distrust in the efficacy of the political system, even a democratic one. The first "People's Power" revolution, in 1986, also known as EDSA 1, was a triumph of civil society over an entrenched authoritarian regime that could not be removed from power by procedural means. In the year 2000, a massive demonstration ("EDSA 2") helped force President Joseph Estrada from power in the midst of impeachment proceedings. However, it sparked a violent counterpart movement

(“EDSA 3”) that reflected deep divisions in Philippine society and a growing base for populist politics.

The EDSAs of this decade show that leaders may be democratically elected but often lack the ability to rule effectively—in part because they may also lack competence and professionalism. This extends to bureaucrats as well. Civil service reforms intended to professionalize the bureaucracy that were introduced during the Ramos administration were largely undone under Estrada. In the years immediately after Estrada’s departure, Arroyo was not able to revive the reforms.

Since the fall of Marcos, whose authoritarian practices included personalizing the military, the leadership of the Armed Forces of the Philippines (AFP) has accepted democratic civilian rule. However, disgruntled factions among the rank and file have periodically attempted coups and mutinies. Some of these, such as the mutiny in 2003, have been as much a protest against corruption within the military as they have been of civilian policies. Indeed, corruption has become a major concern in the Philippines across the board.

This concern is supported by data on the perception of corruption and related factors. The Transparency International Corruption Perceptions Index for 2003 rates the Philippines in the bottom third of countries, placing it among the most corrupt. The Philippines is rated as roughly equivalent to Albania, Ethiopia, and Tanzania. Taiwan, South Korea, Malaysia, Thailand, and China are rated as significantly less corrupt. International concern over corruption in the Philippines is only likely to grow as donors become more aware of the toll that corruption takes on economic and social development.

This trend will likely affect the Philippines, given that more multilateral and bilateral donors are linking good governance criteria to the disbursement of funds. The Millennium Challenge Account (MCA) is one example. The Philippines receives the largest amount of U.S. aid in Southeast Asia, but that cannot be taken as assured. Afghanistan and Iraq will absorb funds for the next several years and reduce the pool available for other countries. MCA funds could be an important new source of aid for the Philippines. It will be eligible to compete for the Millennium Challenge Account next year, but the Philippines is not considered a likely recipient at this time, given its relatively poor governance and serious corruption.

The United Nations Development Programme (UNDP) for Accountability and Transparency cites a catalogue of factors that contribute to corruption in the Philippines, including local bossism; closed political cliques; fluid political parties organized around personalities rather than platforms; low standards of corporate governance; a poorly funded judicial sector with huge case backloads; and demoralized, underpaid security forces. The breadth of the list suggests the need for a broad approach, one that includes government, business, and society, to reduce corruption.

Some Philippine businesses have indicated that they would be willing to devote as much as 2 percent of their revenues for programs to fight corruption. However, the greatest champion of anti-corruption is likely to be Philippine civil society, which has developed a strong activist tradition in the past two decades. Fueled by the Philippines' educated middle class, civil society is beginning to organize anti-corruption watchdog groups. These have tended to focus on individuals rather than the system itself, and to coalesce around elections. The Philippines has tended to lead Asia in civil society development—the National Movement for Free Elections (NAMFREL) model of the 1980s has been widely copied in the region and beyond. There could be useful lessons for the Philippines, however, in the experience of other Asian countries, particularly those which have undergone “shock therapy” because of the Asian economic crisis. The minority shareholders movement in South Korea is one example.

Recommendations

- 1) The Philippine political leadership and economic elites should mount a public campaign against corruption, and individuals should take a personal stand against it.
- 2) This should come from the top and involve the heads of key state and private institutions. Corruption imposes a very real penalty on the economy and society, but it cannot be reduced through systemic measures alone.

- 3) The United States should offer support and technical assistance to encourage the Philippine government to focus on government agencies that are particularly corruption-prone. As in many Southeast Asian countries, the customs bureau is especially vulnerable. In the Philippines, customs revenue represents roughly 20 percent of the government's total annual revenue. However, annual ratios of customs collection to the value of imports show a steady decline in the percentage of revenue to import value. Focusing on smuggling would have an exponential benefit, since many transnational threats (small arms trafficking, narcotics) follow the smuggler's route. Recently, the cost of corruption to human security was demonstrated with widespread smuggling into the Philippines of chicken parts, in defiance of a ban imposed in the face of avian flu.
- 4) The new administration should review and strengthen its anti-corruption mechanisms. These include laws requiring corporate transparency and internationally accepted standards for audits, economic deregulation, and bureaucratic simplification.
- 5) The United States and the Philippines should open formal discussions next year on the possibility of the Philippines' receiving funds from the Millennium Challenge Account when the country becomes eligible to compete for them. Washington should set clear criteria for good governance and anti-corruption measures, and the two countries should come up with a vigorous but realistic timetable for improvements in these areas.
- 6) The United States should increase its support to Philippine civil society groups for anti-corruption activities. Agency for International Development (USAID) programs to foster broad, objective counter-corruption watchdogs should be expanded.

Demands for autonomy in the southern Philippines, and the separatist movements that support it, are dynamics that can be traced back three centuries to Spanish rule. When the United States took control of the Philippines at the end of the nineteenth century, it initially governed the southern provinces of Mindanao and Sulu separately from the rest of the country. However, current separatist movements in the south are focused on modern-day grievances and are rooted in twentieth-century transmigration policies that settled large numbers of Christian Filipinos in Mindanao and changed the ethnic and religious balance. In 1913 Philippine Muslims, also known as Moros, made up 76 percent of the population of Mindanao. However, by 1939 that percentage had dropped to 34 percent, and to 19 percent by 1990.

Moro land ownership suffered a similar drop. Moro owners were in the majority in Mindanao and Sulu in 1912; by 1982, they accounted for only 18 percent of landowners. Christian settlers were granted corporate and individual property rights and titles to Muslim ancestral lands, dismissing Muslim traditional concepts of stewardship over land rather than ownership of it. Grievances over land are deeply felt in the Moro population; ancestral lands often generate revenues for corporations or the government and fail to serve Moro interests. The marginalization of the Moros and the appropriation of ancestral land have contributed to making them some of the Philippines' poorest citizens.

Education is an acute problem for the Muslim community. Many Philippine Muslims send their children to Islamic schools, or *madaris*. Throughout Muslim Southeast Asia, Islamic educational institutions have come under scrutiny as potential breeding grounds for extremists and recruitment sources for foreign terrorists. Officials in Muslim-majority countries in the region have privately warned Manila that terrorist recruitment from Philippine *madaris* is increasing as controls on Islamic schools in other countries are tightened. However, the evidence suggests a more complicated picture. Terrorists are as likely to recruit from secular schools that offer technical training, which can be useful in planning and implementing attacks, as they are from Islamic ones.

In the Philippines, the broader risk posed by Islamic schools at this time is that they do not prepare their students for gainful employment. The majority teach religious

subjects only, leaving their graduates unable to compete for mainstream jobs, and unable to study at the university level. Manila has recently announced an initiative to integrate Islamic schools into the public school system, but progress has been slow since many Muslim parents view public education as a government tool to convert minorities to Christianity. Only .02 percent of Islamic schools are regulated by the government, compared to much higher percentages in other Southeast Asian countries with significant Muslim populations. Even gathering baseline statistics is difficult, and the government is not sure of the number of Muslim children enrolled in *madaris*. Estimates are presently set at 14 percent of all schoolchildren in Mindanao. Since Muslims make up only 19 percent of the province's population, it is likely that a majority of the Muslim children attend *madaris*.

After September 11, U.S. assistance to the Philippines included English-language training and instruction for a small number of *madaris* in such areas as democratic principles and the rule of law. These programs have met with mixed reactions from Philippine Muslims, and some Muslim clerics have charged that their purpose is to undermine religious instruction in the schools.

The issue of Islamic education demonstrates that many of the problems which encourage separatism in the southern Philippines are impossible to divorce from economic conditions among Muslims. Indeed, the first major armed opposition to the central government in the post-colonial era—the Moro National Liberation Front (MNLF)—was grounded in discontent over the effects of Christian migration into Mindanao. The MNLF's negotiations with Manila for a ceasefire and the establishment of an Autonomous Region of Muslim Mindanao (ARMM) brought partial peace to Mindanao. However, the negotiations, as well as the government's failure to follow through on the agreement, encouraged the development of splinter groups from hardline MNLF factions. These spinoffs included the Moro Islamic Liberation Front and the Abu Sayyaf Group, both of which launched insurgencies against the government.

The ASG has become one, but not the only, focal point in Philippine and U.S. counter-terrorism efforts. Manila aims to eradicate it and does not offer the group legitimization through autonomy.

The MILF presents a more complicated picture. It is an example of the current intersection of separatism and terrorism in the Philippines, and, more broadly, in Southeast Asia. However, the Philippine government is negotiating with the MILF, although discussions paused during the elections. The United States has offered to provide \$30 million for the peace process, including assistance to help reintegrate former MILF forces into broader Mindanao society after a durable peace agreement has been concluded. Washington has also warned the MILF that it must break ties with the Jemaah Islamiyah and other foreign terrorist groups. The United States is providing military assistance to upgrade the Armed Forces of the Philippines' counterterrorist capabilities; if a peace accord is not reached, Washington may need to step up such assistance.

If the JI is a complicating factor in the negotiations, it also adds urgency. The presence of foreign extremist networks in Mindanao, including Al Qaeda and the JI, have intensified the divisions and stakes there. Despite the influence of the JI and other Islamists who advocate the creation of a pan-Islamic state in Southeast Asia, there is little possibility that Mindanao will secede from the Philippines. However, unless Mindanao is integrated more successfully into the Philippine nation, the country will pay a price in terms of security and resulting economic loss.

Recommendations

- 1) The United States should urge the new administration to continue negotiations with the MILF, and it should stress the need for a serious approach to autonomy, ancestral domain, and resource allocation in the negotiations. Washington should make clear that U.S. assistance for the peace process is not permanently earmarked and that it could be lost if progress is not forthcoming. The United States should offer to provide technical expertise on the settlement of ancestral domain issues or similar territorial claims.
- 2) The United States should prepare for a splintering of the MILF if an agreement is reached by increasing U.S. counterterrorism assistance to the Philippines. This applies to the front group for the Communist Party of the Philippines, the National

Democratic Front, as well. This phenomenon of “splittism” could produce echo insurgencies or conflicts, albeit on a smaller scale, for several years.

- 3) The United States should encourage the Philippine government to make every effort to help the ARMM succeed with continued support for the autonomous region. Although the peace terms with the MILF are still to be determined, the ARMM is a symbol of Manila’s seriousness about honoring its agreements with separatist groups. More important, the ARMM contains a significant portion of the Moro Muslim community. It would be a mistake to assume that all issues with the MNLF are fully resolved, and that the success of the ARMM is assured. Continued attention and economic support are important for two reasons. First, they will guard against backsliding in the MNLF; the faction could return to insurgency if autonomy fails. Second, a thriving ARMM can provide a general (but not exact) model for an autonomous region under MILF leadership.
- 4) The United States should continue to support the Philippine government’s policy of eradicating the Abu Sayyaf, rather than negotiating with it, through assistance to the military and police.
- 5) In supporting Muslim education in Mindanao, the United States should take a developmental rather than a political approach. Islamic schools have become a focus of attention in U.S. policy because of their potential to harbor terrorists and spread radicalism to new generations. However, they are more at risk of creating extremists not through the spread of radical ideology but by limiting their futures. Assistance should provide academic and vocational instruction, including English-language training, but care should be taken to avoid the appearance of sending political messages through this aid. Assistance should be presented as an economic-development rather than a counterterrorism program. To avoid stirring resentments, this secular curriculum should be offered as a companion to the religious curriculum, rather than a replacement of it.

- 6) U.S. assistance should also be provided to enable administrators and faculty of *madaris* to examine models of Islamic education in other Southeast Asian countries. For example, Indonesian *pesantrens* have useful experience in blending secular and religious curricula, as well as in developing religious institutions of higher education.

- 7) The United States should encourage the Philippines in its efforts to obtain observer status in the Organization of the Islamic Conference (OIC). The government is presently in negotiations with the OIC for observer status as a Muslim-minority country. Participation in the OIC will send a positive signal to Filipino Muslims and to the Islamic world that the Philippines views Islam and Moro culture as essential to Filipino national identity.

STRENGTHENING SECURITY

The Philippines has a broad slate of security issues. These range from concern over aggression by China in the South China Sea; to the need to counter terrorism through law enforcement and other means; to better protection for citizens from widespread crime. The threat presented by conflicting claims over the oil-rich Spratly Islands is diminished with the negotiation of a “code of conduct” between ASEAN and China. Although non-binding, negotiation of the document enabled the two sides to discuss and acknowledge their concerns. Beyond lowering the temperature in the region on this issue, the “code” led to discussions between Beijing and Manila on joint development of oil resources on the islands in dispute between the two nations.

Transnational threats—narcotics, human trafficking, and especially illegal small arms trade—are a continual drain on the government and raise corruption levels. Illegal trade in small arms is part of a broader trafficking problem in Southeast Asia, much of which transits Thailand, but the Philippines is a magnet for illegal arms because of its multiple internal conflicts. Beyond supporting insurgencies, the profusion of small arms raises levels of political and personal violence and endangers ordinary citizens.

To this crowded list must also be added new threats. A growing concern for the insular states of Southeast Asia is the increase in piracy and other maritime crimes in the South China Sea and the Straits of Malacca. Sixty-six percent of attempted and actual piracy attacks in the world occur in Southeast Asia. The problem is encouraged and exacerbated by lax port security, particularly in Indonesia and the Philippines, and national navies that lack coast guard training. Roughly 70 percent of pirate attacks occur in ports rather than on the open seas. Here too corruption is a factor. Many maritime officials are underpaid, and they can often be bribed for information about ships and cargoes. Moreover, a large amount of maritime certificate fraud takes place in the Philippines and Indonesia, which could deliberately or unwittingly aid a terrorist attack.

At the center of many security concerns in the Philippines is the need to further professionalize the Armed Forces of the Philippines, as well as the national and local police. Both forces are underpaid, demoralized and overly factionalized. Counter-terrorism has created competition between the AFP and the National Police. These problems and issues need to be resolved to improve internal security. The Indonesian police were successful in arresting Jemaah Islamiyah operatives responsible for the Bali bombing, with help from Australian police. By contrast, the perpetrators of the Davao City bombings have never been apprehended. Beyond the need to improve detection and arrest records, prison security is often lax, and high-profile arrests are often overshadowed by jailbreaks.

Clearly, no single U.S. initiative can help the Philippines address all these security problems. Three programs are particularly relevant. First, the 2003 Joint Defense Assessment (JDA) for the Philippines and the United States found the Philippine defense establishment weak in a number of areas, such as strategic planning, operations, training, logistics, and acquisition. In the wake of these discoveries, President Arroyo established the Philippine Defense Reform (PDR) program. A U.S.-Philippines PDR steering committee has identified several priorities for multi-year U.S. assistance. Second is assistance to train police, particularly in counter-terrorism. Lastly, the United States is in the process of inaugurating a Regional Maritime Security Initiative for Southeast Asia, and has also proposed several maritime programs through the Asia Pacific Economic Cooperation (APEC) process.

Recommendations

- 1) The United States and the Philippines should continue and expand the Joint Defense Assessment to address concerns about professionalism and modernization of the AFP.
- 2) Priority areas for the next few years include defense planning, staff development, defense budgeting, and modernization. Washington and Manila should, however, guard against assuming that these reforms will be a cure-all for the full range of AFP problems. Issues such as accountability for the military should be addressed through training with International Military Education and Training program funds.
- 3) The Philippines should consider strengthening its existing naval patrol capacity to develop a more robust coast guard. The United States should offer coast guard training and similar assistance to the Philippines under the Regional Maritime Security Initiative.
- 4) The United States should urge the Philippines to strengthen its efforts to intercept illegal small arms. Throughout Southeast Asia, government stockpiles of weapons are one of the leading sources of black market arms. AFP arms, some donated by the United States, have been found in MILF and Abu Sayyaf caches. Increased intelligence sharing on arms flows and programs to destroy excess weapons should also be considered.
- 5) Most important, beyond increased U.S. military assistance, the United States should increase its support for programs to support the professionalism of the Philippine National Police as well as programs to promote community-police relations. This training would touch on several aspects of internal security and improve indigenous and international confidence in the Philippines.

- 6) China and the Philippines should intensify their bilateral efforts to find amicable solutions to disputes over the Spratlys, particularly on joint development of oil resources.

CPA MISSION STATEMENT

The Center for Preventive Action (CPA) seeks to help prevent, defuse, or resolve deadly conflicts around the world and to expand the body of knowledge on conflict prevention. It does so by creating a forum in which representatives of governments, international organizations, nongovernmental organizations, corporations, and civil society can gather to develop practical and timely strategies for promoting peace in specific conflict situations. The CPA focuses on conflicts in countries or regions that affect U.S. interests, but may be otherwise overlooked; where prevention appears possible; and when the resources of the Council on Foreign Relations can make a difference. The CPA does this by:

- *Convening Independent Preventive Action Commissions* composed of Council members, staff, and other experts. The commissions devise a practical, actionable conflict prevention strategy tailored to the facts of the particular conflict.
- *Issuing Council Special Reports* to evaluate and respond rapidly to developing conflict situations and formulate timely, concrete policy recommendations that the U.S. government, international community, and local actors can use to limit the potential for deadly violence.
- *Engaging the U.S. government and news media* in conflict prevention efforts. CPA staff and commission members meet with administration officials and members of Congress to brief on CPA's findings and recommendations; facilitate contacts between U.S. officials and key local and external actors; and raise awareness among journalists of potential flashpoints around the globe.
- *Building networks with international organizations and institutions* to complement and leverage the Council's established influence in the U.S. policy arena and increase the impact of CPA's recommendations.
- *Providing a source of expertise on conflict prevention* to include research, case studies, and lessons learned from past conflicts that policymakers and private citizens can use to prevent or mitigate future deadly conflicts.

CPA ADVISORY COMMITTEE

JOHN W. VESSEY
General, USA (Ret.), Chair

GEORGE A. JOULWAN
General, USA (Ret.); One Team, Inc.

MORTON I. ABRAMOWITZ
The Century Foundation

JANE HOLL LUTE
United Nations

PATRICK M. BYRNE
Overstock.com

VINCENT A. MAI
AEA Investors Inc.

ANTONIA HANDLER CHAYES
Tufts University

MARGARET FARRIS MUDD
Financial Services Volunteer Corps

DANIEL W. CHRISTMAN
Lieutenant General, USA (Ret.);
U.S. Chamber of Commerce

KENNETH ROTH
Human Rights Watch

JOACHIM GFOELLER JR.
GMG Capital Partners, LP

BARNETT R. RUBIN
New York University

RICHARD N. HAASS
Council on Foreign Relations

JULIA VADALA TAFT
United Nations Development Programme

DAVID A. HAMBURG
Cornell University Medical College

STROBE TALBOTT
Brookings Institution

JOHN G. HEIMANN
Financial Stability Institute

ROBERT G. WILMERS
Manufacturers & Traders Trust Co.

About the Author

Catharin E. Dalpino is a former Deputy Assistant Secretary of State in the Bureau of Democracy, Human Rights, and Labor, and now teaches at Georgetown University and The Johns Hopkins University School of Advanced International Studies.

