PHILIPPINE ECONOMIC UPDATE

ACCELERATING REFORMS TO SUSTAIN GROWTH

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Preface

The *Philippine Economic Update* provides a bi-annual update on key economic and social developments, and policies. It presents findings from recent World Bank studies on the Philippines and places them in a longer-term and global context, and assesses the implications of these developments and policies on the outlook for the Philippines. Its coverage ranges from the overall macroeconomy and financial markets to indicators of human welfare and development. The report is intended for a wide audience, including policymakers, business leaders, financial market participants, and the community of analysts and professionals engaged in the Philippines.

The *Philippine Economic Update December 2012* was prepared by Tehmina Khan (Task Team Leader), Marianne Juco (Co-Task Team Leader), Karl Kendrick Tiu Chua (Senior Economist), and Paul Mariano (Research Analyst), under the guidance of Rogier van den Brink (Lead Economist). This report has benefited from comments from World Bank colleagues including Kai Kaiser, Leyla Castillo, Lynnette Dela Cruz Perez, Motoky Hayakawa, Nazmul Chaudhury, Keiko Kubota, Victor Dato and Shubham Chaudhuri. The following contributed to the special focus sections: Alan Townsend for Mindanao Power Crisis, Hanif Rahemtulla and Rogier van Den Brink for Open Government/Open Data and Tehmina Khan for BPO in the Philippines. The task team acknowledges data contribution from the Business Processing Association of the Philippines for the special focus on the BPO industry.

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For information about the World Bank and its activities in the Philippines, please visit www.worldbank.org/ph.

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Executive Summary

The Philippine economy has emerged as one of the fastest growing economies in East Asia, with growth accelerating to 7.1 percent in the third quarter. Higher economic growth was driven by the strong performance of the construction sector, buoyed by robust private consumption and the recovery of government spending. The acceleration of domestic demand since the first quarter of 2012 reflects the country's strong macroeconomic fundamentals, stronger government finances, and high confidence in the Aquino government's commitment to reform. Sound macroeconomic fundamentals, as seen in low inflation, and large current account surpluses and foreign exchange reserves, have continued to shield the economy from external headwinds, while a more diversified export basket allowed total exports to grow, despite the decline in electronics exports. Overall, the economy is expected to expand by over 6 percent this year, up from 3.9 percent last year.

Nonetheless, weak global activity and an uncertain global economic outlook pose downside risks. Although global financial market tensions have eased since the third quarter, growth and employment in high income countries remain subdued. Growth in China, the region's powerhouse, is showing signs of having bottomed out, but is not expected to continue at the previously high rates, while the limits of its investment-led growth model could be tested going forward. In addition, the boost to exports from Japan's recovery is unlikely to be repeated. Meanwhile, growth in remittances has slowed over the past year and could decelerate further if the recession in Europe continues and the nascent United States economic recovery is undermined by fiscally-induced contractions. Resurging capital inflows also pose a challenge, given rising credit growth and booming construction activity.

Strong domestic demand should hold up growth at around 6 percent in the near term, if the reform momentum is enhanced. Several reforms have successfully started, notably in public financial management, anti-corruption, and tax policy. The recently passed tobacco and alcohol excise tax reform bill is estimated to yield nearly 0.4 percent of GDP in revenues earmarked for the universal healthcare program. And higher public infrastructure spending, combined with rising private sector investment, should push the country's investment-to-GDP ratio to around 24 percent in the coming years, boosting potential growth.

However, more structural reforms are needed to create more and better jobs, as the overall labor market outcome has been less responsive to the higher economic growth. The economy needs to shift from consumption towards investment, both public and private. Sectorally, this translates to less dependence on low-wage and low-skill services and more on labor-intensive manufacturing and high value services, underpinned by rising productivity in agriculture. These will require implementing difficult policy reforms in agriculture, manufacturing, business and labor regulations, and social protection, which would raise the incentives for entrepreneurship and job creation. Underpinning these reforms would be greater public investment in health, education, and infrastructure. Implementing this strategy would allow the Philippines to take full advantage of opportunities arising from the global economic rebalancing, including rising production costs in the rest of the region.

The nature of the country's political and economic institutions, with strong vested interests in the status quo, has made such reforms often difficult to undertake historically. However, the current administration's track record suggests that it does not shy away from making difficult choices in the interest of pursuing a more inclusive growth path. This difficult context, however, does challenge the government to prioritize its reform efforts wisely, with an emphasis on those economic and social reform efforts which also change the country's institutions towards more inclusion. The Special Focus sections of this update demonstrate that the implementation of such reforms can have high payoffs in terms of jobs and inclusive growth. For instance, the earlier opening up of the telecoms sector has now led to a world-class business process outsourcing industry. In Mindanao, investing in power infrastructure now is essential to avert a looming power crisis and lower input costs to firms. Finally, by scaling-up and broadening several open government/open data initiatives in the country, the strengthening of inclusive institutions would be greatly enhanced, in line with the core principles of this government.

Recent Economic and Policy Developments

Output, Demand and Employment

1. **In contrast to other major economies in the region, GDP growth accelerated in the Philippines in the third quarter, making it one of the fastest growing economies in East Asia** (Figure 1). In the third quarter of 2012 (3Q2012), the economy expanded by 7.1 percent year on year (y-o-y) following a 6.0 percent outturn in 2Q.[1] Growth rebounded considerably compared to last year, when it fell to 3.9 percent due to sharp contractions in electronic exports and public spending. The acceleration of domestic demand since the first quarter of 2012 reflects the country's strong macroeconomic fundamentals, which have shielded the domestic economy from persistent global economic weakness, stronger government finances, and high confidence in the Aquino government's commitment to reform. Average growth in the first three quarters of 6.5 percent suggests that overall growth for the year as a whole is likely to be higher than 6 percent, above the government's 5-6 percent budgetary growth target.

2. **Higher economic growth in 3Q was driven by the strong performance of the construction sector and recovery of government spending.** Construction grew by 24.8 percent, its fastest pace in nearly two years, and contributed 1.9 percentage points (ppt) to GDP growth. Private construction grew by 25 percent as demand for office and residential buildings increases with the rapid growth of the business process outsourcing (BPO) industry and the low interest rate environment. Growth in public construction (i.e., infrastructure) was equally impressive although this reflects more the recovery of infrastructure spending from last year's slump (i.e., the base effect) rather than new infrastructure spending. And investment in durable equipment which accounts for nearly 45 percent of fixed capital formation declined by 2.4 percent (Figure 2), pulling down overall investment growth to 8.7 percent from 11.8 percent in 2Q.

3. **Government consumption grew by 12 percent**. This was up from 6.8 percent in 2Q, contributing 1.2 ppt to growth following the release of the fourth tranche of the government-wide salary increase and an acceleration of government disbursements for program and project implementation, notably in social services.[2] As in previous years, private consumption, supported by large inflows of overseas worker remittances, continued to underpin overall growth. It grew by 6.2 percent y-o-y in 3Q and contributed 4.3 ppt to overall growth (Figure 3).

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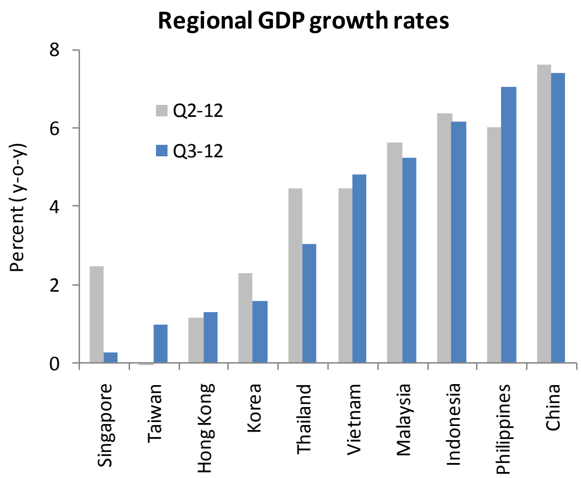
[1] Growth in the second quarter was revised upward from 5.9 percent. Growth in the third quarter must be tempered by the fact that statistical discrepancy explains 1.4 ppt of the 7.1 percent growth. This suggests that either third quarter growth will be revised downwards or fourth quarter growth will be lower by around two percentage points as statistical discrepancy is zeroed out in the full year growth statistic.

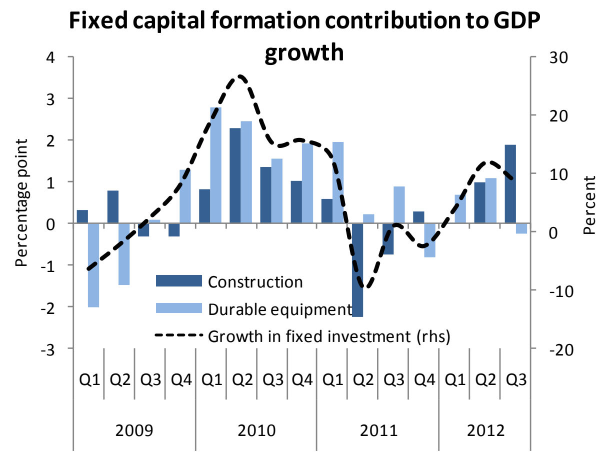
[2] Higher budgetary allocations in agriculture, health, and education account for the bulk of the increase in government spending on maintenance and other operating is rapidly expanding, its contribution to GDP growth is still miniscule (at less than 0.01 ppt) given its relatively small amount (PHP40 billion) relative to the size of the economy (PHP10 trillion).

Figure 1. The Philippine economy was one of the fastest growing economies in East Asia in the third quarter.



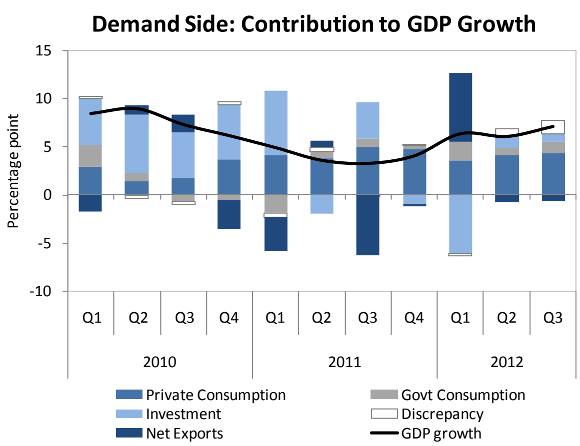
Source: Haver Analytics

Figure 2. Weakness in investment in durable equipment was offset by strong growth in construction.



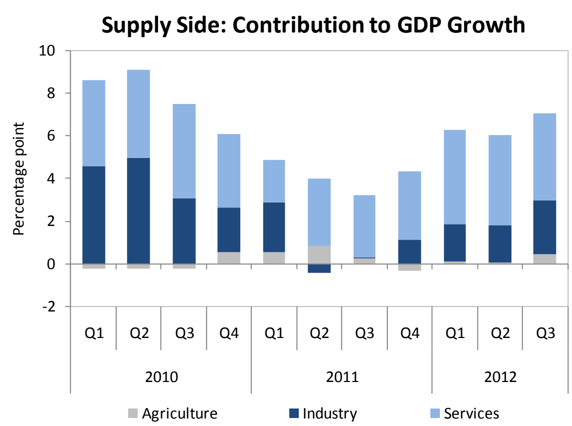
Source: National Statistics Coordination Board (NSCB)

Figure 3. Growth was sustained by strong private consumption, public spending and investment.



Source: NSCB

Figure 4. Growth in the services sector, the key driver of the economy, remained resilient while manufacturing and agriculture also picked up.

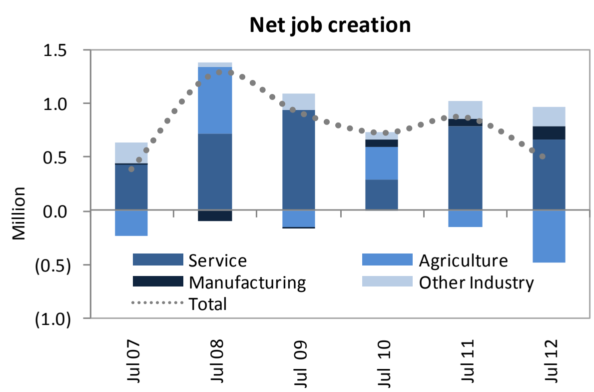


Source: NSCB

4. **A more diversified export basket allowed overall exports to grow despite the decline in electronics exports.** Exports have recovered from last year's slide mainly supported by growing demand for non-electronics and service exports. Despite weak off-shore demand for electronics, exports rebounded strongly this year, growing by 6.9 percent in 3Q reflecting rising shipments of non-electronics exports (mostly to Japan) and buoyant services exports growth. However, equally strong growth in imports of 8.6 percent, mostly fuel, consumer goods, industrial machinery and transport equipment resulted in a negative growth contribution of net exports at -0.7 ppt.

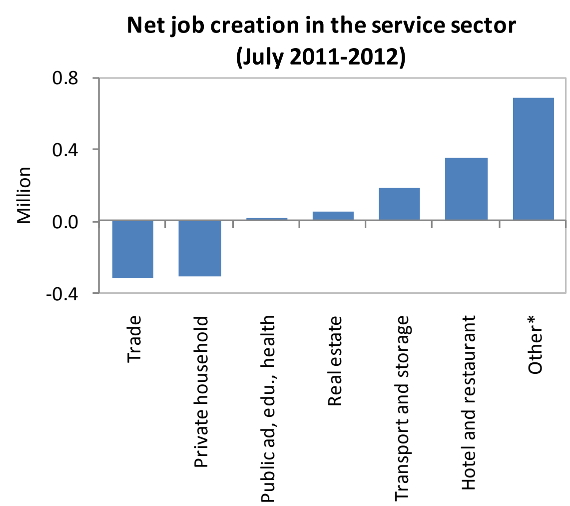
5. **On the production side, a resilient services sector propelled growth, while manufacturing and agriculture also expanded at a faster pace.** The services sector posted 7.0 percent growth (y-o-y), contributing 4.1 ppt to GDP growth in 3Q (Figure 4), bolstered mainly by the trade sector, and real estate, renting and business sector (which includes the fast growing BPO industry). Despite the weather disturbances from typhoons and monsoon rains, agricultural growth accelerated from 0.6 in 2Q2012 to 4.1 percent, with rising production of major crops (*palay*, corn, coconut and sugarcane) and livestock and poultry farming largely offsetting the decline in fishing output. The fishing industry, which was already suffering from a depletion of fishing stocks, continued to contract due to fishing bans in the West Philippine Sea. Output in the industrial sector expanded by 8.1 percent from no growth last year. Manufacturing, which accounts for two-thirds of industrial output benefitted from a rebound in exports, growing by 5.7 percent in 3Q.

Figure 5. Net new job creation in July fell to its lowest level since 2007.



Source: National Statistics Office (NSO)

Figure 6. Sectors characterized by high informality have shed jobs…



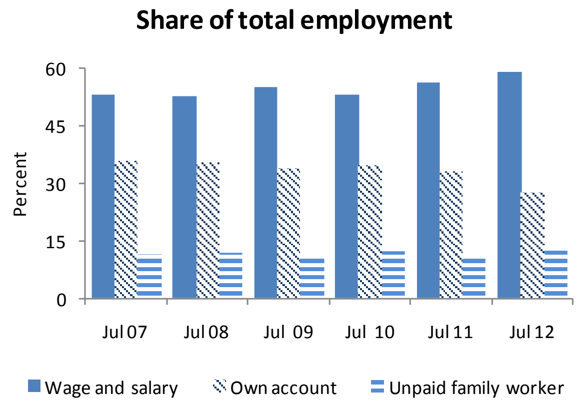
Source: NSO
Notes: *"Other" is a residual category that includes personal service activities. Informal jobs are comprised of self-employment or unpaid jobs in family enterprises.

6. **Strong growth translated to a reduction in informal jobs[3], although unemployment rates remain high.** Sectors characterized by high informality have shed jobs. Agriculture which struggled to expand in the first half of the year, shed some 0.5 million jobs between July 2011 and 2012 (Figure 5). While this was offset by increases in jobs in manufacturing and services, the net addition of 0.5 million jobs is the lowest level of net job creation since July 2007. Within services, wholesale and retail trade and private household sectors, also characterized by high informality, have shed some 0.6 million jobs (Figure 6). Consequently, the share of formal employment (wage and salaried workers) rose to 59.1 percent, a 3 ppt improvement from last

[3] This comprises self-employment or unpaid jobs in family enterprises.

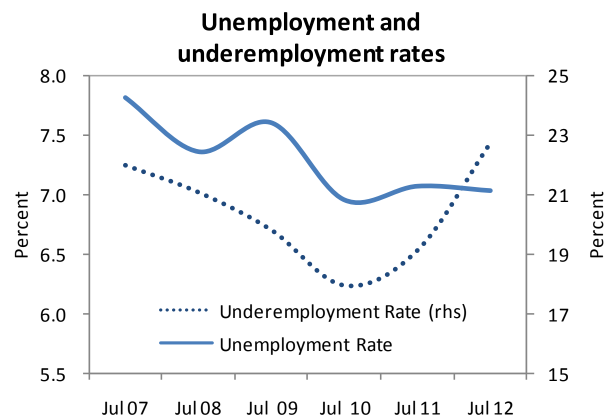
year (Figure 7) mostly from manufacturing, hotels and restaurants, and other services. Overall labor outcomes, however, have been less responsive to growth. The unemployment rate has stayed stubbornly high at 7.0 percent (Figure 8) while the underemployment rate rose to 22.7 percent as the number of full-time[4] jobs declined by 500,000 in the same period.

Figure 7. … which has led to an increase in the share of formal jobs in total employment.



Source: NSO
Notes: Informal workers comprise own account and unpaid workers employed in family businesses

Figure 8. Unemployment remains high.



Source: NSO

External Accounts

7. **The country's external position remained healthy, helped by a rebound in merchandise exports and robust remittances.** The balance of payments remained in surplus in 2Q equivalent to 2.8 percent of GDP on a four-quarter rolling sum basis (Figure 9). However, this was lower compared to previous quarters (i.e. the BOP surplus for 2011 amounted to 4.5 percent of GDP). It reflected outflows due to debt service repayments on public sector debt and the easing of capital inflows in 2Q attributable to global financial market tensions stemming from the Euro Zone crisis. The current account surplus remained slightly above 3 percent of GDP, thanks to a narrower trade deficit due to the strong rebound in goods exports and buoyant remittance receipts equivalent to around 8 percent of GDP.

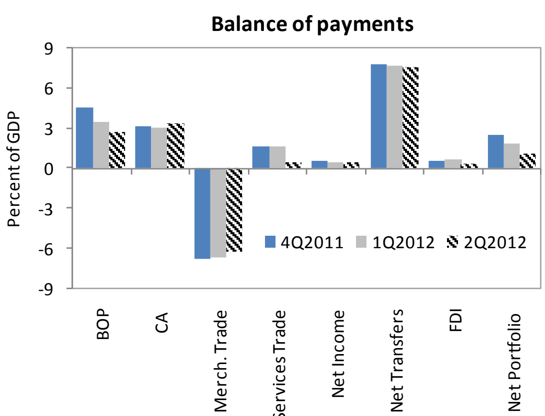
8. **Merchandise exports through September were held up by improving demand for non-electronic goods.** Merchandise goods exports grew by 22.8 percent (y-o-y) in September, the strongest since December 2010 and the highest in the East Asian region. On a year to date basis, growth was around 8 percent compared to the 5 percent (electronics-led) contraction during the same period of last year. The G-3 is a key destination for Philippine exports compared to Indonesia, Malaysia and Thailand (Figure 10), and weak domestic demand there

[4] This is characterized by 40 hours or more of work in a week.

has led to sharp contractions in electronic exports over the past year (Figure 11). With the North American book-to-bill ratio[5] continuously deteriorating since March, a recovery in electronic exports does not appear to be in sight. However, diversification towards non-electronic goods and rising shipments to Japan has helped to offset weakness in electronic exports. Non-electronic exports, which constitute nearly 55 percent of total merchandise exports[6], rose by 35.5 percent in September, led by growing demand from Japan. Japan has become an increasingly important export destination (Figure 12) and demand over the past year, notably tuna, metal components, food, woodcraft and furniture has been boosted by the country's recovery from the tsunami and earthquake in 2011.

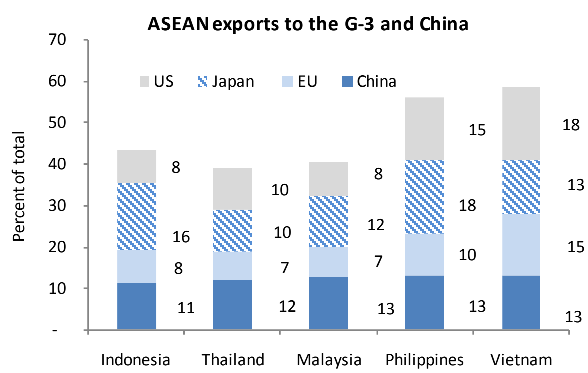
9. **Weak growth in merchandise imports helped constrain the trade deficit in 3Q** (Figure 13). In USD terms, merchandise imports grew by 3.6 percent y-o-y in September and by 0.5 percent on a year to date basis. Combined with robust growth in exports, this has helped constrain the trade deficit to USD 5.9 billion in the year to September (compared to USD 8.2 billion a year ago). Weakness in import growth mainly reflects negative base effects arising from a sharp expansion in imports last year and weak demand for inputs used by the semiconductor and electronics industry. Imports of capital goods, however, increased by 13.7 percent y-o-y through September, with industrial machinery and equipment rising by 10 percent. Growth in consumer goods imports remained strong, growing by an average of 6.1 percent through September, reflecting the strength of private domestic demand in the Philippines.

Figure 9. External balances remain healthy helped by strong exports and remittances.



Source: *Bangko Sentral ng Pilipinas* (BSP)
Notes: four-quarter rolling sums reported

Figure 10. The G-3 is a key destination for Philippine exports.

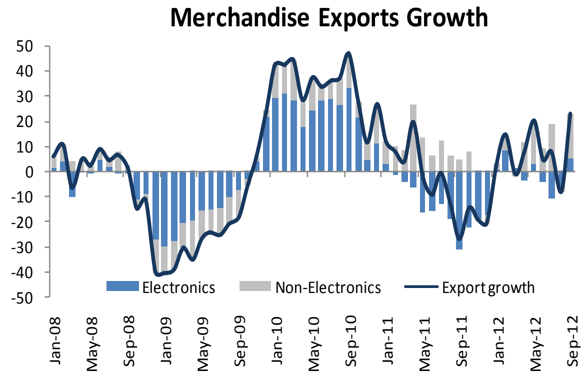


Source: International Monetary Fund (IMF) Direction of Trade Statistics
Notes: Data for first six months of 2012

[5] The Book-to-Bill report from Semiconductor Equipment and Materials International (SEMI) tracks the billings (shipments) and bookings (orders) worldwide of North American headquartered manufacturers of equipment used to manufacture semiconductor devices.

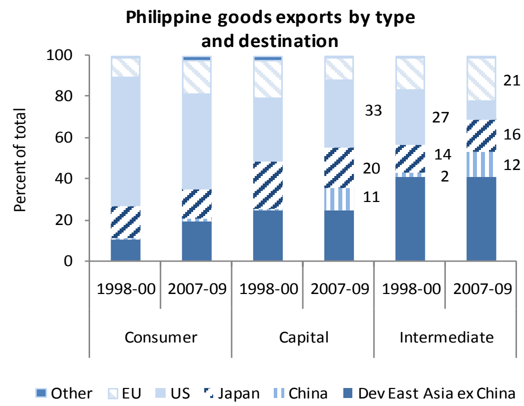
[6] The share of non-electronics to total exports has risen considerably from a share of 48 percent in 2011, and only 37 percent in 2010.

Figure 11 Weakness in electronics exports was offset by diversification towards non-electronic goods…



Source: NSO

Figure 12. … mostly to Japan, an important destination for capital and intermediate exports.



Source: IMF Regional Economic Outlook (2011)

10. **Remittance inflows remained robust, although the pace of growth eased compared to last year.** In nominal dollar terms, remittances in 3Q amounted to USD5.4 billion, an increase of 6.3 percent (y-o-y) (Figure 14). Growth was particularly strong in August (y-o-y) as overseas Filipinos increased the amounts remitted home in the wake of monsoon rains and flooding earlier that month. Receipts from Europe, which account for 16 percent of the total, rebounded in the same month, following 8 consecutive months of declines, despite the persistent debt crisis in the region (Figure 15). This was mainly due to a recovery in inflows from sea-based workers in the region. Demand for skilled Filipino workers remained strong with a 4.2 percent y-o-y increase in deployment in the first half.

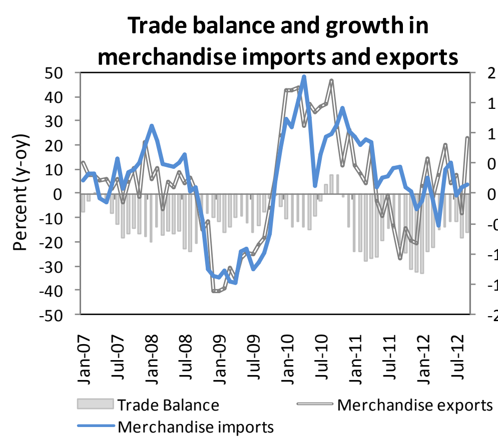
11. **Stable remittance inflows reflect the large number of Filipinos employed overseas, as well as their occupational and geographical diversity** (Figure 16). The Philippines is the fourth largest remittance recipient in the world, and an estimated 10 million Filipinos (25 percent of the labor force) are deployed overseas across a range of occupations.[7] Among land based workers, the Middle East accounts for nearly 44 percent of jobs and about 15 percent of total remittances, although this is likely to be an underestimate.[8] Sustained inflows from these workers have boosted current account surpluses, supported domestic consumption in the Philippines, and shielded the economy from persistent weakness in the global economic environment in recent years. Over the longer term, with populations ageing in developed countries, employment opportunities for overseas Filipinos are likely to grow even more. However remittances also pose challenges in terms of Dutch Disease effects, and the

[7] See Box 2 of World Bank (2011), Philippine Quarterly Update (June), for detailed analyses on the pattern of overseas employment during the global financial crisis.

[8] The US is the largest source of remittances, accounting for 43 percent of the total on a YTD basis in September, although this likely overestimates the true amount due to the fact that remittances from other regions are routed through US financial institutions.

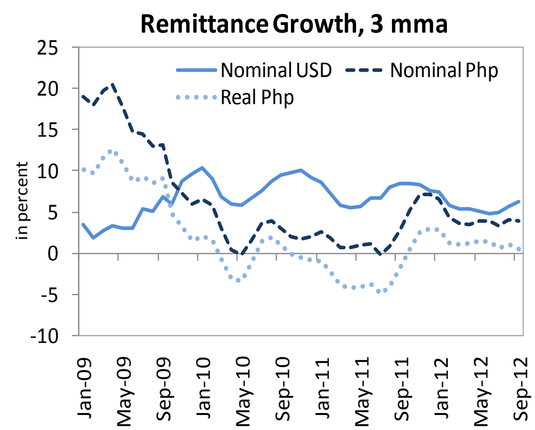
competitiveness of the economy. Preliminary findings from a World Bank study[9] investigating the impact of out-migration and remittances, found evidence of Dutch Disease effects in the form of an appreciation of the long-run real exchange rate and of lower supply of labor by members of households with overseas workers, possibly reflecting higher reservation wages[10]. In addition, Philippine firms were relatively reluctant to invest in training, citing the inability to internalize the benefits of training, possibly owing to the high international mobility of workers.

Figure 13. Slower import growth relative to exports helped restrain the trade deficit.



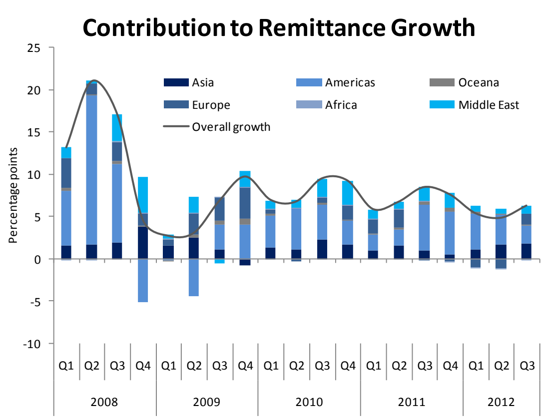
Source: BSP

Figure 14. Growth in remittances remains stable, albeit slowing.



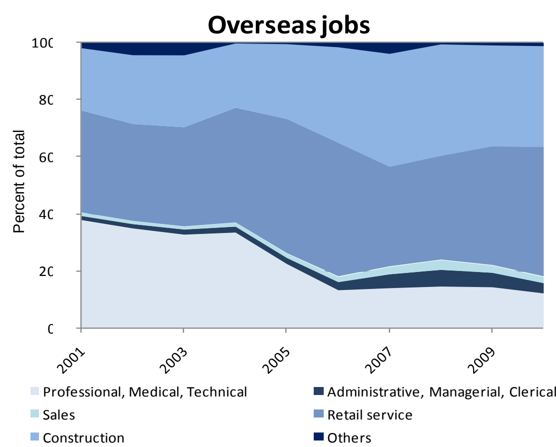
Source: BSP

Figure 15. Remittances from Europe have rebounded despite the ongoing debt crisis.



Source: BSP

Figure 16. Continued inflows likely reflect the diverse jobs held by overseas Filipinos.



Source: Philippine Overseas Employment Agency (POEA)

12. **Beginning the second half of 2012, foreign portfolio investment (FPI) and foreign direct investment (FDI) inflows increased following recent credit rating upgrades and an**

[9] World Bank (2012), "The Impact of Migration and Remittances on the Philippine Labor Market," preliminary.
[10] The minimum wage levels at which they are willing to work

easing in global financial market tensions (Figure 17). Net FPI inflows of from July to October stood at USD1.8 billion, triple of the registered net inflows in 1H2012 following S&P's and Moody's upgrade of the country's sovereign credit rating, the announcement of the European Central Bank's bond buying program and the Fed's third round of quantitative easing beginning 2H2012. The top destinations for FPI inflows were the bond and the equity markets. Foreign direct investment inflows increased to USD1.1 billion through September (from USD782 million in the same period last year) and were directed towards the manufacturing, real estate, trade, finance and mining sectors. Compared to other East Asian countries, Philippine FDI inflows have been considerably smaller, owing to the country's weak investment climate, including restrictions on foreign ownership in several sectors (refer to Box 2 of the March 2012 Philippine Quarterly Update for more discussion).

13. **The sustained influx of remittances and portfolio investments pushed gross international reserves (GIR) to record highs, and has put pressure on the peso to appreciate.** Preliminary GIR in October reached another record-high of USD82.1 billion (Figure 18), 31 percent higher than the country's outstanding external debt of USD62.5 billion in June[11], and could cover a year's worth of imports or 6.6 times the country's short-term external liabilities by residual maturity. GIR continued to rise despite outflows due to payments for the public sector debt service and losses from the revaluation of BSP's gold holdings with the decline in gold prices. Higher demand for Philippine bonds and equities has put greater pressure on the peso to appreciate. The exchange rate strengthened further to PHP40.8/USD at the end of November, its lowest level since 2008, and an appreciation of 6.9 percent since the start of the year. The *Bangko Sentral ng Pilipinas* (BSP) remains poised to implement open market operations and easing policies to limit adverse impacts of the peso's appreciation on exports and remittance-receiving households.

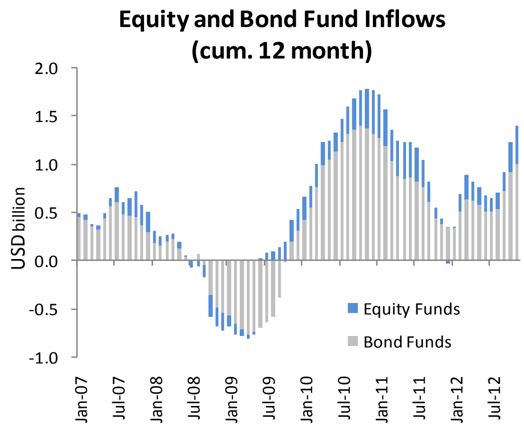
Financial Markets

14. **Philippine bonds and equity markets benefited from interest rate differentials, risk aversion in advanced economies, and the positive outlook for the Philippine economy**. Emerging market equity funds recorded some USD359 million worth of inflows into the Philippines in the year to November, compared with net outflows of USD29.6 million during 2011 (Figure 18)**.** Bond market inflows have also surged, while sovereign bond spreads have narrowed to 121 basis points (bps) from a high of around 300 bps last year. This, together with strong market liquidity, has enabled the government to reduce its borrowing costs as reflected in recent Treasury bill auctions in early November. Short-term rates such as the 91-day T-bill fell to a low of 0.15 percent from 0.3 percent in end-October (Figure 19). Meanwhile, capital inflows have driven equities even higher. Net foreign purchases, which amounted to a cumulative of PHP85.2 billion since January (1.5 times higher than last year), helped push the

[11] Latest available data

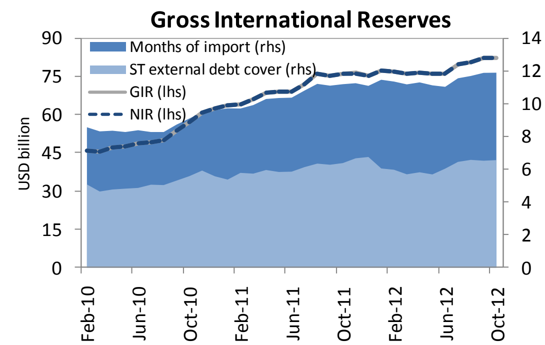
Philippine Stock Exchange index (PSEi) towards another record high of 5,534 points in mid-November (Figure 20).

Figure 17. As global financial market tensions have eased, capital inflows have rebounded.



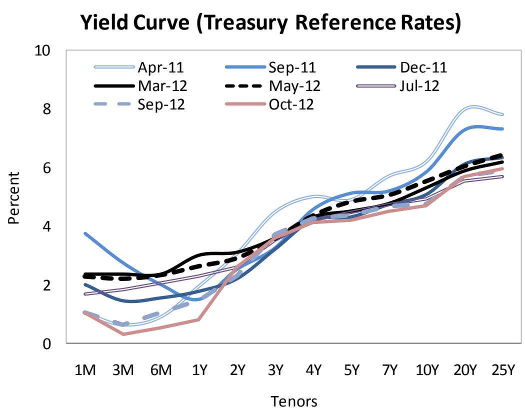
Source: Haver Analytics

Figure 18. GIR climbed to new highs supported by remittances and net portfolio inflows.



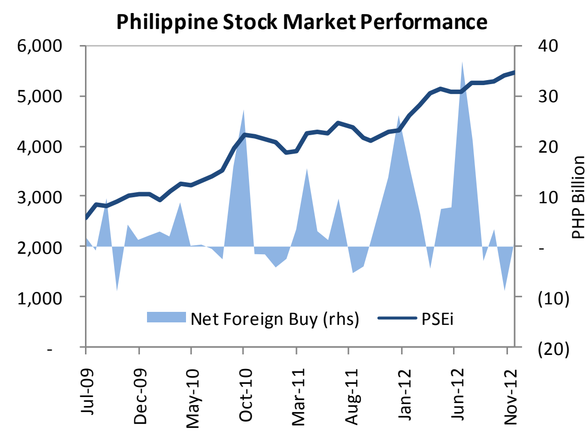
Source: BSP

Figure 19. Treasury yields have declined substantially across the term structure.



Source: Philippine Dealing & Exchange Corp. (PDEX)

Figure 20. Overseas investors have helped push the PSEi to new highs.



Source: Philippine Stocks Exchange (PSE)

Fiscal Policy

15. **In contrast to last year's slow spending, government disbursements have markedly increased.** Following the reduced level of spending in 2011[12], government spending increased

[12] Government expenditure slowed during 2011 as a review of all existing projects and bids in government agencies was undertaken to increase spending efficiency and reduce corruption. Refer to Box 3 of the July 2012 Philippine Quarterly Update for the early results of the DPWH transformation program.

this year as allotments were released at a faster pace. Fiscal spending through October was 15 percent higher than last year. Notable increases were seen in infrastructure and capital outlays, up by 27 percent to PHP224 billion, as key infrastructure projects were rolled-out more speedily. Maintenance and other operating expenditures (MOOE) increased by 39 percent y-o-y to PHP191 billion, financing the coverage expansion of the conditional cash transfer (CCT) program or the *Pantawid Pamilyang Pilipino* Program under the Department of Social Welfare and Development, routine maintenance projects of the Department of Public Works and Highways (DPWH), and major programs of the departments of agriculture, environment and health.

16. But with outlays well below the budgeted amount and strong revenue growth, there remains considerable room to expand spending further. Despite the increase in the pace of disbursement, total spending in the first ten months was equivalent to only 75 percent of the programmed PHP1.8 trillion for the full year.[13] In addition, earlier improvements on tax administration and collection are bearing positive results: total revenue collections for the year till October registered at PHP1.25 trillion (GFS basis), (11.7 percent of projected full year GDP) and up by 12 percent from last year. As a result, the budget deficit through October has fallen below the target for the year, amounting to 1.2 percent of GDP, significantly below government program of 2.7 percent of GDP for full year.

17. On tax policy, the President signed the excise tax reform bill on tobacco and alcohol, also known as the "sin tax bill", into law, promising higher revenues going forward. The excise tax reform law is estimated to raise PHP34 billion in revenues (0.3-0.4 percent of GDP) in the first year of implementation.[14] The law stipulates a unitary rate of PHP26 per pack levied after 2017 and set a 70-30 burden-sharing between cigarettes and alcohol for 2013-14. The sin tax reform bill is projected to generate around PHP250 billion in the first five years of implementation. Additional revenues from the sin tax bill will be earmarked for the government's universal healthcare program and assistance to tobacco farmers to help them diversify towards other crops. The next tax policy reform to be discussed in the legislature will be the fiscal incentives rationalization bill, which has its main objective to limit redundant incentives and anti-competitive tax breaks and exemptions in order to create a more level playing field.

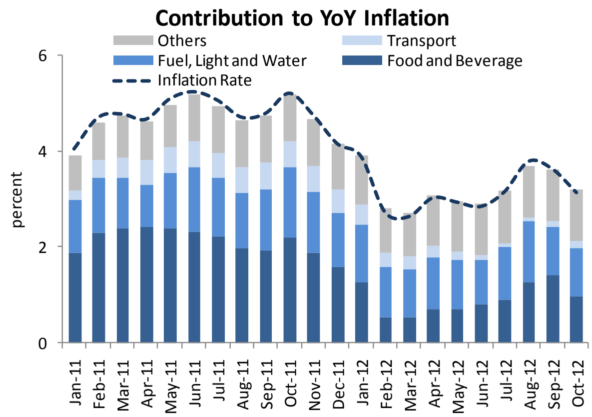
[13] Note that total government spending for 2012 can exceed the programmed PHP1.8 trillion as last year's under-spending (equivalent to 25 percent of the PHP1.7 trillion budget) can be spent this year as continuing appropriations.

[14] This is almost 50 percent lower than the government's original base revenue of PHP60 billion.

Inflation and Monetary Policy

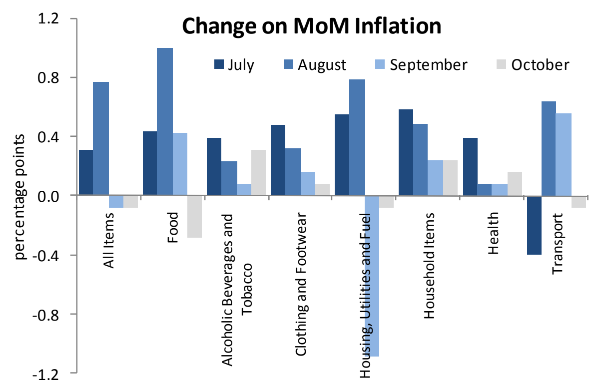
18. **Headline inflation decelerated to 3.1 percent in October after peaking at 3.8 percent in 3Q** (Figure 21). Slow adjustments in food, utilities and fuel, and transport prices helped ease overall inflation in October (Figure 22). Food inflation declined by 0.3 percentage points from September as food supply recovered from the production disruptions caused by the August monsoon rains. Lower international oil prices and an appreciating peso weakened fuel and transportation inflation. Electricity price inflation likewise eased reflecting lower oil prices, despite a worsening power shortage in Mindanao (see the Special Focus section II). Hence, inflationary pressures from non-food items kept year-to-date average core inflation (y-o-y) steady at 3.7 percent. Headline inflation, meanwhile, has averaged 3.2 percent since January, still at the low-end of central bank's target of 3-5 percent.

Figure 21. Inflation remains benign and is at the lower end of the central bank's target…



Source: BSP

Figure 22. … due to slow adjustments in food, utilities, fuel and transport prices.



Source: BSP

19. **With a benign inflation environment, the BSP cut policy rates further to boost domestic demand and to curb speculative foreign exchange inflows.** The BSP, through the Monetary Board, reduced policy rates in July and October by 25 bps each, following the two cuts in January and March. Overnight lending and borrowing rates were reduced to a low of 5.5 percent and 3.5 percent, respectively, representing a cumulative decline of 100 bps for the year. The rate cuts are expected to further boost domestic consumption and investment. Interest rates for special deposit accounts[15] (SDAs) were also cut by a cumulative of 5.5 bps in July. The BSP has been keen on curbing speculative foreign exchange inflows with prompt policy responses this year with the prohibition of foreign funds from investing in SDAs in July, and further cuts in SDA rates and policy rates in October.

[15] An SDA is the central bank's virtual risk free facility which earns 4 percent across all maturities.

20. **With policy rates at record lows, bank lending continued to grow at a steady pace and exposure to the real estate sector increased.** Bank lending grew by 15 percent through July with loans for production activities comprising more than four-fifths of banks' aggregate loan portfolio. However, exposure of banks to the real estate sector reached an all-time high of 15 percent of banks' total loan portfolio in June, from 13 percent last year. Although real estate exposure defined as bank loans to property developers is on the rise, the BSP asserts that these are well below the cap of 20 percent of total loan portfolio. Bank balance sheets remain healthy with non-performing residential and commercial real-estate loans at 4 and 4.8 percent, respectively, both lower than last year.

21. **Overall, the country's economic resilience and solid macroeconomic fundamentals translated to a credit rating upgrade to one-notch below investment grade by all major rating agencies.** Following the earlier rating upgrade of Fitch Ratings' to one-below investment grade last year, Standard & Poor's (S&P) raised the country's long-term foreign currency credit rating to BB+ with a stable outlook in July this year. The rating agency cited the government's debt profile improvement resulting from its fiscal consolidation, and the country's strengthening external position and ample international reserves. Moody's followed suit in late October, raising the country's credit rating to Ba1 with stable outlook and citing the country's improved economic performance, fiscal resilience, stable financial system, and potential to sustain medium and long term growth.

PROSPECTS

Output, Demand, and Employment

22. **Philippine economic growth in 2012 continues to benefit from a stable macroeconomic environment conducive to growth.** The country's macroeconomic fundamentals have been strong and improving in recent years thanks to improving government finances and several reform successes have bolstered private sector confidence in the Aquino government (e.g., tackling corruption, improved transparency and efficiency of budgeting, tax administration and social protection reforms). These have contributed to a buoyant domestic demand supported by growing remittances, a booming business process outsourcing (BPO) industry, and recently strong private investments in construction, in addition to positive base effects from last year's low growth.

23. **Given the strong domestic demand through 3Q, Philippine GDP is expected to grow by around 6 percent in 2012 despite the weak external environment**. Baseline growth projections for the Philippines are at 6.0 percent for 2012 and 6.2 percent for 2013. Consumption, which accounts for 75 percent of GDP, is expected to drive overall growth underpinned by continued growth in remittances and election–related spending[16] in 2013. Meanwhile, the strong expansion of the BPO industry is expected to generate 100,000 new jobs this year[17]. The sector, which has recently overtaken India to become the global leader in providing voice-related services, is expected to remain a major source of job creation in the economy (see Special Focus I). The current account is projected to remain in healthy surplus, supported mainly by remittance inflows and a slight recovery in electronics exports.

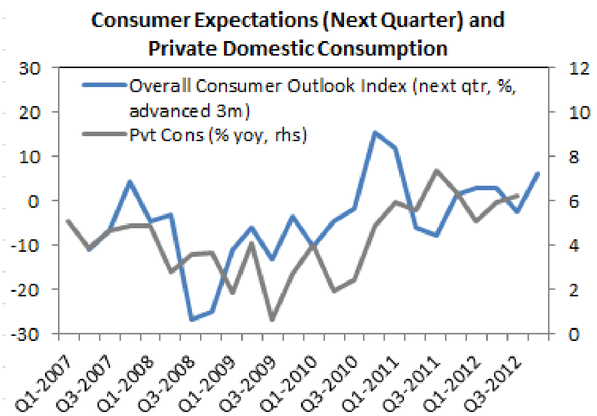
24. **Strong domestic demand should also buoy growth at above 6 percent over the next two years**. Record-low interest rates and election-related spending should remain supportive of growth going into 2013. Meanwhile, private household demand should help sustain growth supported by healthy remittance flows and a positive consumer outlook (Figure 23) while buoyant business confidence also bodes well for investment and future jobs (Figure 24). In the medium term, the Aquino administration is expected to continue rolling out infrastructure projects, and combined with rising private investment, this should help raise the country's investment-to-GDP ratio from 22 percent currently to around 24 percent of GDP by 2015.

25. **Risks to the growth projection mainly stem from the weak and uncertain global economic environment.** The Euro Area and Japan slid into recession earlier in the year, while the nascent economic recovery in the US is at risk of being undermined by fiscally induced contractions unless a compromise on the "fiscal cliff" can be reached quickly. Growth in the BRIC economies has also disappointed over the past year, in part reflecting persistent weakness in the G3. Although the growth slowdown in China is showing signs of having bottomed out, it is

[16] Historical data show that GDP growth rises by around 1 ppt from its long-run average during an election year.
[17] Source: Business Processing Association of the Philippines (BPAP)

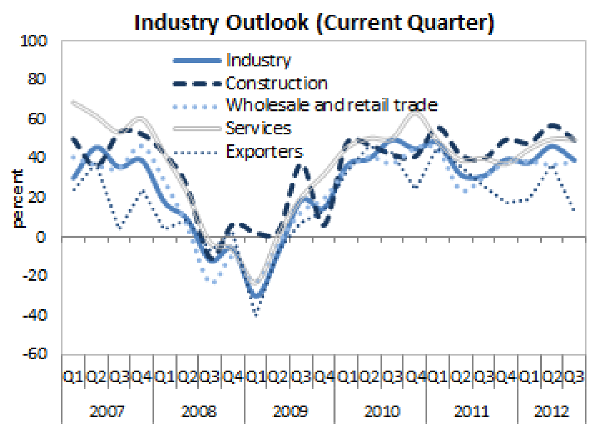
not expected to continue at previous high rates and a possible decline in growth as the investment-led model is unable to sustain the economy's growth momentum. For the Philippines, spillovers from weak external demand should mainly be felt in the manufacturing sector, particularly in employment. However, these should be mitigated by new jobs created in construction and trade as the government ramps up infrastructure spending over the coming year. A subdued global economic environment could also impact remittances, which are growing more slowly than in previous years, although, that said, experience from the 2009 Global Financial Crisis shows that these have tended to remain resilient.

Figure 23. A positive consumer outlook suggests private demand should hold firm.



Source: BSP

Figure 24. Business sentiment also remains positive with the exception of exporters.



Source: BSP

External Accounts

26. **The balance of payments surplus is expected to remain in surplus over the near term given both strong current and capital accounts.** The balance of payments is expected to be resilient, driven by remittances and services export receipts translating to a projected current account surplus of 3.2 percent of GDP in 2012 (from 3.1 percent in 2011). Growth in remittance inflows is expected to moderate to 5 percent this year from 7.2 percent last year mainly resulting from a slowdown in inflows from Europe.[18] Overall though, remittance inflows are expected to remain resilient as was the case in the 2009 global slowdown, although growth could decelerate in case of a deepening global economic downturn. Merchandise exports growth this year can be attributed to Japan's recovery from last year's natural disasters but this is unlikely to repeat. With the industry outlook on electronics exports flat[19] exports are

[18] In particular, from sea-based overseas workers in Norway whose remittances comprise nearly a third of sea-based worker remittances from Europe.
[19] Source: Semiconductor and Electronics Industries in the Philippines, Inc. (SEIPI)

therefore projected to grow at a slower rate of close to 6 percent over the near term – with risks weighted on the downside owing to weak prospects in advanced economies. With government spending ramping up, particularly on infrastructure, and private domestic demand expected to accelerate further, imports are likely to grow at a faster pace than exports, at around 7 percent growth for the forecast period.

27. **An improvement in the investment climate and liberalization should also boost FDI.** The Philippines can take advantage of the regional rebalancing through a re-evaluation and reform of some of its restrictive investment policies. For example, in the region, the Philippines has some of the strictest foreign equity rules in a several sectors.[20] In order to take advantage of foreign manufacturing firms relocating away from China, Japan, and Thailand due to rising costs, and environmental and political risks, the Philippines can re-evaluate its Foreign Investment Negative List (FINL) which contains the equity restrictions of foreign firms with the least restrictive at 60 percent ownership and most restrictive at zero foreign equity, and make it "less negative."[21] Over the longer term, a successful and lasting resolution of the conflict in Mindanao can further improve the business climate through a heightened sense of peace and security in the island. For instance, with the shortage in electricity in the region, and better security, investors in power generation facilities can be attracted to invest there (See Special Focus II).

28. **Large interest rate and growth differentials between advanced economies and emerging economies like the Philippines, and continued monetary easing in advanced economies may drive further capital inflows**. Foreign portfolio inflows are expected to remain strong provided the country's stable macroeconomic prospects and widening interest rate spreads. Emerging Asia including the Philippines will remain as one of the most attractive investment destination for private entities, due to interest differentials and growth prospects. Strong portfolio inflows together with remittance inflows will buoy the country's gross international reserves which are projected at around 11 times the country's import requirements through 2014.

29. **External debt is projected to remain within comfortable levels, declining to around 30 percent of GDP by 2014.** The downward trajectory is attributed to the national government's shift in borrowing strategy from foreign to domestic, increasing the share of local currency borrowing to about 75 percent of total new borrowings in order to reduce exchange rate risks

[20] Source: World Bank's Investing Across Borders 2010 report

[21] For example, no foreign equity is allowed in mass media and practice of all professions (e.g. engineering, medicine, accountancy). Up to 25 percent foreign equity allowed for construction and private recruitment. Up to 30 percent allowed for advertising. Up to 40 percent allowed for mining, ownership of real estate property, utilities, and education. And up to 60 percent allowed for financial and investment companies.

and control the peso's appreciation.[22] Philippine borrowing conditions have also benefited from recent sovereign credit rating upgrades.

Fiscal Policy

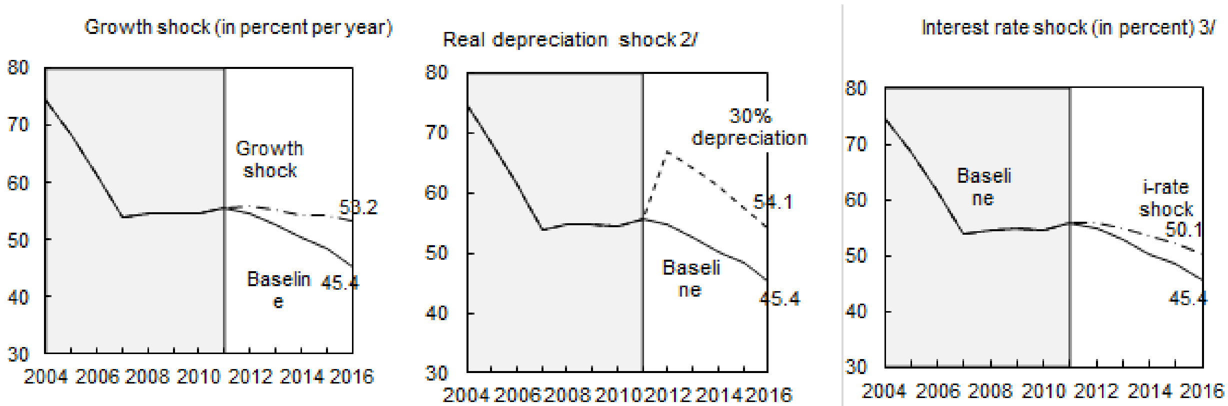
30. **The fiscal deficit is expected to increase modestly in 2012 given higher spending, but should remain within the government's target**. The fiscal deficit for this year is expected to widen to 2.4 percent of GDP from 2.1 percent last year (GFS basis), on account of stronger and more efficient budget execution of the government, and some election spending beginning in the latter part of the year. Raising adequate revenues will be vital to supporting higher spending while keeping the deficit within sustainable bounds. Despite continued revenue mobilization challenges, improvements in tax administration (additional 0.2 percent of GDP) together with additional tax collections from inflation-indexed excise duties on alcohol and tobacco (equivalent to some 0.3 to 0.4 percent of GDP) expected to be implemented next year will help buoy tax revenues to around 14 percent in 2014. Lower interest payments, owing to a combination of lower debt level, a strong peso, and continued low interest rates, are expected to deflate government expenditures moving forward.

31. **Public sector debt sustainability is expected to strengthen further, in part due to continued active debt management by the Department of Finance**. Although debt-to-GDP indicators are high by regional standards, debt ratios have fallen sharply, reflecting prudent debt management and fiscal policies, coupled with the central bank's increasingly solid track record of inflation management. This has allowed for an improvement in the country's debt structure, including lower average borrowing costs, declining foreign currency exposure and a lengthening of average maturities. The country has also accumulated a large buffer of foreign exchange reserves, while an increasingly large Bond Sinking Fund (BSF) [23] has reduced liquidity and rollover risks. Total consolidated non-financial public sector debt-to-GDP ratios and foreign currency debt in particular have fallen sharply and are expected to follow the same trajectory going forward. Standard "deterministic Debt Sustainability Analysis (DSA)," shows national government debt on a downward trajectory with the debt-to-GDP ratio falling to about 45 percent in 2016 (Figure 25), indicative of a sustainable macroeconomic policy environment barring any unexpected or large shocks to the economy (Box 1).

[22]Currently the share of local currency borrowing stands at 60 percent of total borrowing.

[23] Legislation from the 1950s requires the Treasury to establish a bond sinking fund (BSF) sufficient to redeem at maturity domestically issued government bonds. This applies to government bonds with maturity greater than 3 years. Contributions are made into the BSF to allow it to purchase assets to match the liability; and when a particular bond issue matures, the payment of the principal obligation is met from the sinking fund. The assets of the BSF amounted to 773 billion pesos at the end of 2011, equal to 7.9 percent of GDP.

Figure 25. Philippines: public sector deterministic debt sustainability analysis (DSA)1/: national government debt-GDP ratio projections



Source: World Bank staff calculations

Notes: 1/ The shaded areas represent actual data. 2/ One-time real depreciation of 30 percent, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator). 3/ Represents a 1 standard deviation shock to interest rates.

Box 1. Assessing Fiscal Sustainability for the Philippine Economy

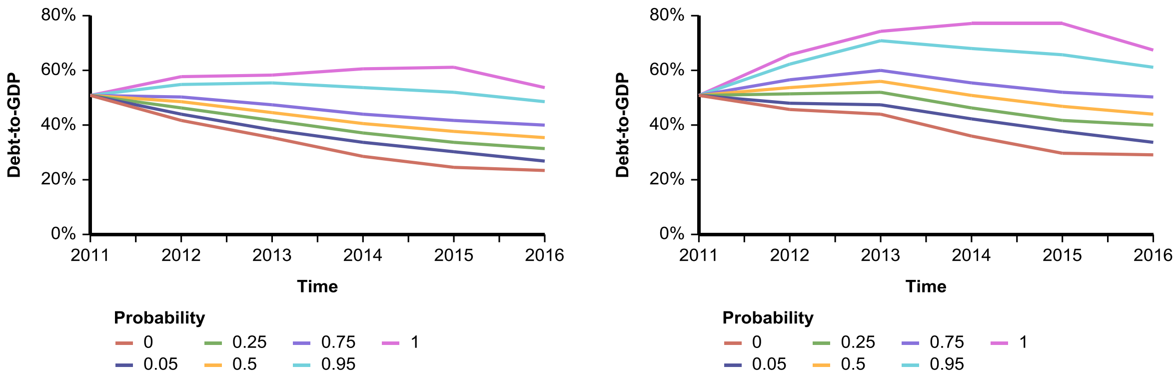
The Philippines has made considerable progress in improving its debt sustainability in recent years through prudent fiscal and monetary policies and active debt management. Total consolidated non-financial public sector debt-to-GDP ratios have fallen from 71 percent in 2006 to 55.7 percent in 2011, while foreign exchange debt has fallen by around 16 ppt to 27.6 percent. Reflecting these achievements, the Philippine sovereign credit rating has been revised up to just one notch below investment grade by Fitch and S&P over the past year, and most recently by Moodys (in October).

Nevertheless, there remain concerns about fiscal sustainability. Aside from exposure to interest and exchange rate shocks and to a slowdown in the global economy, the country remains vulnerable to natural disaster shocks as underscored by heavy flooding in Manila in August. In addition, government-owned and controlled corporation (GOCC) debt is large, amounting to some 13.8 percent of GDP in 2011 and poses risks of contingent liabilities. In addition, there are other contingent liabilities resulting from growing reliance on public-private partnerships (PPPs) and the ramping up of government spending. Compounding these risks, debt-service to revenue ratios are high (53 percent) limiting fiscal space in case of an unexpected revenue/expenditure shock, although it is important to note that a fifth of debt service reflects payments into the Bond Sinking Fund, from which the government can also borrow in case of a severe shock.

Such fiscal risks are more clearly illustrated in the “fancharts” in Box Figure 1.1 which show probability distributions for key debt ratios generated within a stochastic DSA framework. Such a framework helps to assess the risks to fiscal sustainability more clearly than in the deterministic DSA described in the main text, by introducing shocks to the main macroeconomic and financial variables – real GDP growth, real interest rates and real exchange rates – which reflect the pattern of co-movement among these variables over the last two decades.[24] Under baseline scenarios, the fancharts show that there is a 75 probability that the debt to GDP ratio will fall to or below 40 percent in 2016 under the baseline. However in a low probability but high impact catastrophic event such as extremely severe or large natural disaster that also affects the potential growth rate (by destroying capital stock), debt to GDP ratios remain elevated and the probability that the debt to GDP ratio falls below 40 percent is only around 25 percent.

Box Figure 1.1: Philippines: national government stochastic debt sustainability analysis (DSA)1/: baseline vis-à-vis large natural disaster scenarios

Debt to GDP ratio under the baseline scenario | **Debt Service to GDP Ratios under a large natural disaster**



Source: World Bank staff calculations
Notes: The fan charts represent the probability distributions of fiscal and debt outcomes.

The scenario considered above underscores that, despite substantial improvement in debt indicators and fiscal sustainability in recent years, vulnerability to shocks, e.g. to large natural disasters or a severe deterioration in the global economic environment with large spillovers to the Philippines, remains high. It is therefore important to monitor these risks and undertake measures that reduce their likelihood or the associated negative impacts in case they materialize. As part of its efforts to strengthen fiscal sustainability, the government is now publishing an annual fiscal risk statement that identifies priority fiscal risks and mitigation strategies. There has also been sustained effort to improve and strengthen debt management and monitoring of risks. It is worth noting that debt service mostly comprises principal repayments (61 percent) largely for repayment of domestic debt. Accordingly, while high levels of debt service limit space in the near term, the reduction in debt that it achieves (and eventually the decline in interest payments) should help to create more space in the longer term.

[24] The shocks are generated through stochastic or Monte Carlo simulations using a standard joint probability distribution and a covariance matrix estimated econometrically using a vector autoregression model. The stochastic DSA itself is developed using fiscal sustainability analysis tools developed by PREMED in the World Bank, using the Analytica software.

Inflation and Monetary Policy

32. **Headline inflation is expected to remain manageable and within the BSP's target range.** Inflation for the year is projected to remain within the BSP's 3-5 percent target range at 3.5 percent for 2012. Upside risks to inflation include higher global food prices in light of another drought in the United States given that the Philippines imports nearly 75 percent of its total corn stock from the United States[25]. Despite the small share of corn (0.67 percent) in the overall CPI basket, pass-through to headline inflation could be moderate given that 60 to 70 percent of corn supply (both local and imported), is used as feeds for livestock and poultry industries. Growing domestic bank lending activity, higher prices in the global commodities markets especially oil, and higher power rates with the country's looming power shortage[26] (particularly in Mindanao, also see Special Focus 2) are upside risks. In 2013, inflation is forecast higher at 4 percent, on the back of higher domestic demand come election year, and higher energy prices amid renewed tensions in the Middle East. The continued appreciation of the peso may temper the effects of imported inflation, including oil prices.

33. **Managing resurging capital inflows will remain a key challenge going forward.** The BSP's response to higher inflows has been to lower SDA rates, cut policy rates, accumulate reserves and allow the currency to appreciate. Although the BSP has been sterilizing the accumulation in reserves (which are currently well above precautionary levels according to the IMF) to prevent domestic credit from expanding too rapidly, sterilization costs have increased reflecting the difference between foreign and domestic interest rates. In addition, the pace of credit growth has also picked up, helping to support domestic demand and a booming construction sector. However, this may pose large risks to financial stability if not properly monitored and managed.

34. **Given that monetary policy is expected to remain accommodative and interest rates low, careful monitoring of bank lending activities by the BSP is needed.** This will be helpful in averting asset price/quantity bubbles in the Philippine property market and to ensuring healthy non-financial corporate balance sheets and healthy deleveraging by banks. Overall, unchanged lending standards for loans to firms and households reflect the stable asset portfolio of banks and generally steady outlook on the economy, unchanged financial system regulations, and banks' unchanged tolerance for risk. The tightening in credit standards for commercial real estate loans especially in stricter collateral requirements and loan covenants for commercial real estate loans reflect the banking system's prudence.

[25] Source: United States Department of Agriculture

[26] Power shortage not expected to be resolved soon with power plants under construction expected to become operational no earlier than 2014.

The Medium Term Reform Agenda

35. **Structural reforms are needed to spur higher, sustained, and more inclusive growth.**[27] The economy needs to shift from consumption towards investment, both public and private. Sectorally, this translates to less dependence on services and more on labor-intensive manufacturing underpinned by rising productivity in agriculture. This will require wide-ranging and comprehensive structural reforms in agriculture, manufacturing, business and labor regulations and social protection that raise profitability and incentives to invest in agriculture, improve the business climate and spur investment, entrepreneurship and job creation. The reform agenda benefits from a broad consensus among policy analysts, but has historically been difficult to implement by policy makers, given the vested interests in the status quo.

36. **The development of the agricultural rural sector and the manufacturing sector will be key to accelerating inclusive growth** (Table 1). Agriculture employs the poor, typically sets the reservation wage for unskilled labor, and can therefore most efficiently reduce poverty. In addition, productivity improvements in agriculture can also help expand the manufacturing sector by lowering input costs. In manufacturing, given the potential in creating jobs, priority should be given to liberalizing 3 key sectors: ports, shipping, and water. Further, improving competitiveness, business and labor regulations are also needed to be simplified so that it is easier to set up businesses, and to employ and train workers.

37. **Sustaining these reform efforts, and increasing their chances of success, will also need greater public investment in health, education, and infrastructure.** These reforms would boost pro-poor growth and allow the Philippines to take advantage of opportunities arising from the global economic rebalancing, including rising production costs in the rest of the region. In infrastructure, new investment should focus on key areas with strong employment and poverty impact. These include power, ports, the arterial road system, the urban commuter system, and agriculture infrastructure. On basic education, priority should be given to achieving universal primary education, increasing secondary enrolment, and improving the overall quality of education. In addition, health interventions need to be scaled up to meet public health and poverty alleviation goals, while expanding the coverage and improving the fiscal and institutional sustainability of public health insurance.

[27] Refer to the forthcoming Philippine Development Report (2012) "Creating More and Better Jobs," for a more detailed discussion on reform agenda.

Table 1. Selected key policy recommendations

Agriculture	
Improve the current land reform program and secure long-term property rights on land for farms of all sizes	- Improve investment incentives on redistributed land by securing long-term individual property rights for the beneficiaries, and re-organizing support services as part of a more decentralized and community-driven approach
Reallocate spending from crop subsidies to support services for farmers	- Redirect resources from programs with negligible impact (e.g., crop subsidies) to provision of services supporting productivity enhancement of farmers - Improve and scale-up demand-driven extension services, R&D, and market access
Improve the delivery of agricultural public goods	- Invest more in agricultural public goods and associated services geared towards diversified agriculture - Enact institutional reforms for R&D and irrigation to improve property rights of farmers
Manufacturing	
Liberalize key industries in the economy	- Priority sectors, given their pro-poor and pro-jobs impact: water, ports and shipping
Strengthen regulatory capacity	- Strengthen fiscal and managerial autonomy, improve transparency, reduce discretionary powers, and conduct regular regulatory assessments in order to ensure the independence, competence, and impartiality of key regulatory bodies - Establish regulatory impact assessment including a regulatory review unit and regulatory registry
Strengthen competition policy	- Establish a fair competition policy - Create a competition (or anti-monopoly) authority - Set-up an independent advisory body to advance economic reform agenda
Review foreign investment negative list and consider reducing restrictions	- Amend economic provisions in the 1987 Constitution to remove explicit rigidity imposed on natural resources, land, public utilities, mass media, educational institutions, and practice of profession and give prerogative to grant restrictions to Congress

38. **Historically, the nature of the country's political and economic institutions, with strong vested interests in the status quo, has made such reforms often difficult to undertake.** However, the current administration's track record suggests that it does not shy away from making difficult choices in the interest of pursuing a more inclusive growth path. This difficult context, however, does challenge the government to prioritize its reform efforts wisely, with an emphasis on those economic and social reform efforts which also change the country's institutions towards more inclusion. The focused implementation of such an institutional reform agenda would maximize the chances of boosting inclusive growth.

39. The Special Focus sections which follow demonstrate that the implementation of such reforms can have high payoffs in terms of jobs and inclusive growth. For instance, the earlier opening up of the telecoms sector has now led to a world-class business process outsourcing industry. In Mindanao, investing in power infrastructure now is essential to avert a looming power crisis and lower input costs to firms. Finally, by scaling-up and broadening several open government/open data initiatives in the country, the strengthening of inclusive institutions would be greatly enhanced, in line with the core principles of this government.

SPECIAL FOCUS

I. Sustaining Growth in the Philippine BPO Sector: Opportunities and Challenges

The Philippine Business Process Outsourcing (BPO) industry has enjoyed tremendous success over the past decade, emerging as a global leader in voice-services and the second largest provider of non-voice, more complex services. With revenues of over USD11 billion, and credited with nearly 2 million jobs (directly and indirectly), the sector has become a major driver of the economy. However, there are both opportunities and challenges ahead. The global off-shoring industry is expected to roughly double in size to about USD260 billion by 2016 with the expansion in knowledge and analytical services. This Special Focus takes a closer look at the factors that have underpinned past success, and what it will take for the Philippines to sustain its lead in voice services and capture a greater share of the knowledge and analytical services going forward. [28]

Introduction

1. **The Philippine Business Process Outsourcing (BPO) industry has grown at an extraordinary pace over the last decade, catalyzed by reforms in the telecommunications sector in the early 1990s.** The deregulation of the telecoms industry in 1993 transformed the industry from a virtual monopoly to one with several players, and from a limited network and poor service to an expanded network at much lower prices and better service. It also facilitated the growth of a highly dynamic BPO sector. Total employment in the sector has surged to nearly 640,000, of which nearly 400,000 work in "voice-related services" (call centers). The Philippines has the largest global market share, ahead of India which until 2010 had dominated this particular segment of BPO. Service export revenues – from call-centers, but also increasingly other information technology (IT) services such as medical transcription, software services and back-office processes – have climbed from USD6.1 billion in 2008 to over USD11 billion (or about 5 percent of GDP) in 2011.[29]

2. **The industry has become a major driver of the economy and job creation.** Aside from earning significant amounts of foreign exchange, it has also spurred growth in other parts of the economy, notably real estate, retail trade and telecommunications. The BPO industry's total (i.e., direct plus indirect) contribution to growth through real estate, construction, retail trade, and telecommunications is estimated at around 11 percent of GDP in 2011 - roughly the same

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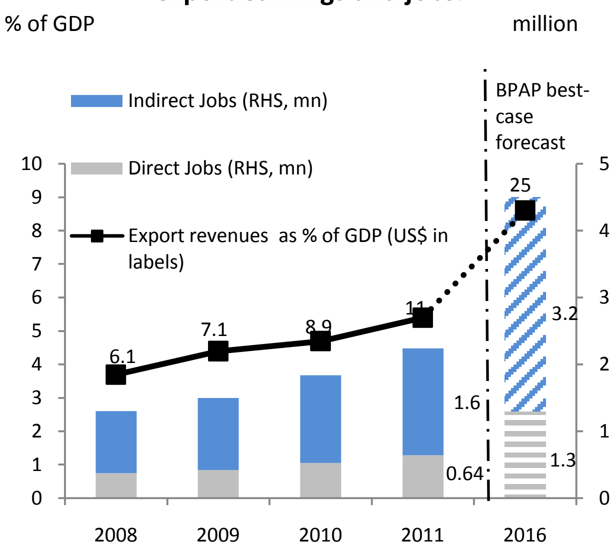
[28] This Special Focus was contributed by Tehmina Khan, Economist at the World Bank and draws on, among other sources, data provided by the Business Processing Association of the Philippines.
[29] BPAP (2012a)

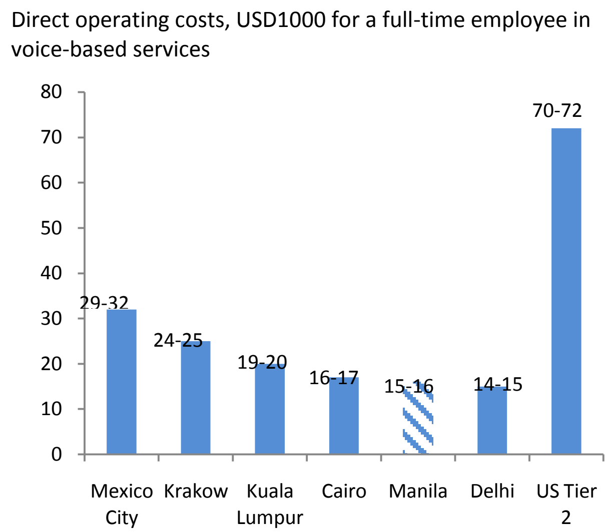
as merchandise exports value-added as a share of GDP.[30] In addition to those directly employed in BPO work, the sector has been credited with helping to create some 1.6 million jobs in real estate, construction, telecommunications and other related sectors as it has expanded (Figure 1.1).

Figure 1.1 The Philippine BPO sector is a major driver of the economy, generating substantial export earnings and jobs.



Source: BPAP (2012a), World Bank

Figure 1.2 Costs are among the lowest in the world for a largely English speaking workforce.



Source: BPAP (2012a), World Bank

3. **BPO services are shifting away from traditional "voice" services to "non-voice" services, and from Metro Manila to other cities in the Philippines.** In addition to being the leading global provider of voice based services, the Philippines is also increasingly diversifying towards other more complex non-voice services such as finance and accounting, HR and other back office support services. For instance, in 2006, the non-voice BPO sector accounted for 15 percent of total export revenues, and this figure had risen to 20 percent by 2010. In addition, there has been a diversification in location from Metro Manila. At the end of 2011, some 115,000 full-time BPO employees (of the total 640,000) were working outside Metro Manila in the so-called "New Wave cities" (BPAP, 2012a). This is helping to spur growth, incomes, and employment outside Metro Manila.

4. **Growth prospects for Philippine BPO sector look bright as companies in high-income countries continue to offshore business processes.** The Business Processing Association of the Philippines (BPAP) is targeting a doubling in size by 2016, earning nearly USD25 billion in export revenues and employing some 1.3 million people directly and 3.2 million indirectly[31]. This would place the sector at par with, or even ahead of, other traditional mainstays of the

[30] For example, see the Philippines Quarterly Economic Update, March 2012

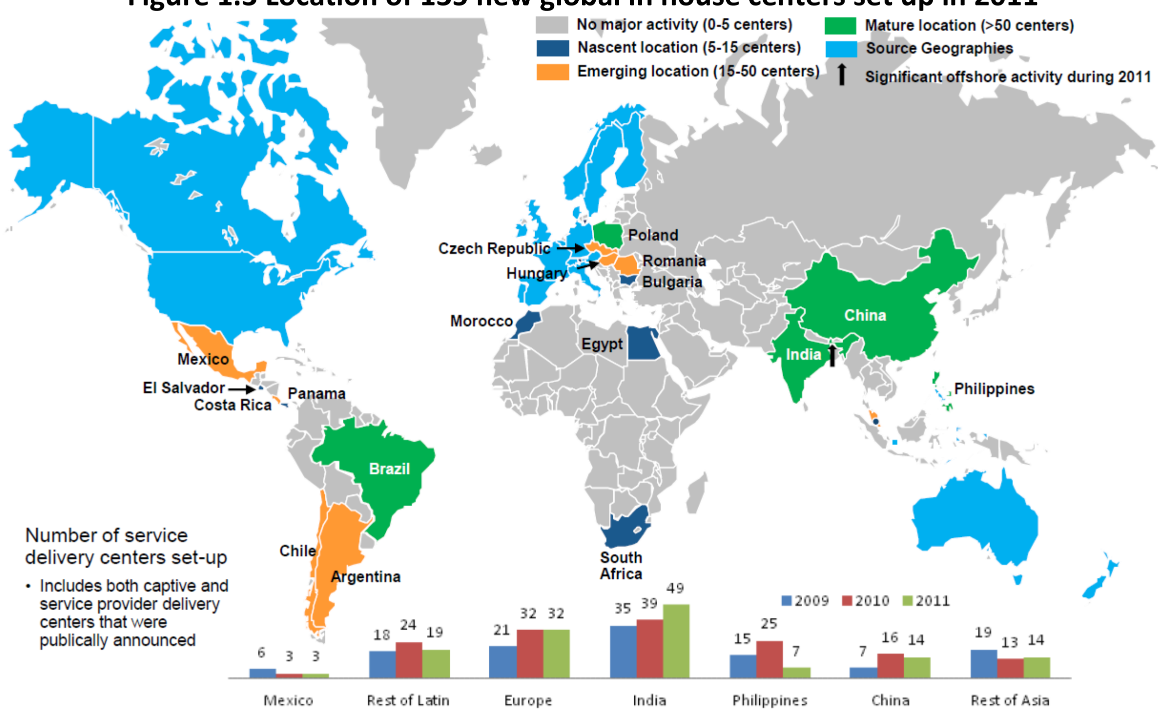
[31] BPAP (2012b)

economy notably remittances. The sector would also help generate substantial amounts of tax revenues for the government, both directly as well as indirectly by stimulating additional growth in other related sectors in the economy.

Key Factors Underpinning Success So Far

5. **The industry's success has been underpinned by a competitive cost structure, notably low labor costs.** The BPAP estimates the Philippines as one of the lowest cost-destinations for voice-based services, with direct operating costs (wages, training and attrition costs, equipment and telecommunication) ranging between USD15-16,000 per full-time employee compared to USD14-15,000 in India, USD16-17,000 in China, USD20-25,000 in eastern Europe and USD21-23,000 in Mexico (Figure 1.2). Following India and China, the largest number of global offshore centers set up in Asia during 2011 was in the Philippines (Figure 1.3), and in the previous year, the number of global centers set up in the Philippines even exceeded that in China (Gale, 2012).

Figure 1.3 Location of 135 new global in house centers set up in 2011



Source: Gale (2012)

6. **A large English-speaking workforce and a service-oriented culture have also helped attract a significant share of the offshore business towards Asia.** The Philippines is one of the largest English speaking countries in the world producing some 500,000 high school and college graduates every year with a close cultural affinity to and understanding of the United States, the largest market for BPOs. These advantages combined with a service oriented culture have allowed the Philippines to successfully compete and emerge as the leading global provider of voice-based offshore services. Table 1.1 ranks the Philippines compared to other major offshore

service providers, and shows that the Philippines compares particularly well in terms of language, cost and cultural compatibility.

Table 1.1: Global industry surveys show the Philippines as among the top-ranking destinations for offshoring.

Top 10 Leading Locations for Offshore Services, 2012

Gartner Rating (2010-2011)	Countries	Language	Government Support	Labor Pool	Infrastructure	Educational System	Cost	Political and economic environment	Cultural Compatability	Global and legal maturity	Data and IP security and privacy	Total Score
	India	Very Good	Excellent	Excellent	Good	Very Good	Very Good	Very Good	Very Good	Good	Good	39
	Mexico	Good	Very Good	Very Good	Good	Good	Very Good	Good	Very Good	Good	Very Good	35
	Chile	Good	Very Good	Good	Very Good	Good	Good	Very Good	Good	Good	Fair	32
	Czech Republic	Good	Good	Good	Good	Very Good	Good	Good	Good	Good	Very Good	32
	Malaysia	Very Good	Very Good	Good	Very Good	Good	Good	Good	Good	Good	Fair	32
	Poland	Good	Good	Good	Good	Good	Good	Very Good	Very Good	Good	Fair	31
	China	Fair	Very Good	Good	Very Good	Good	Very Good	Very Good	Good	Fair	Poor	30
	Mauritius	Good	Good	Fair	Good	Good	Very Good	Good	Very Good	Good	Fair	30
	Philippines	Very Good	Good	Good	Good	Good	Very Good	Fair	Very Good	Fair	Fair	30
	Brazil	Fair	Good	Good	Good	Fair	Fair	Excellent	Very good	Good	Fair	29

Source: Gartner Group, cited from Gale (2012)

Table 1.2: Government incentives for the BPO sector are generous in the Philippines

		Philippines	India	China	Egypt	Malaysia
Capital	Investment Related	Import duty waver for capital equipment	Concessional 3.09% customs duty on imported capital goods	Varies		Capex subsidies of up to100%
		VAT, customs duty waiver				Import duty waiver- multimedia equipment
Operating	Talent Development	Training grants for finishing schools (Technical Education and Skills Development Authority or TESDA)		Training charges tax exempt up to 8% of payroll	Training subsidy	Training subsidy 20% - 40%
	Other input cost linked	Exemptions on local taxes and permits, value-added tax (VAT) exempt inputs	Services, sales tax exemption; 50% exemption on stamp duty		Telecom and rental discounts	Subsidy on telecom, rentals and utilities
Taxation	Tax linked	6-year tax holiday extendable to maximum of 8 years (or) 4 years extendable to a max of 6 years	5-year income tax holiday in special economic zones (SEZ) only, plus 50% exemption for 2 successive 5-year block subject to reinvestment			
		Post tax holiday, payment at 5% gross income	100% depreciation on capital goods for 5 years	Business tax exemption	Corporate tax rate cuts	Accelerated depreciation

Source: BPAP (2012a)

Challenges and Opportunities

7. **The global offshoring industry is undergoing significant structural change driven by technological advances and growing competition among offshore service providers.** Although reducing costs remains a key motivation for offshoring, the traditional model of offshoring which bases pricing on the cost of labor and customized applications, is giving way to industrialized and standardized services, placing a greater pressure on supplier margins. Technological advances, such as the development of cloud computing[32], have also propelled the shift towards greater automation and have pushed solutions to cloud, and services to cloud service providers. They too are transforming delivery and pricing models (Gale 2012, Lewin, 2012, Manning et al, 2008).

8. **Knowledge and analytical services are increasingly important components in BPO services.** The global offshore service market, including IT-BPO and global in-house center (GIC) services, is currently estimated at above USD125 billion and is expected to grow in size to about USD255-260 billion by 2016. However this expansion is mostly concentrated in the more complex, non-voice (finance and accounting, knowledge, procurement, and human resource) and IT and engineering services segment which together are expected to account for 80 percent of offshoring service activity by 2016 (Figure 1.4). The annual Offshoring Research Network (ORN)[33] survey, showed a significant portion of firms considering future offshoring in product development functions, such as engineering, research and development (R&D), and product design, and back-office support functions such as finance and accounting and administration (Figure 1.5).

9. **Firms that are offshoring business processes increasingly have more choices and greater flexibility to locate across multiple regions using multiple vendors and frequently multiple sources** (e.g. cloud- and crowd-sourcing supplemented by rural sourcing and onshore or nearshore capabilities, global in-house centers). “Rural” and “nearsourcing” where suppliers are located close to the buyer (within rural United States or in Eastern Europe for example) are emerging as viable alternatives to offshoring as they help to overcome cultural, language and time zone constraints and also more politically palatable at a time when unemployment in the advanced economies is persistently high. In addition, there may be fewer infrastructure and legal and financial issues, wage savings (wages tend to be 20-40 percent lower) and (perceived) data protection and security concerns (Gale 2012).

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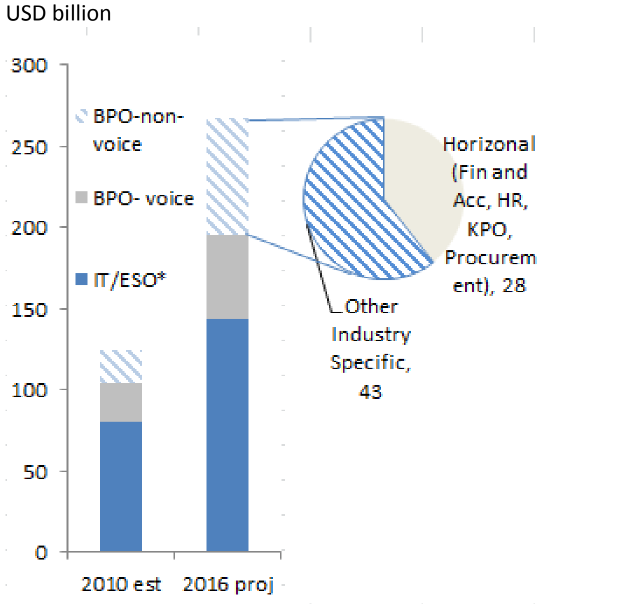
[32] Cloud computing is the use of computing resources (hardware and software) that are delivered as a service over a network (typically the Internet). The name comes from the use of a cloud-shaped symbol as an abstraction for the complex infrastructure it contains in system diagrams. Cloud computing entrusts remote services with a user's data, software and computation

[33] ORN was initiated in 2004 at Duke University in the USA and tracks more than 2000 large, mid-sized and small firms located in the US and Europe that are or are not considering offshoring, and 700 suppliers located worldwide. The survey monitors the strategic drivers, service delivery models and implementation models on both the buy- and sell-side of the global offshoring industry

10. **Seizing the growing opportunities for value-addition in the global BPO sector will have to be a top priority for the Philippine BPO sector to sustain past high rates of growth.** That the Philippines surpassed India in 2010 to take the lead in providing voice-based services is an indication of its competitiveness as well as the mobility of the industry in an increasingly globalized world where buyers choose suppliers on the basis of multiple criteria. The ORN survey shows that globally, offshore service suppliers (particularly larger ones) are already responding aggressively to the increased demand for analytical and knowledge based services by significantly increasing the number of skilled full-time employees (Figure 1.6).

Figure 1.4. Global offshoring services are expected to expand significantly over the next few years, mostly in the non-voice complex services segment.

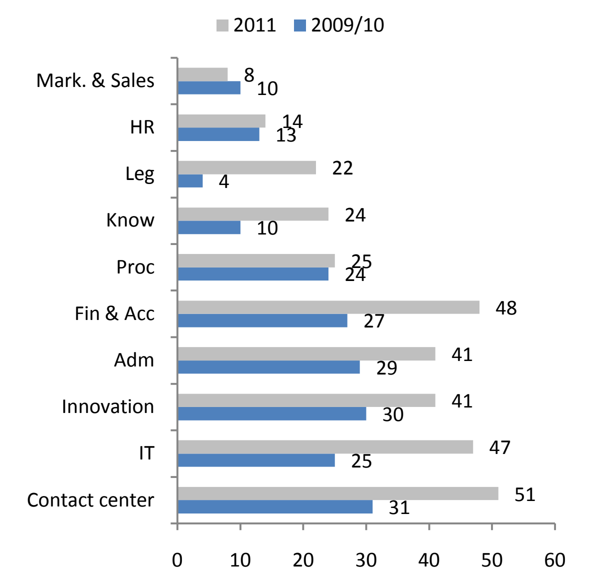
USD billion



Source: BPAP (2012a), Nasscom, World Bank: ESO refers to engineering outsourcing services. KPO refers to knowledge process outsourcing.

Figure 1.5. Industry surveys show that a significant portion of the United States and European firms are considering offshoring product development and innovation functions.

% of firms considering offshoring by function

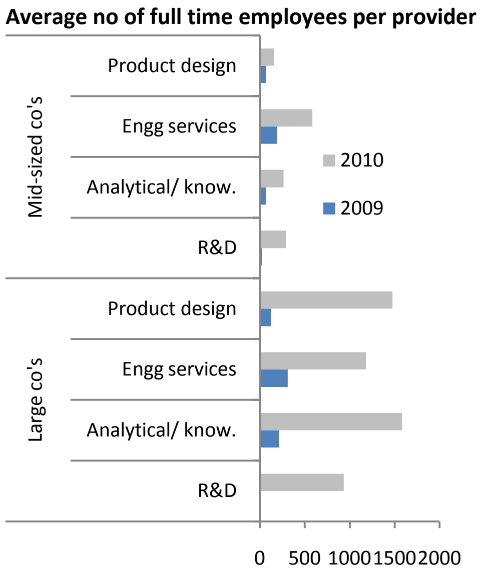


Source: Offshoring Research Network Survey (2011) cited in Lewin (2012)

11. **However, capturing a greater share of non-voice complex and analytical services will require sustained investments in human capital and training in more specialized areas of expertise.** Despite the nearly 500,000 graduates that the Philippines produces every year, there remains a shortage of talent. According to BPAP, the industry turns away on average some 93-95 percent of call centers applicants on account of poor communication and technical skills. Results from the Global Competitiveness Assessment Tool (GCAT), an industry-benchmarked

assessment system used by BPO companies, show that the average scores of applicants from a majority of the schools are below the industry benchmark range.[34]

Figure 1.6. Large global offshore service providers are significantly investing in skilled employees



Source: BPAP (2012), Nasscom, World Bank: ESO refers to engineering outsourcing services

Table 1.3 Key challenges facing the Philippine BPO sector.

Scalable Educated Talent Pool	5-8% recruiting pass rate Attrition challenges Access to executive, specialized skills
Cost Competitiveness	High annual salary inflation India 20-30% lower cost especially with currency depreciation Power costs among the highest
Infrastructure	Country disaster risks Airport and ground traffic congestion Some Next Wave cities face infrastructure challenges
Government Support and Public Private Partnership	Investor investment policies being contested regularly Need to actively protect legislative and regulatory environment Gov't policy and program continuity at risk, especially by 2016
Track Record	Need to move up analytics, innovation Less reliance on expat talent Readiness for next big shift

Source: BPAP (2012)

12. **As part of its support to develop skills, the government agreed in late 2011 to provide PHP500 billion for a training fund administered by the Technical Education and Skills Development Authority (TESDA)**. This is in partnership with BPAP to provide short-term training for "near-hire" applicants who require remedial training. However, to successfully move beyond voice based services towards higher value-added knowledge based services will also require more emphasis on scientific, engineering, IT and other specialized skills (Manning et al, 2008). In other words, the industry will face bottlenecks to its continued expansion and development on both the quantity as well as the quality of the labor force needed.

13. **Improving infrastructure needs will help in reducing business risks associated with natural disasters, reducing logistical costs, and expanding the industry to the "Next Wave" cities** (see Table 1.3)**.** A survey in September by the BPAP and Outsource2Philippines (BPAP,

[34]In particular, schools score below the benchmark range in the following areas: learning ability, English proficiency, perceptual speed and accuracy, and in behavioral components of the assessment. On basic skills, 60 percent of test takers score below the 30th percentile. On behavioral skills, 70 percent of test takers score below the 30th percentile.

2012c) showed that a fifth of respondents, consisting of 166 IT-BPO and global in-house center (GIC) executives regarded vulnerability to natural disasters as a significant risk factor in doing business in the Philippines.[35] In addition, the Philippines also needs to address continuity in power supply: for instance, there are indications of possible shortages in Luzon in the coming years if demand constraints are not addressed today. Finally, further deregulation in the telecom sector will benefit the BPO sector – foreign ownership levels are currently restricted to 40 percent – by raising productivity and spurring overall business activity.

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Manning,S, Massini, S., and. Lewin, A., (2008) A Dynamic Perspective on Next-Generation Offshoring: The Global Sourcing of Science and Engineering Talent, Academy of Management Perspectives, Aug 2008, Volume: 22, Issue: 3

[35] Slightly more than 40 percent of respondents also indicated that it took more than 2-3 days for operations to return to normal after the flooding in August, and most firms reported high levels of absenteeism on account of the floods, much worse than in the wake of Typhoon Ondoy in 2009.

II. The Mindanao Power Crisis: Can Natural Gas Make a Difference?

Historically, Mindanao has relied on hydropower to satisfy its power consumption needs. But with few attractive hydro plants left to be built, and modest potential in smaller renewable energy power plants, other options, notably coal fired power plants, are being considered. This Special Focus examines whether liquefied natural gas (LNG) based plants are a viable and cost-efficient alternative, and why an LNG terminal and associated power plants are not being actively developed.[36]

1. **The island of Mindanao, home to 25 million people, suffers from a chronic shortage of power.** This causes significant hardship to households that have access to electricity, constrains government efforts to increase access of households with no electricity connections, imposes huge costs on existing businesses, and deters new investment. Power shortage is easily the most important economic issue on the island, and has wide-ranging social and political dimensions. Solving the power crisis will be critical to Mindanao's development.

2. **Mindanao's power problems stem from a historical reliance on hydropower.** The state-owned Agus and Pulangi plants currently account for half the available capacity on the island – over 700 megawatts (mw) of useable capacity (less than the designed capacity of about 900mw). At one time, these plants provided Mindanao with reliable supply at a very reasonable price of only PHP2.9 per kilowatt hour (kwh). But as the population and the economy grew over time, new power plants to supplement the hydro plants were not added in sufficient quantity. Capacity is inadequate to meet demand economically at the best of times and most vividly felt during periods of drought. Mindanao should have, overall, at least 300 mw of reserve capacity, however, Mindanao's reserve margin is estimated at about -200 mw. With few attractive hydro plants left to be built, modest potential in smaller renewable energy projects, and no access to natural gas, Mindanao has only two options to fuel new power plants – coal and oil.

3. **Oil plays a huge role in the island's generation mix, on a scale that is unique in Asia**. When it rains, oil accounts for at least 20 percent of the energy in the network; when it does not, oil provides 25 percent or more. At current oil prices, the purchase of fuel represents over 40 percent of the total power bill for Mindanao consumers (and even with that, those consumers are constantly cut off when oil supply runs short or when consumers cannot afford oil-generated power, which can cost PHP12 per kwh or more). And the true size of the bill for oil-generated power would need to include the estimated 400 mw of captive generation owned by the island's businesses; most businesses (other than smaller enterprises) are practically required to have their generators for back-up supplies.

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[36] This Special Focus was contributed by Alan Townsend, Senior Energy Specialist at the World Bank and draws on the Mindanao Generation Planning Study completed in November 2012 and which forms the background for the Mindanao Energy Strategy. Both are part of analytical work being carried out by the World Bank on behalf of the Philippine government.

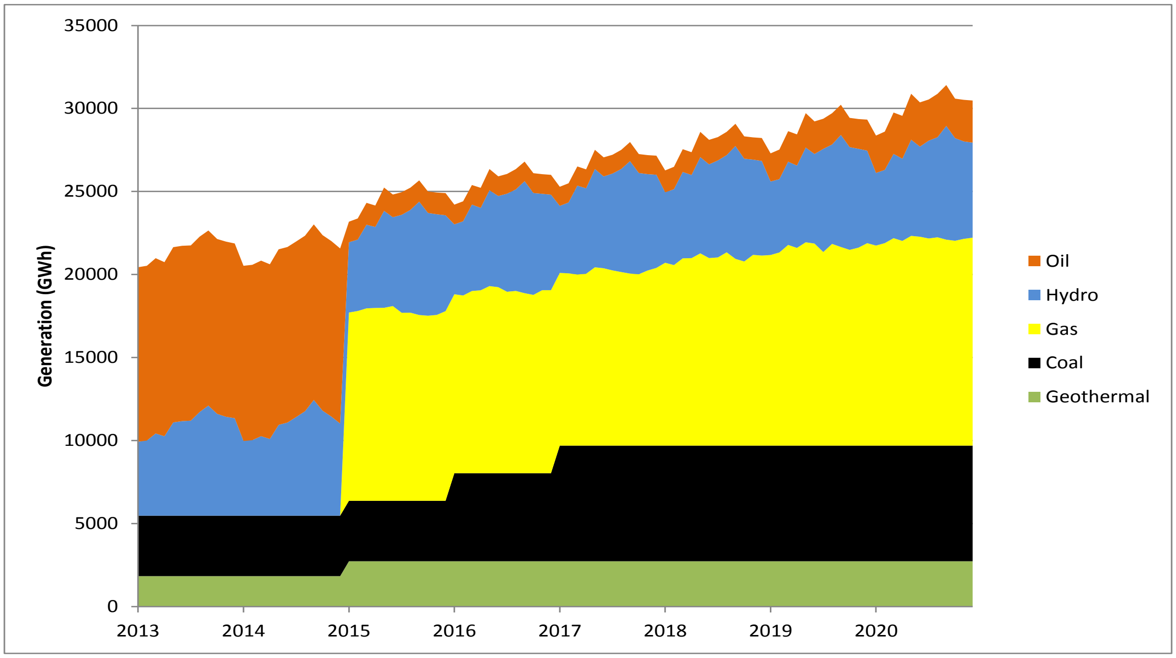
4. **Apart from one existing coal-fired power plant, almost all new power projects are to be fired by coal**. Coal plants are expensive to build. A 300 mw plant under construction in southern Mindanao has an estimated cost of USD660 million. An efficient gas-fired power plant of a similar size would cost less than half that amount. So why is natural gas not available in Mindanao? There are no local supplies that can be commercially developed, so gas would have to be imported in the form of liquefied natural gas or LNG. The import facilities are highly specialized, but good technical options exist.

5. **Recent work by the World Bank looks at the question of the affordability of LNG-fired power in the Mindanao electricity market.** A model of the Mindanao power system was built, incorporating a range of inputs on demand, existing generation capacity, new generation capacity, fuel costs, and other variables. It draws on three gas price scenarios (low, medium and high) drawn from the East Asian LNG market; and it draws on 9 water inflow scenarios, based on nine years of detailed, monthly hydrologic data that has been recorded at the Agus and Pulangi plants. In addition, the considerable uncertainty associated with gas prices and water availability was also explicitly taken into account in the model. The model is structured so that it always meets demand, which is why in Figure 2.1, one can see that the share of demand that is met by oil-fired generation is even higher than what is actually observed in the market today.

6. **Essentially, in balancing the market, the model selects the least-cost way of meeting demand from the generation resources available.** When new capacity is needed, it "builds" new power plants. In the base case result shown in the diagram, the model selects a 450 mw LNG-fired power plant that takes over two years to come into the market. The cost of this power plant includes a large portion of the LNG import facilities that would be needed. This mix of generation is least-cost for every month of the forecast. Baseload resources with low marginal costs – coal and geothermal – operate at high utilization. Hydro is used more when water supply is available, and less when water is scarce. The model recognizes the value of storing water, so that it can be used in periods of peak demand and during drought scenarios. The role of natural gas is to provide flexibility – to compensate or alternate with hydro power depending on water supply availability. There is a dramatic reduction in the use of oil-fired power, which is relegated to its more typical role of providing only peak power. As oil is used more intensively after 2020, the model builds new, cheaper capacity (either mid-cycle gas, or baseload coal) as needed.

7. **Based on the probabilistically determined gas price and hydrology inputs, the model shows that a LNG-fired power plant in Mindanao of 450 mw in size would be utilized about 70 percent of the time over the forecast period.** It would back most oil out, at considerable savings to Mindanao consumers, enable demand to be met even in times of drought, and allow the operation of the hydro plants to be optimized so that water scarcity was more accurately valued. Electricity consumption would grow rapidly with previously suppressed demand now served by the system (the model does not directly value the reduced expenditures on oil by captive generation owners, but this is obviously an added benefit).

Figure 2.1: Mindanao monthly generation output projections (gigawatt hour [gwh])



Source: World Bank

8. **So if LNG is part of a least-cost fuel mix, why is an LNG terminal and associated power plant not being actively developed? The answer is simple:** The Government of the Philippines, through the coordinated actions of the Department of Energy, the Department of Finance, and the Mindanao Development Authority, needs to undertake some targeted policy and regulatory steps so that private sector developers have the incentive to make these investments. The most important step that Government can take is to develop a policy for the recognition of the value of power generation capacity in the regulatory framework. This policy would then be implemented under the supervision of the Energy Regulatory Commission (ERC). It would establish a sound basis for investments in least-cost generation to ensure that there is a sufficient capacity reserve in Mindanao to cope with the reduced availability of hydro power during droughts.

9. **The establishment of dry-year reserves requirements would be supplemented by the development of a public-private partnership for an LNG terminal.** The DOE has identified the Phividec industrial park in northern Mindanao as the least-cost location for a floating LNG terminal. This location, near the city of Cagayan de Oro, has vacant land for the anchor power plant, access to power transmission capacity, benign marine characteristics, and concentrated industrial demand. It would be an excellent location to land natural gas. This single initiative would have the potential to transform Mindanao from being the country's most expensive but short electricity market, to its cheapest and most abundant.

III. Open Government/Open Data

How can 'Open Data' provide Government a change platform for improved transparency and citizen participation in the Philippines?

In this new era of 'Open Development' we are seeing a fundamental shift in how governments communicate with its stakeholders in civil society, academia, media and ultimately citizens to form coalitions around improved transparency, accountability and access to services. The Philippines has the opportunity to lead the conversation on this new paradigm of development through increased availability of development data that was previously available to select government officials. This Special Focus addresses some of the opportunities and challenges that the Philippines must consider towards realizing this vision to achieve inclusive growth.[37]

The Philippines and the Open Government Partnership

1. **In March 2011 the Aquino administration adopted the Philippine Development Plan (PDP)[38] 2011-2016 representing the government's blueprint for implementing its "Social Contract with the Filipino People".** The development plan represents a vision anchored in

[37] This Special Focus was contributed by Hanif Rahemtulla, Governance and Geospatial Specialist at the World Bank and Rogier van den Brink, Lead Economist for the Philippines. It draws on a report completed in November 2012 and builds on the Government of the Philippines' inclusion in the Open Government Partnership, a multilateral initiative launched on September 20, 2011 that commits participating governments to embrace meaningful reforms in governance by promoting openness, engaging citizens in decision-making, implementing high standards of professional integrity and increasing access to new technologies.

[38] Philippines Development Plan 2011-2016 by the National Economic Development Authority available at http://www.neda.gov.ph

transparent, accountable and participatory governance in pursuit of the President's commitment of "*kung walang corrupt, walang mahirap*"[39] to address the grand challenges of improving public services, increasing public integrity and more effectively managing public resources.

2. **On the 20th of September 2011 the Philippine government demonstrated a clear commitment to and capacity for operationalizing and institutionalizing the Philippine Development Plan** as one of the eight founding members and signatories of the Open Government Partnership (OGP) alongside Brazil, Indonesia, Mexico, Norway, South Africa, United Kingdom, and the United States. Through this multilateral initiative, the Philippines and participating governments (together with prominent heads of state, country representatives, and international civil service organization (CSO) leaders committed to embracing meaningful reforms in governance) expressed their commitment to promote openness, engage citizens in decision-making, implement high standards of professional integrity, and increase access to new technologies.

3. **In realizing this vision, the Philippine government embarked on an open multi-stakeholder consultation process with national networks of CSOs to submit its first OGP Action Plan[40] in January 2012.** The Action Plan titled "Institutionalizing People Power in Governance to Ensure Direct, Immediate and Substantial Benefits for the Poor" represents a broad-based plan that articulates the government's commitment to address the grand challenges through escalating the reform process and broadening policies and mechanisms that widen the space for citizens to actively and meaningfully participate in their own government. This ranges from disclosing greater budget information of national government agencies (NGAs) and local government units (LGUs), to involving citizens in monitoring public works and social services, to escalating accountability to ethical and performance standards, and to leveraging technology to improve information management.

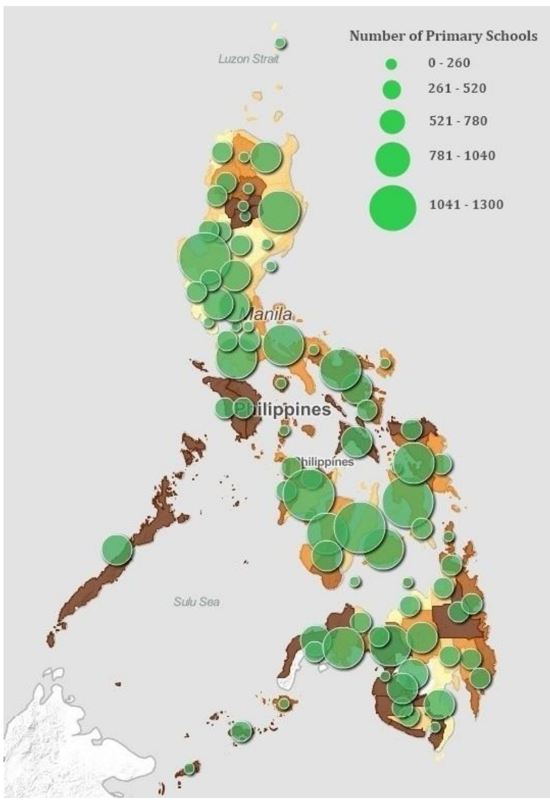
4. **To this end, the Open Government movement gives rise to important opportunities for the Philippines which if harnessed correctly hold the potential to improve transparency and governance and set a new paradigm for how states engage citizens around development issues.** The Philippines is well positioned to harness these opportunities especially around "Open Government Data" movement to achieve a broad range of public policy goals and become a catalyst for other initiatives in the region.

[39] The phrase "*kung walang corrupt, walang mahirap*" translates to "If no one is corrupt, no one will be poor."
[40] http://www.opengovpartnership.org/countries/philippines.

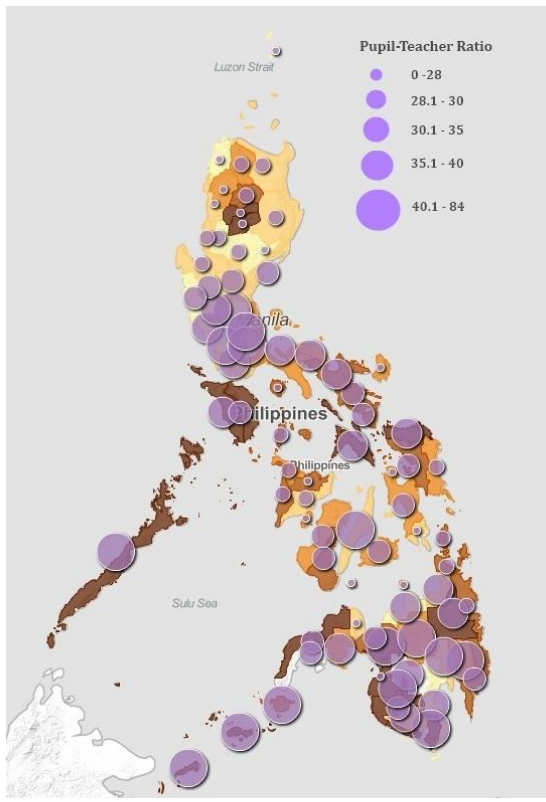
Open Government Data

5. **The Open Government Data movement also known as the Open Data refers to the philosophical and methodological approach to democratizing data**, enabling individuals, communities and organizations to access and create value through the reuse of non-sensitive, publicly available information. This data is typically available online at no cost to citizen groups, non-governmental organizations (NGOs) and businesses. Some view Open Data as the logical conclusion to the Freedom of Information Acts (FOI) in various countries – if citizens can ask for the data, why not simply publish it in the first place?

Figure 3.1 The Power of Open Data - Mapping the results of the Philippines Education Census (2011) to reveal interesting patterns and trends including the number of elementary schools and pupil-to-teacher ratio in each province across the Philippines



Source: World Bank



Source: World Bank

6. **Governments around the world including the Philippines continue to produce immense amounts of data from economic and social statistics to program and administrative records that have a traditional development audience.** Such data, if open, can be extremely useful for a wide set of stakeholders including citizens, civil society and NGOs especially in identifying challenges and in the planning of policies and programs. However, such data often remain untapped and inaccessible, even between government departments. While there may

be legitimate confidentiality concerns for not opening up certain data sources, the most common reasons that such data is inaccessible are due to practicalities and costs. However, new technologies now make it possible to share such data cheaply and in practical and secure ways, which enables stakeholders to collaborate around multiple data sources and build the services and applications that expose the data in useful ways and help answer pressing development questions (Figure 3.1).

7. **The proactive release of public data online will also provide a vehicle for expanding public outreach and enhancing public engagement leading to a more responsive and citizen-focused government.** This will also open new opportunities that will create economic value for citizens who build innovative applications and services that make use of government data. Such innovation, it is envisioned, will drive enterprise, create new products and markets, and improve efficiency, delivering benefits to firms, customers and society.

A Single Open Portal for Government Data

8. **Today, Open Government Data is gathering momentum and forms part of a global movement linked to Open Access and comparable to other such movements such as Open Source.** To date, this movement is being led by the United Kingdom and United States through pioneering initiatives such as data.gov and data.gov.uk, and these initiatives are being replicated across cities, states and countries such as Kenya[41] and Moldova[42] proactively sharing data in the public domain (Figure 3.2).

9. **The Philippines through the OGP has committed to a single portal for government information which complies with basic Open Data standards.** The Department of Budget and Management, Department of Social Welfare and Development, Department of Agriculture and National Anti-Poverty Commission (NAPC) are among the agencies at the forefront of government transparency efforts actively moving towards making their data public online where platforms will allow for constructive engagement between government, civil society, and citizens.

10. **To sustain this initiative over the long term, the Philippine government has embedded provisions in the 2011 National Budget** that mandate the publication of major information on budgets, finance and performance indicators in the websites of national departments and

[41] Rahemtulla, H. *et al.* (2011). Open Data Kenya – A Case Study on the Underlying Drivers, Principal Objectives and Evolution of one of the first Open Data Initiatives in Africa: http://www.scribd.com/doc/75642393/Open-Data-Kenya-Long-Version

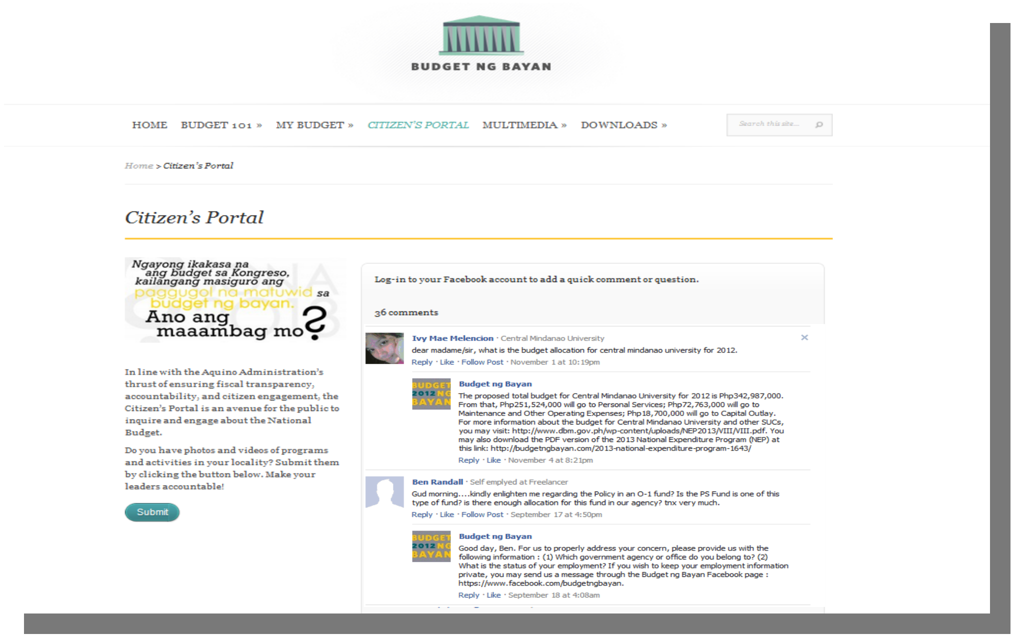
[42] Rahemtulla, H. *et al.* (2012). The Journey of Open Government and Open Data Moldova. Available at http://www.scribd.com/doc/99595560/The-Journey-of-Open-Government-and-Open-Data-Moldova

agencies. In parallel, the Department of Budget and Management has launched "*Budget ng Bayan*" (Budget of the Nation) an online interactive platform for citizens to learn about, find information on and file reports on the National Budget as well as engaging site visitors via the Citizen's Portal, through which users can leave feedback on the National Budget and other related matters (Figure 3.3).

Figure 3.2 United States and Kenyan Open Data portals hold hundreds of datasets including budget and expenditure data, as well as information on health care and school facilities.

Source: Open Government Platforms – United States (data.gov) and Kenya's (opendata.go.ke)

Figure 3.3 Budget of the Nation: An interactive platform for citizens to learn about, find information on and file reports on the National Budget as well as to file citizen reports on its implementation through social media such as Facebook.



11. **However, much data remains untapped and inaccessible even between government departments.** For instance, the Philippines has a comprehensive National Household Targeting System (NHTS) which it uses to identify and locate beneficiaries of targeted poverty reduction programs. Such data if open can be extremely useful for a wide set of stakeholders especially in identifying challenges and in the planning of policies and programs.

The Policy Hurdle of Openness and Data Publication

12. **Open Government Data initiatives demand a strong enabling environment** focusing on four environmental factors which have the ability to bolster or retard the initial take-off of such initiatives: (1) legislative and regulatory frameworks; (2) national information infrastructure and policies; (3) government legitimacy and civic space; and (4) organizational culture and norms of bureaucracy.

13. **To this end, while the Philippines has shown strong early promise and commitment to publishing Open Government Data**, there is a need to complement this commitment by ensuring the right legislation, infrastructure, institutions, and human resources are in place to realize this vision. The extent to which governments successfully leverage these factors to cultivate an enabling environment will inject considerable momentum into Open Government Data initiatives, whereas if not sufficiently addressed they can constitute a significant limitation.

14. **Moving forward, the Philippine's "Freedom of Information Act of 2012" is a measure that seeks to provide citizens wider access to government documents and is currently at a critical stage of discussion by the House.** Section 4 of the House Bill clearly states the right of the citizen and the responsibility of Government agencies around information. In addition to this it clearly states exceptions to data that will remain classified to protect national security, hinder the function of the state or compromise individual privacy interests. A positive underpinning of this act which gives shape to the Open Government Data agenda is the government's interest to make public 'government research data used as a basis for policy development' in addition to public expenditure data.

"SECTION. 4. Access to Information. – Every person who is a Filipino citizen has a right to and shall, on request, be given access to any record under the control of a government agency. Government agencies shall make available to the public for scrutiny, copying and reproduction in the manner provided by this Act, all information pertaining to official acts, transactions or decisions, as well as government research data used as a basis for policy development, subject to the exceptions enumerated under section 6 of this Act, regardless of their physical form or format in which they are contained and by whom they were made"

Freedom of Information Bill (2012) submitted to the Committee on Public Information of the House of Representatives

Open Government Data at your Fingertips

15. **The fast spread and use of ICTs in the Philippines is revolutionizing the way people communicate.** Access to telecommunications is almost universal with 99 percent of the Philippine population within range of mobile phone networks. The majority of Filipinos now have access to basic telephony, the result of substantial private investments in telecommunications infrastructure over the past decade. The Philippines has one of the East Asia and Pacific region's highest mobile phone penetration rates and one of the highest rates of text messaging (SMS) usage worldwide (Figure 3.4). As of 2008, there were 68 million mobile phone subscribers representing 76 percent of the population[43].

16. **Given the growth of ICT technologies and the rise of data in the public domain the Philippines has the opportunity of defining the future of how free and open data combined with better mobile technology drive citizen engagement in development.** ICTs can serve a valuable role in disseminating information in remote and conflict-affected regions of the country and connecting people with markets, government, services and with each other in new ways. This has the potential to change the way citizens and policy-makers communicate with one another by allowing governments to more rapidly transmit information to citizens, and enabling citizens to provide feedback to policy-makers, thus decreasing the effective distance between them. By providing innovative ways of gathering and exchanging information, ICTs thus have the capacity to improve government responsiveness and increase the voice of citizens.

Figure 3.4 Mobile Subscriptions (per 100 people) in the Philippines from 1990 to 2012

Source: World Bank 2012

17. **The growth in Business Process Outsourcing (BPO) has shown that the Philippines is able to connect to the world efficiently.** In the past few years it has outperformed most

[43] International Telecommunications Union (ITU) 2008

countries in terms of IT-BPO industry growth and is second only to India where exports could potentially reach USD55 billion in 2020. Call centers and back office functions of a growing number of multinationals are being executed highly efficiently from the Philippines, showing that the human skills and IT infrastructure are already in place to achieve world class standards.

18. **Surely, this capacity can be brought to bear on the public sector at home and see the country leapfrog towards improved citizen participation and empowerment with respect to public service delivery and good governance.** That said, information policies must deal with a broader scope of issues for ensuring the breadth of participation across all social strata, ameliorating technical, economic and social-cultural access inequalities while expanding the information capabilities of citizens to make use of Open Government Data.

19. **Importantly, as the Philippines educates the next generation, it will need to address new challenges in managing and using the data as its availability grows exponentially in the coming years.** Furthermore, while making this data available systematically will remain the focus of many development institutions the quality of data should be enhanced by establishing standards and data management systems to ensure data are not only available, but also meaningful to users. Moreover, there is an opportunity to collect new data as well as data for existing parameters rapidly, thoroughly and systematically, given the ubiquity of cell phones and the proliferation of other ICTs in the Philippines.

Conclusion: Realizing the Vision of Open Government and Open Data

20. **In this new era of 'Open Development' we are seeing a fundamental shift in how governments communicate with its stakeholders in civil society, academia, media and ultimately citizens to form partnerships around fundamental challenges in development.** The Philippines is best positioned to address the challenges of the new data frontier for development and citizen engagement especially given the country's current commitment to the principles in the Open Government partnership, ICT penetration and strong civil society to promote transparency, empower citizens, fight corruption, and harness new technologies to strengthen governance.

Data Appendix

Table 2. Philippines: Selected Economic Indicators, 2009-14

	2009	2010	2011	2012	2013	2014
	Actual		Prel. Act.	Projection		
Growth and inflation	(in percent of GDP, unless otherwise indicated)					
Gross domestic product (% change)	1.1	7.6	3.9	6.0	6.2	6.4
Inflation (period average)	3.2	3.8	4.8	3.5	4.0	4.0
Savings and investment						
Gross national savings	22.1	24.8	24.9	25.2	25.5	26.3
Gross domestic investment	16.6	20.5	21.8	22.0	22.5	23.6
Public sector						
National government balance (GFS basis) 1/	-3.9	-3.6	-2.1	-2.4	-2.3	-2.1
National government balance (Govt Definition)	-3.7	-3.5	-2.0	-2.3	-2.1	-2.0
Total revenue (Govt Definition)	14.0	13.4	14.0	14.0	14.6	14.9
Tax revenue	12.2	12.1	12.3	12.8	13.4	13.7
Total spending (Govt Definition)	17.7	16.9	16.1	16.3	16.7	16.9
National government debt	54.8	52.4	50.9	49.0	48.0	46.7
Balance of payments						
Merchandise exports (% change)	-22.1	34.8	-6.8	7.0	6.0	6.0
Merchandise imports (% change)	-24.0	31.5	2.6	4.0	6.7	7.2
Remittances (% change of US$ remittance)	5.6	8.2	7.2	5.0	4.0	4.0
Current account balance	5.6	4.2	3.1	3.2	2.9	2.7
Foreign direct investment (billions of dollars)	1.6	1.2	1.3	1.5	2.0	2.5
Portfolio Investment (billions of dollars)	-0.6	4.0	5.5	3.5	4.0	4.2
International reserves						
Gross official reserves 2/ (billions of dollars)	44.2	62.4	75.3	83.2	83.4	83.6
Gross official reserves (months of imports)	8.7	9.6	11.1	11.8	11.2	10.6
External debt 3/	37.3	36.3	34.8	33.0	31.8	30.8

Source: Government of the Philippines for historical, World Bank for projections

1/ Excludes privatization receipts and includes CB-BOL restructuring revenues and expenditures (in accordance with GFSM)

2/ Includes gold

3/ Based on the World Bank definition. The difference with the central bank definition is that it includes the following: i) Gross Due to Head Office/Branches Abroad of branches and offshore banking units of foreign banks operating in the Philippines, which are treated as quasi-equity in view of nil and/or token accounts of permanently assigned capital required of these banks, ii) Long-term loans of non-banks obtained without BSP approval which cannot be serviced using the foreign exchange resources of the Philippine banking, and iii) Long-term obligations under capital lease agreements.

Table 3. Philippines National Government Cash Accounts (GFS Basis), 2008-12

	2008	2009	2010	2011		2012		
				Jan-Oct	Year	Jan-Oct	Budget	WB proj.
	(in percent of GDP, unless otherwise stated)							
Revenue and grant	15.2	14.0	13.4	11.5	14.0	11.7	14.2	14.0
Tax revenue	13.6	12.2	12.1	10.1	12.3	10.4	13.1	12.8
Net income and profits	6.2	5.2	5.4	4.8	5.9	4.8	5.9	6.1
Excise tax	0.8	0.7	0.7	0.6	0.7	0.5	0.6	0.9
Sales taxes and licenses	2.3	2.7	2.4	1.9	2.4	2.2	2.7	2.5
Others	0.8	0.6	0.7	0.6	0.7	0.6	0.6	0.8
Collection from Customs	3.4	3.1	2.9	2.2	2.7	2.2	3.3	2.5
Nontax revenue 1/	1.6	1.7	1.3	1.4	1.6	1.3	1.1	1.2
Grant	0.0	0.00	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure 2/	16.7	17.9	17.0	12.4	16.1	12.9	16.9	16.4
Current expenditures	13.6	14.3	13.8	10.4	13.3	10.5	13.4	13.2
Personnel services	4.9	5.2	5.2	4.0	5.1	4.0	5.4	5.2
MOOE	1.8	2.1	2.0	1.4	2.1	1.8	2.4	2.4
Allotment to LGUs	2.2	2.5	2.4	2.0	2.4	1.7	2.0	2.0
Subsidies	0.2	0.2	0.2	0.2	0.5	0.2	0.2	0.3
Tax expenditures	0.8	0.6	0.5	0.2	0.3	0.2	0.3	0.3
Interest payment	3.7	3.7	3.4	2.5	3.0	2.6	3.1	3.0
Capital outlays	2.9	3.4	3.1	1.8	2.6	2.1	3.3	2.7
Net lending	0.2	0.2	0.1	0.2	0.2	0.3	0.2	0.5
Balance (GFS definition)	-1.5	-3.9	-3.6	-0.9	-2.1	-1.2	-2.7	-2.4
Balance (GOP definition)	-0.9	-3.7	-3.5	-0.8	-2.0	-1.1	-2.6	-2.3
Primary Balance (GFS)	2.2	-0.3	-0.2	1.6	0.8	1.4	0.4	0.6
Memorandum items								
Privatization receipts (PHP billions)	31.3	1.4	0.9	0.7	0.9	0.5	2.0	2.0
CB-BOL interest payments (% of GDP)	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Nominal GDP (PHP trillion) 3/	7.7	8.0	9.0	9.7	9.7	10.7	11.0	10.7

Source: Department of Finance, Bureau of Treasury, and Department of Budget and Management

1/ This excludes privatization receipts. These are treated as financing items in accordance with the Government Financial Statistics Manual (GFSM).

2/ Data are sourced from the Department of Budget and Management. Allocation to local government (LGUs) units excludes capital transfers to LGUs. They are included in national government capital outlays.

3/ Nominal GDP is based on World Bank staff estimates.

Selected Special Focus sections from Previous *Economic Updates*

July 2012: From Stability to Prosperity for All

Access to Basic Financial Services in the Philippines. Financial inclusion, or broad access to basic formal financial services, supports inclusive growth as it assists individuals to mitigate risks and smooth consumption. Financial services offered by formal financial institutions are also safer and cheaper than informal alternatives which are often the only available option for the poor, and enable micro-entrepreneurs to integrate into a formal economy. However, in the Philippines, actual use of formal financial services is low, particularly among low income groups: less than a third of Filipinos have an account with a formal financial institution. In addition, the overall size of the banking system is small and and the Philippines exhibits the widest gap between high and low income groups in terms of account access in the East Asia and Pacific region, mirroring broader economic inequality. Instead many Filipinos rely heavily on a wide range of informal sources for borrowing money, including friends, stores, private lenders and employers. While access remains low, the government has implemented a number of important reforms aiming to improve access to basic financial services. Through the implementation of the Microfinance Strategy and introduction of enabling environment for mobile banking, the Philippines is recognized as one of the pioneers in exploring innovative approaches to improve financial inclusion.
In the Global MicroScope 2010, the Philippines was recognized to have the best regulatory environment for microfinance among 54 countries.

Building Human Capital – Education. The Philippines faces major challenges in access to education, quality of education and an insufficient school infrastructure. Given these existing challenges, additional resources for the basic education sector are needed. The implementation of a new K-12 program is expected to further increase resource requirements. The necessary budgetary increases must come from both the central and local governments. This requires, among others, motivating the local government units to invest more of their own resources in local education improvements and supporting the empowerment of schools and communities. The government can also promote private involvement in basic education to help share necessary resource requirements with the private sector, though this requires an effective audit and fraud monitoring mechanism in place. The Education Service Contracting Program has been shown to be a cost-effective scheme compared to the alternative option of building new schools and classrooms and hiring new teachers to accommodate the growing number of enrollees in public schools. Finally, as higher spending does not automatically translate into better education outcomes, it is important to address institutional and policy issues to improve access to education across regions and the quality of education.

March 2012: From Stability to Prosperity for All

Financing the Economic Costs of Disasters in the Philippines: Challenges and Opportunities. The Philippines is one of the most disaster-prone countries in the world. It is regularly hit by earthquakes and typhoons. These natural disasters, in particular typhoons, have grave social and economic consequences for the country. About 1,000 lives are lost every year and the estimated cost to the economy is almost one percent of GDP per year. The fiscal capacity of the general government to mitigate risks and address these costs is limited. The amount of funds available is well below 10 percent of the total direct property damages incurred annually. Recent disasters suggest that the country needs up to five percent of GDP to mitigate risks and rebuild damaged properties. Recognizing this shortcoming, the government recently revamped its disaster and risk management strategy from ex-post reconstruction to ex-ante preparedness. Moreover, the Philippine government is preparing an analytic framework and strategy to explore the feasibility of disaster risk financing and transfer options to address the layers of risks faced by the country. In this process, the government could employ a risk layering methodology, commonly adopted in corporate risk management, to improve overall risk management.

Cycles of Conflict and Displacement in Mindanao. This special focus summarizes the results of a major survey conducted in and around the Autonomous Region in Muslim Mindanao (ARMM) to understand the people's experience of conflict and displacement in the past decade. The findings are analyzed in a joint World Bank-World Food Programme (WB-WFP) report entitled "Violent Conflicts and Displacement in Central Mindanao: Challenges for Recovery and Development." The results highlight the frequency and prevalence of displacement, and the damage done to livelihood, access to services, and social cohesion. The study makes some recommendations on how to improve support to vulnerable households and shape strategies for sustainable peace.

The Philippine Real Estate Market: A Cause for Concern? The real estate market plays a unique role in economic development and financial stability. Boom-bust cycles are intrinsic in real estate markets and impact the economy directly and indirectly through other sectors such as construction and finance. Real estate is often the largest store of wealth in any economy. In the Philippines, households tend to have greater preference for holding wealth in the form of real estate rather than equities. Given these, a closer look at real estate market developments is a critical element of ensuring macroeconomic stability. The Philippine real estate market today is largely driven by BPOs and remittances and less on investors seeking higher returns. Borrower leverage is low and banks have more prudential measures in place. Overall, systemic risks are fairly low, although the residential segment may face downside risks arising from oversupply, hence, the need for careful monitoring.

Stepping Up Disbursements by Improving Absorptive Capacities in Agencies. Weak public spending, especially in the first half of 2011, slowed down Philippine economic growth last year. In October 2011, the Aquino government launched the PHP72 billion Disbursement Acceleration Plan (DAP). The DAP strategy entailed identifying slow-moving projects, including unspent allocations, and then realigning them to i) agencies that can quickly disburse funds, ii) programs and projects that have poverty reduction impact, and iii) programs and projects that have big multiplier effects. While the strategy helped to boost public spending in the last quarter of 2011, the mere realignment of funds does not guarantee sustained improvement in public spending to address growth and poverty targets. A long-term strategy should address internal bottlenecks in national government agencies, which include low absorptive capacity of agencies and weak monitoring and evaluation system, among others.

December 2011: Sustaining Growth in Uncertain Times

Raising Excise Taxes on Tobacco and Alcohol Products. The real revenue yield from excises on tobacco and alcohol has declined significantly since 1997. As a result, from 1997 to 2009, excise collection as a share of GDP fell by about 0.6 percentage points from an already low yield of 1.2 percent of GDP. Quite alarming, Philippine tobacco excise tax rates and burden are among the lowest in South East Asia. Raising excise tax revenues requires i) shifting from multiple to uniform excise tax rates, ii) raising excise tax rates closer to international benchmarks and indexing to nominal GDP growth thereafter, and iii) improving tax administration to minimize leakages from smuggling and evasion. A first best reform would yield as much as 1.3 percent of GDP in additional revenues over the next five years. This incremental revenue would enable the government to increase its human and physical investment to improve the country's growth and development prospects.

Philippine Exports: Where Do They Stand? Despite being an open economy, the Philippines' openness to trade is lower than its neighbors and its exports have been growing slower than GDP. Export diversification has improved in terms of market destination (e.g., more exports to China and other emerging markets and less to the US) but not in terms of product line. The global market share of its main export, semiconductors, has continued to decline. This is in part due to the adverse external environment, changing technology that the Philippines has yet to fully adopt (e.g., new generation gadgets such as tablet computers and smart phones), and stagnant physical capital per worker. In terms of exports survival, the Philippines scores the lowest among comparable ASEAN countries. Thus, improving the country's business environment, particularly in non-PEZA areas, will be essential to boost physical investments, encourage innovations, and promote investments in human capital so that the country can better internalize and harness advanced technologies and business know-how embedded in foreign direct investments. In terms of services exports, a more efficient regulatory system would improve the industry's productivity, thus improving its competitiveness.

September 2011: Solid Macroeconomic Fundamentals Cushion External Turmoil

External Spillovers to Philippine Growth. During 1997-2011, shocks from East Asian-3 economies, China in particular have become more important for ASEAN-5 including the Philippines than those from the United States and the Euro Zone. Spillovers of East Asian economies' shocks are channeled to the Philippines through trade, while the United States and the Euro Zone shocks are transmitted largely through financial variables. The findings suggest that vigorous growth in the East Asian economies can cushion declines in demand from the West.

The 2012 Proposed National Government Budget. The 2012 national budget is a results-focused budget and calls for higher spending in general, particularly on social services. The budget will rest on increased revenue collection efficiency by broadening the tax base and improving tax administration and collection efforts. The Administration aims to lower government debt payment for 2012, which would release additional resources available for priority spending. The budget continues to employ the zero-based budget approach to rationalize expenditures and includes reforms to make further progress in improving spending efficiency, transparency, and accountability. Some of the major reforms include (i) fleshing out lump sum funds and (ii) tightening the use of savings, particularly from unfilled authorized positions. The reform in the use of savings implies that the government agencies and institutions, in particular those in the education sector, need to speed up on hiring. For poverty reduction and inclusive growth, higher spending on priority areas (education and health in particular) is required – an increase to 5-7 percent of GDP. To support this additional spending needed, the government needs to continue to strive for heightened revenue mobilization.

June 2011: Generating More Inclusive Growth

Poverty and Inequality in the Philippines. The recently released 2009 poverty estimates and household survey (FIES) provide a much needed update on poverty, inequality and income dynamics in the Philippines. The FIES reveals that in contrast with previous trends, household per capita incomes grew from 2006 to 2009 and that, remarkably, rural and poorer households strongly outperformed. However, despite this increase and a resilient economy poverty incidence continued to increase through 2009 though, some improvements occurred in both the gap and severity of poverty. Therefore, poverty, and especially poverty dynamics, in the Philippines remains worse than its neighbors. Spatially, poverty remains highly concentrated in rural areas and in terms of sectors, households that rely on agricultural income are significantly more likely to be poor than other households. From 2006 to 2009, poverty in urban areas increased more rapidly, became more severe, and contributed more to the continuous increase in poverty. Across regions, 10 of the 17 administrative regions experienced an increase in poverty incidence.

The Service Sector in the Philippines. The service sector has the potential to play an important role in promoting inclusive growth in the Philippines. The sector is already large and has been an important driver of employment and GDP growth. However, this has not necessarily led to a rise in the average quality of jobs or productivity gains. Unshackling the constraints on services as a source of inclusive growth will require broad-based policy action: providing higher quality education for all to meet the demand for skills as services move up the value chain; improving infrastructure and enabling policies to facilitate agglomeration economies; removing investment climate distortions to allow services firms to invest and innovate.

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1	Doing business in a more transparent world 2012 - economic profile : Philippines - comparing regulation for domestic firms in 183 economies	1/1/2012	Working Paper
2	Philippines quarterly update : sustaining growth in uncertain times	12/1/2011	Working Paper
3	Making everyone count : Gender-sensitive Monitoring and Evaluation in a Community-Driven Development Project - the case of the Philippines KALAHI-CIDSS	11/1/2011	Working Paper
4	Quarterly economic update : solid macroeconomic fundamentals cushion external turmoil	9/1/2011	Working Paper
5	Ripe for a big bang ? assessing the political feasibility of legislative reforms in the Philippines' local government code	9/1/2011	Policy Research Working Paper
6	The Economic Returns of Sanitation Interventions in the Philippines	8/1/2011	UNDP-Water & Sanitation Program
7	Philippines - Discussion notes : challenges and options for 2010 and beyond	6/9/2011	Other Financial Accountability Study
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15	The Search for Durable Solutions : armed conflict and forced displacement in Mindanao, Philippines	3/1/2011	Working Paper
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17	Doing business in the Philippines 2011 : comparing business regulation in 25 cities and 183 economies	1/1/2011	Working Paper
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19	Philippines - Fostering more inclusive growth : main report	1/1/2011	Working Paper
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23	Philippines - Typhoons Ondoy and Pepeng : post-disaster needs assessment (Vol. 3 of 3) : Sector reports	1/1/2011	Other Environmental Study
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