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PHILIPPINE ECONOMIC UPDATE

PURSUING INCLUSIVE GROWTH THROUGH SUSTAINABLE RECONSTRUCTION AND JOB CREATION

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PREFACE

The *Philippine Economic Update* provides an update on key economic and social developments, and policies over the past six months. It also presents findings from recent World Bank studies on the Philippines. It 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 macro-economy and financial markets to indicators of human welfare and development. It 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* is a report of the World Bank's Philippine Poverty Reduction and Economic Management (PREM) team. It was prepared by Karl Kendrick Chua (Senior Country Economist and Task Team Leader), Paul Mariano (Research Analyst and Co-Task Team Leader), Kai Kaiser (Senior Economist), Amelia Johnston (Economist), Joseph Louie Limkin (Research Analyst), Kevin Cruz (Research Assistant), and Anthony Sabarillo (Junior Research Assistant) under the guidance of Rogier van den Brink (Lead Economist). Secretarial and publication support by Maria Consuelo Sy (Program Assistant) and Ayleen Ang (Team Assistant) are gratefully acknowledged.

The sections on Typhoon Yolanda were contributed by a diverse group of individuals from the Philippine Country Management Unit, the East Asia Poverty Reduction and Economic Management Unit, Human Development Unit, and the Sustainable Development Unit. Special thanks go to Catherine Vidar (Disaster Risk Management Specialist) for coordinating the World Bank's typhoon assistance to the Philippines.

The following contributed to the special focus sections: Kai Kaiser (Senior Economist) on tourism industry challenge and Julien Labonne (Consultant) on the KALAHI-CIDSS impact evaluation.

The Manila Communications Team, comprising Leonora Gonzales (Senior Communications Officer), David Llorito (Communications Officer), Justine Letargo (Online Communications Officer), and Geralyn Rigor (Program Assistant), prepared the media release, dissemination, and multimedia products for the web.

The report benefited from advice, comments, and views of various stakeholders in the World Bank, the Government, business, labor, academe, and civil society. The team is very grateful for their time and inputs.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

Recent economic and policy developments

Despite Typhoon Yolanda and a string of natural disasters throughout 2013, Philippine economic growth accelerated to 7.2 percent in 2013. Underlying this remarkable growth are the country's strong macroeconomic fundamentals which continued to support domestic demand and shield the economy from the persistent weaknesses of the global economy.

Higher growth was underpinned by the robust performance of consumption and services, and supported by the expansion of investments and manufacturing. As in previous quarters, sustained inflow of remittances fueled private consumption, which grew by 5.6 percent. Private construction increased by around eight percent, supported by low interest rates and strong demand for office and residential spaces by the booming business processing outsourcing (BPO) industry and its 900,000-strong workforce. Improved efficiency of public infrastructure spending also contributed to higher growth. Exports, while improving, remained lackluster, given slack demand for electronic products. On the production side, both the services and manufacturing sectors were drivers of growth.

Like other emerging markets, Philippine financial markets experienced large volatilities as investors responded to the tapering of the US stimulus program. Stock and bond prices fell significantly in June, August, and December 2013. In August, when volatility was most pronounced, the Philippine Stock Exchange index lost nearly 30 percent of its value (peak to trough), while bond prices fell by 20 percent. The outflow of portfolio investment contributed to the peso's 12-percent nominal depreciation by year end. However, confidence in the domestic economy remained high and the country was globally recognized with a third credit rating upgrade to investment grade.

Monetary and fiscal policy remained supportive of growth. In 2013, CPI inflation eased to three percent, equivalent to the low end of the central bank's inflation target of three to five percent. With low and stable inflation, policy rates were kept at historically low levels of 3.5 and 5.5 percent for the overnight borrowing and lending rates, respectively. Government finances continued to improve, thanks to improvements in tax administration and spending efficiency. Public spending was supported by strong growth in infrastructure spending despite slowdowns in other spending categories. Revenue collection grew by about 12 percent, driven by improved tax administration and incremental revenues from the "sin tax." Further public finance reforms are underway. These include rationalizing fiscal incentives, improving customs administration, and enhancing the accountability and transparency of the budget through the reform of budget execution.

Prospects, risks, and policies

Amid the challenging global environment and the impact of Typhoon Yolanda, the Philippines is likely to sustain high growth in the medium-term. The damage brought about by Typhoon Yolanda is likely to pull down consumption growth, but reconstruction spending can partially offset the decline in GDP growth. Taking these into account, growth is now projected at 6.6 percent in 2014 and 6.9 percent in 2015. These projections crucially depend on the speed and scope of the reconstruction program. In the short-term, a well-designed and rapidly executed reconstruction program can boost economic growth beyond current projections. Over the medium-term, growth prospects can be enhanced by a sustainable ramping up of high impact infrastructure spending. In this context, the Update discusses how strategic infrastructure spending can help boost the development of the tourism industry (Special Focus 1).

Risks to growth include a slower global recovery, financial market volatilities following the tapering of the US stimulus program, potential bubbles in the real estate sector, slower post-typhoon reconstruction, and domestic reform lags. As seen in 2013 and despite the Philippines' strong macroeconomic fundamentals, the country will be affected by regional contagion, given the large share of financial market assets held by foreigners. Slower global recovery in high-income countries and financial market volatility could slow growth through weaker external demand, large capital outflows, and higher interest rates. Unchecked growth of the real estate sector, including shadow financing for real estate, is also a source of risk. Slower pace of reconstruction spending could pull down 2014 growth by up to 0.6 ppt. Finally, domestic reform lags, in particular reforms to raise tax revenues, could undermine a fiscally sustainable acceleration of the Government's infrastructure program. With slower infrastructure growth and high dependence on consumption, growth potential could be limited to below six percent over the long-term.

Building back better after Typhoon Yolanda

Typhoon Yolanda, a category five typhoon that struck central Philippines in November 2013, inflicted severe damage on the social and economic fabric of the Visayas and the MIMAROPA region. The typhoon displaced 4.1 million people and destroyed over half a million houses. Around 8,000 people died or are still missing. The loss of capital and assets, and disruption in electricity and irrigation services, have led to the collapse of local economies in the severely affected areas.

The long-term risks of the typhoon include an increase in unemployment and underemployment, a rise in poverty levels, and deteriorations in human capital indicators, in particular if education and health services are not quickly restored. The scale of potential job losses is significant: around six million workers were affected by the typhoon, of which around 2.6 million are vulnerable workers. And Eastern Visayas, where the entire population was reported to have been affected by the typhoon, has one of the highest poverty incidences in the country, at around 45 percent. With very limited savings capacity, the disruption in economic activity and incomes as a result of the typhoon is expected to bring severe hardship. Pre-typhoon, the poverty rate in the most affected provinces was about 33 percent. Because of the typhoon, an additional one million people could have been pushed into poverty.

The Government responded quickly to the typhoon by rolling out immediate humanitarian aid and preparing the "Reconstruction Assistance on Yolanda (RAY)," a strategic plan to guide recovery and reconstruction in the affected areas. The plan estimates the value of damaged physical assets, both public and private, at PHP 424 billion (3.7 percent of GDP) and recovery and reconstruction costs at PHP 361 billion (3.1 percent of GDP), of which around PHP 125 billion (1.1 percent of GDP) would be borne by the Government in 2013 and 2014. This initial estimate of recovery and reconstruction costs is likely to increase, as it covers only 85 percent of the estimated damage, whereas a "build back better" strategy suggests that recovery costs could be 30 percent higher than the estimated total damage.

Given the country's ongoing vulnerability to disasters, the key challenge of the reconstruction process will be to develop and enforce explicit standards for "building back better." The strategy should identify standards for safe and resilient buildings and infrastructure, and for risk-informed land-use planning. During implementation, public participation and consultation, quality control, strict enforcement, and training will be essential in ensuring that prescribed standards are not compromised. Another key principle for the reconstruction program is to give households substantial control over how and where their houses are rebuilt, as this has proven to be the most effective and efficient approach in other post-disaster recovery programs. Support to households could be provided through the Government's community-driven development program (Special Focus 2). The Government could support such quick, community-driven development by ensuring the efficient functioning of the market for housing materials. And key economic infrastructure and services, such as electricity and access to credit, need to be prioritized to enable affected households to rebuild their livelihoods. To ensure outcomes are achieved and funds are spent transparently and effectively, the Government has begun to track expenditure and physical progress of the reconstruction program.

The Philippines will also need to prepare more broadly for the increased risk of disasters brought about by climate change. Work has begun on developing an integrated strategy for increasing resilience to climate change impacts and natural disasters at four levels: i) at the household level, by exploring options to provide disaster insurance to vulnerable households and safety nets to the poorest so that they can quickly restore their livelihoods after a disaster, ii) at the local level, by developing mandatory disaster insurance for local governments, iii) at the national level, by proposing additional insurance and investment mechanism to build resilience and ensure against catastrophic shocks, and iv) at the international level, by participating in international partnerships to support increased resilience. Such an integrated strategy has the potential to greatly improve the Philippines' resilience to natural disasters and integrate existing disaster risk management programs into a single coherent framework.

Medium-term agenda: Working together to address the jobs challenge

Notwithstanding higher growth in recent years, poverty incidence, according to official statistics, declined only moderately between 2009 and 2012. In December 2013, the National Statistical Coordination Board (NSCB) reported that poverty incidence of the population barely improved from 26.3 percent in 2009 to 25.2 percent in 2012, suggesting that the gains from higher growth were not fully benefiting the poor. In addition, more frequent occurrences of calamities owing to climate change have pushed millions of Filipinos into poverty.

Underlying the slow progress in poverty reduction is the lack of good jobs, which could have reduced the vulnerability of millions of Filipinos who are the likely victims of calamities. As of 2012, 10 million Filipinos were either unemployed (three million) or underemployed (seven million). In addition, around 1.15 million Filipinos enter the labor force every year from 2013 to 2016. However, only a fourth of them find good jobs in the country. The remaining three-fourths or 910,000 find jobs abroad, exit the labor force, become unemployed, or join the ranks of millions of underemployed workers in the informal sector. All in all, 75 percent of workers or around 28 million Filipinos are informally employed with little or no protection from job losses and opportunities to find gainful employment.

Moving forward, the country needs to continue focusing its attention on generating higher, sustained, and more inclusive growth—the type that creates more and better jobs and reduces poverty. With good jobs, Filipinos can increase their income, save more, and invest for the rainy days, thereby reducing vulnerabilities to calamities. The World Bank recently released the draft of the Philippine Development Report (PDR) "Creating more and better jobs" for public discussion. The report, a summary of which is included in this Update, argues that the challenge of sustaining growth and creating more and better jobs will have to focus on raising the productivity of the majority of the country's workers, in particular farmers and MSMEs.

More and better jobs can be created by accelerating reforms to protect property rights, promote more competition, and simplify regulations, while sustainably ramping up public investments in infrastructure, education, and health. However, fiscally sustainable increases in investment levels are only possible through a combination of more efficient government spending and increased revenues from new tax policy and improved administrative measures. With these reforms, the private sector will have the incentive to invest more and create jobs, and the country can attract more investments as the economic rebalancing in the world's most dynamic region takes place. An initial assessment of a new dataset on trade in value-added suggests that the Philippines is well-positioned to further enhance its participation in the region's supply chains.

To increase the chances of success, broad reform coalitions — that is, multi-sectoral groups composed of many interests that can address diverse options at the national or local levels — are crucial. Locking in good governance and translating it into inclusive growth can only occur if government, business, and labor, supported by civil society, agree on a practical agenda for job creation for *all* Filipinos.

A unique window of opportunity is open today for such an action-oriented and coalition-supported program on job creation. First, the country is benefiting from strong macroeconomic fundamentals, political stability, and a popular government committed to improving the lives of the people. Second, the country stands to benefit from the strong growth prospects of a dynamic East Asia region. Third, past the half way mark, the reform momentum of the Aquino Government is accelerating. And finally, there is a growing consensus among a broad spectrum of stakeholders that the current opportunity to enact reforms marks a critical juncture in the country's history. By undertaking structural reforms now, the economy can move towards a more inclusive growth path and create more and better jobs for the majority of the population.

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Output and demand

1. **Despite Typhoon Yolanda and a string of natural disasters throughout 2013, the Philippine economy managed to grow at a remarkable 7.2 percent.** The immediate impact of Yolanda was less severe than initially projected. After growing by 7.4 percent in the first three quarters, growth remained broadly robust at 6.5 percent in the fourth quarter of 2013 (Q4 2013). Higher growth in 2013 was underpinned by the strong performance of consumption and services, and supported by the expansion of investment and manufacturing. Growth in 2013 was the highest among the ASEAN-5 countries and was nearly at par with China (Figure 1).

2. **Private consumption continued to drive GDP growth.** In 2013, private consumption, fueled by remittances from abroad, grew by 5.6 percent and contributed 3.9 percentage points (ppt) to overall growth (Figure 2). All major components of private consumption expanded by at least five percent, with the exception of tobacco and alcoholic beverages, which barely grew at 0.4 percent (Figure 3). The implementation of the "sin tax" law beginning January 2013, which raised retail prices of alcohol and tobacco products by 15 to 50 percent through higher excise taxes, appeared to have reduced the consumption of these products.[1]

3. **Sustained growth of capital formation and government spending accounted for the remainder of GDP growth.** Private sector investment was driven by strong purchases of durable equipment, notably automobiles, airplanes, and machineries. The completion of several real estate projects led to a deceleration in private construction growth to around eight percent. In the public sector, infrastructure spending grew by 22 percent, reflecting both election-related spending and more efficient delivery of infrastructure.[2] Government consumption growth decelerated in the second half of 2013, but full-year growth remained robust at around nine percent. With exports barely growing, net exports subtracted 1.7 ppt from overall growth.

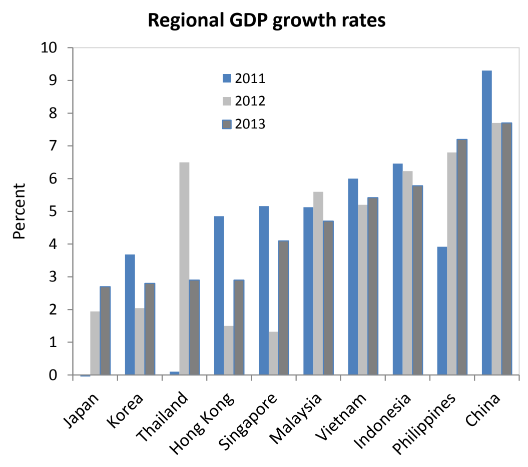
4. **On the production side, the services sector remained the main engine of growth, while manufacturing provided a boost** (Figure 4). The services sector expanded by 7.1 percent, contributing four ppt to overall growth in 2013. The resilient growth of trade, financial intermediation, and real estate and other business activities, which include the booming business process outsourcing industry, supported the robust

[1] The sin tax law aims to curb smoking, especially among young adults and the poor, and to generate revenues to finance the Government's social services program.

[2] Historically, election-related spending contributed up to two ppt to domestic demand growth in the first semester. See Box 3 of the May 2013 edition of the Philippine Economic Update for more discussion.

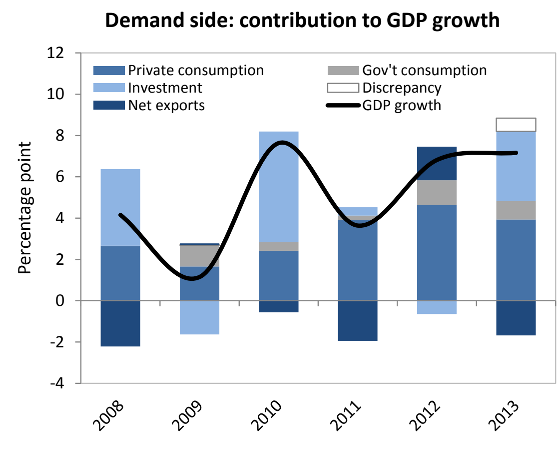
growth of the services sector. Manufacturing also grew strongly at 10.5 percent. The strong domestic demand for food, chemical products, furniture and fixtures, communication equipment, basic metal products, buoyed the sector's expansion, despite negative growth in textile, garments, petroleum and other fuel products, and transport equipment. Agriculture barely contributed to growth as production of major crops, such as corn, coconut, sugarcane, and banana declined.

Figure 1. Philippine economic growth emerged as one of the fastest in East Asia.



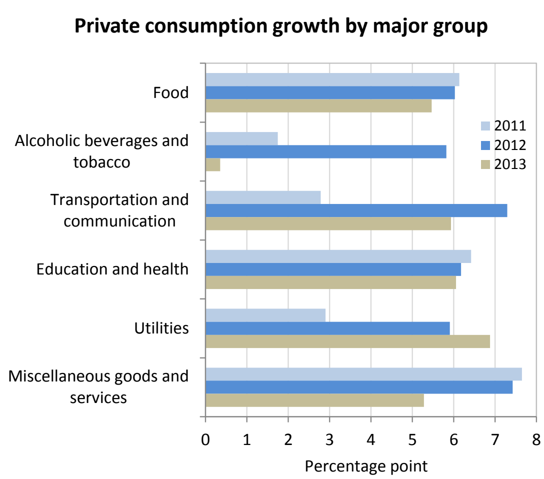
Source: CEIC

Figure 2. Private consumption, investment, and government consumption were the main drivers of growth on the demand side.



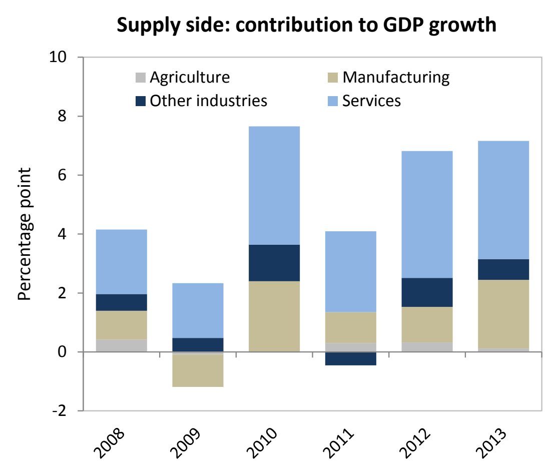
Source: Philippine Statisitics Authority (PSA)

Figure 3. All major consumption groups expanded by more than five percent, except for tobacco and alcoholic beverages, reflecting the implementation of the sin tax law.



Source: PSA

Figure 4. The services sector remained the key driver of growth on the production side. Manufacturing was a close second.



Source: PSA

Poverty and employment

5. **Notwithstanding higher growth, poverty hardly declined between 2009 and 2012.** In December 2013, the National Statistical Coordination Board (NSCB)[3] reported that poverty incidence of the population barely improved from 26.3 percent in 2009 to 25.2 percent in 2012 (Figure 5),[4] suggesting that gains from higher growth are not fully benefiting the poor. Regional disparities remain high with poverty incidence in the Autonomous Region in Muslim Mindanao exceeding 55 percent, Typhoon Yolanda-struck Eastern Visayas at 45.2 percent, while the National Capital Region had the lowest poverty incidence at 3.9 percent (Figure 6).

6. **Underlying the slow progress in poverty reduction is weak job creation.** In October 2012, the economy saw a net destruction of jobs. A year later, in October 2013, job creation was positive, but only 63,000 net jobs were created (Figure 7).[5] Job creation was driven by industry and services while agriculture shed 313,000 jobs. In the industry sector, the rapid growth of construction activities generated 58,000 jobs, but mining and manufacturing saw a decline of 21,000 and 3,000 jobs, respectively. The decline in mining jobs reflects a government policy which limits the issuance of new mining permits. The decline in manufacturing jobs is consistent with the decline of labor-intensive manufacturing. The bulk of employment was generated by the services sector at 318,000 jobs, although a majority of jobs were generated in the informal services sector.

7. **Unemployment and underemployment rates improved modestly, although the overall quality of jobs remains weak** (Figure 8). In October 2013, unemployment decreased to 6.5 percent from 6.8 percent a year ago. The youth (aged 15 to 24), many of whom are college graduates, accounted for nearly 50 percent of total unemployment, suggesting a weak match between job demand and skills, or a relatively high reservation wage, as many educated Filipinos wait for job opportunities abroad or receive remittances from family members abroad.[6] In the same period, the rate of underemployment declined from 19 to 17.9 percent. However, informality remains very high at over 70 percent of total employment. This means that a great majority of Filipinos do not have protection from job losses (e.g., many have no social and health insurances), making them highly vulnerable to poverty and the effects of climate change. This Update's section on the medium-term reform agenda discusses in detail the jobs challenge facing the Philippines today and how this could be addressed by

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[3] In January 2014, NSCB was merged with three other major statistical agencies to form the new Philippine Statistics Authority (PSA).

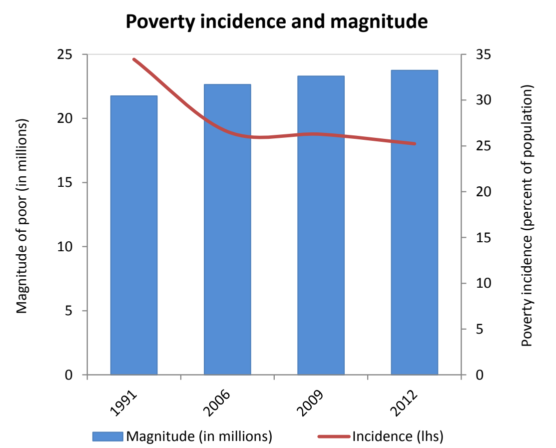
[4] The decline in the poverty incidence is statistically insignificant according to the NSCB.

[5] Shortly before publication, January 2014 statistics became available. However, these statistics do not cover the entire country.

[6] Around 12 percent of Philippine household income is derived from remittances, according to the Family Income and Expenditure Survey (FIES).

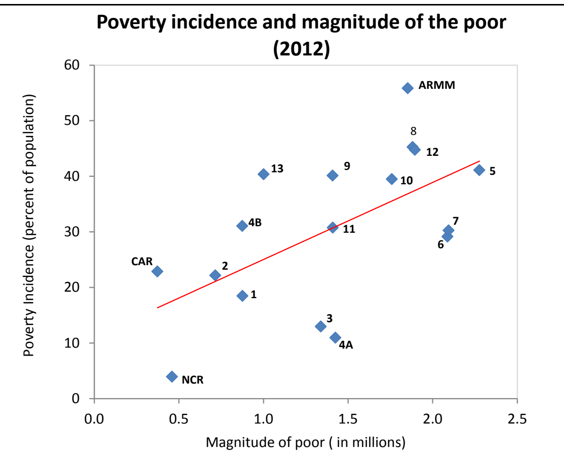
forging strong reform coalitions that will support practical reforms to create more and better jobs.

Figure 5. Poverty reduction was very slow despite higher growth in recent years.



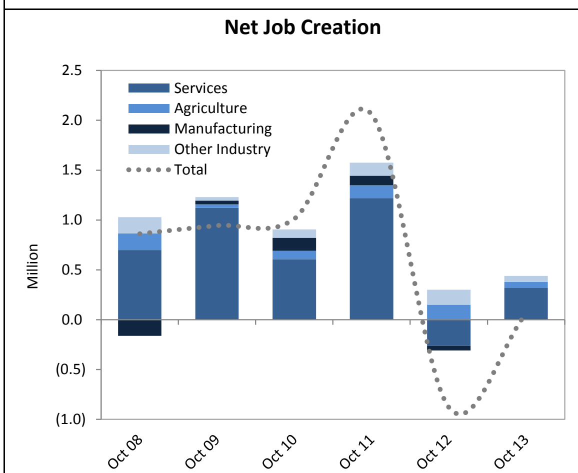
Source: PSA

Figure 6. Regional disparities of poverty are huge.



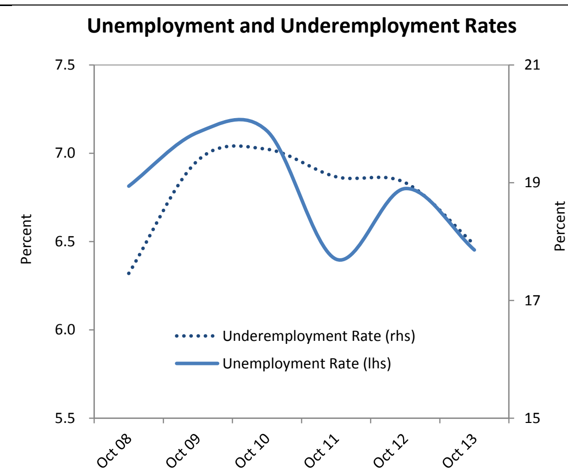
Source: PSA

Figure 7. Employment generation remained relatively weak in October 2012 and October 2013, leading to slow progress in poverty reduction.



Source: PSA

Figure 8. While improving in recent months, the rates of unemployment and underemployment remained structurally high.



Source: PSA

Typhoon Yolanda

Impact of Typhoon Yolanda

8. **The Filipino people's vulnerability to poverty and the negative consequences of climate change was further exposed by Typhoon Yolanda, a category five typhoon that struck central Philippines in November 2013.** The typhoon affected 16.1 million people across nine regions. It displaced around 4.1 million people, including over 101,000

people in 381 evacuation centers and around four million people outside evacuation centers. The Government reported 6,201 fatalities and 1,785 persons missing. A total of 1.1 million houses were damaged, of which close to 551,000 were totally destroyed.[7] While nine out of the country's 17 regions were affected, four regions bore the brunt of the typhoon: Western, Central, and Eastern Visayas, and the MIMAROPA Region.[8] Within these regions, the provinces of Eastern Samar, Western Samar, Leyte, Biliran, northern Cebu, Occidental Mindoro, Negros Occidental, Capiz, Aklan, Romblon, and northern Palawan—already among the poorest provinces in the Philippines—were the worst affected.[9]

9. **The typhoon severely affected the local economies, which is likely to have long-lasting consequences.** The loss of capital and assets, and disruption in electricity and irrigation services, have led to the collapse of local economies in the severely affected areas. The long-term risks include i) a sustained increase in unemployment and underemployment, ii) a rise in poverty levels in the absence of social safety nets, and iii) a deterioration in human capital indicators if education and health services are not quickly restored.

10. **The large-scale destruction of crops, equipment, and other physical assets has disrupted industry and has pushed up unemployment and underemployment.** Vast quantities of crops were destroyed, including 161,400 hectares of coconut farms. Farmers reported losses of livestock, agricultural equipment, post-production facilities, fishing vessels, and irrigation systems. A number of local flagship industries will require significant financing to fully reconstruct, as well as other forms of social assistance, such as cash for work. These industries include, for instance, sugarcane in northern Cebu, poultry in Bantayan Island, and fisheries and tourism in northern Iloilo. These losses have had a substantial long-term negative impact on the domestic economy and household welfare. And there are strong multiplier effects to the informal sector, which constitutes a large share of the local economy. The scale of potential job losses is significant. The Government estimates that around six million workers were affected by the typhoon, of which around 2.6 million are vulnerable workers without adequate social insurance or are unpaid family workers.

11. **Damage to critical infrastructure, particularly electricity networks, has slowed business recovery, exacerbating the impact on jobs.** The typhoon brought the power sector in the affected provinces to a standstill. The wholesale market in the Visayas remains suspended, as available generation is too tight for the spot market to operate

[7] See NDRRMC Update Situation Report No. 104 as of 6:00 AM on January 29 for more discussion.
[8] This region consists of five provinces: Occidental Mindoro, Oriental Mindoro, Marinduque, Romblon, and Palawan.
[9] These provinces were directly hit by Yolanda. The following provinces were peripherally hit: the rest of Cebu, Bohol, Siquijor, Negros Oriental, Iloilo, Guimaras, Antique, Oriental Mindoro, Marinduque, the rest of Palawan, and all provinces in the Bicol Region.

effectively. As of mid-February 2014, the key generation facility, the United Leyte geothermal plant, remains out of service and may only return to full service in the first half of 2015. While service has been restored on most major transmission lines, some of the restoration is based on interim towers and it will take some time before all permanent replacement towers are installed. In most areas (other than the hardest hit ones), distribution services are returning to normal, but electricity cooperatives are still facing challenges as many are under-capitalized. Damage to roads, flood controls, ports, and water supplies will also take time to repair. In the meantime, the absence of basic infrastructure will hinder industry recovery efforts and lead to further losses of jobs and livelihoods.

12. **Businesses are struggling to replace lost capital as credit services in typhoon-hit provinces have been severely constrained.** In the absence of a comprehensive assessment of the impact of Typhon Yolanda on credit services, the International Finance Corporation (IFC) of the World Bank Group conducted a rapid assessment of credit services in two Yolanda-affected provinces: Cebu and Iloilo. The assessment found that a number of financial institutions were able to support current clients through loan restructuring and new lending, although many clients had resorted to using their own savings. However, the needs of many prospective clients affected by the typhoon have yet to be addressed given the lack of suitable products (e.g., emergency loans with flexible terms) and the perceived high risk of some affected clients.

13. **The typhoon-struck areas are among the poorest and most vulnerable**. Eastern Visayas, where the entire population was reported to have been affected by the typhoon, has one of the highest poverty incidences at 45.2 percent in the Philippines.[10] With very limited savings capacity, the disruption in economic activity and incomes as a result of the typhoon is expected to bring severe hardship. Pre-typhoon, the poverty rate in the most affected provinces was about 32.5 percent. Because of the typhoon, an additional one million people could have been pushed into poverty.

14. **The poor health status of the people in affected areas has likely worsened further, as the typhoon damaged health service infrastructure, while increasing health risks and healthcare needs.** The affected areas included those with some of the worst health outcomes in the country. Available reports indicate that i) about half of government hospitals and rural health units have sustained significant damage, ii) the supply chain for medicines and equipment has been disrupted, iii) the cold chain was destroyed, and iv) many health care workers have been displaced. Thousands of people are in need of short and long-term care from psycho-social stress and physical injuries, while the risk of potentially life-threatening diarrheal and water-borne diseases stemming from the absence of clean water and sanitation has sharply increased.

[10] The national poverty rate was 25.2 percent in 2012. Eastern Visayas is the second poorest region in the country in terms of poverty incidence by population.

Furthermore, food shortages experienced by typhoon victims have compromised the health of vulnerable groups such as young children, pregnant women, and the elderly. Overcrowding in temporary shelters has increased the incidence of communicable disease. Poor drainage and stagnant water has increased the risk of contracting dengue fever. And there has been increased environmental exposure due to damaged buildings.

15. **The typhoon has also disrupted the education of about 1.8 million children.** More than 2,500 schools were either totally or partially damaged, with 4,400 classrooms requiring replacement and 12,400 classrooms requiring repairs. Some schools still serve as evacuation centers. In Eastern Visayas, eight schools remain closed as of mid-February and serve as homes for 902 families.[11] In addition, the traumatic experience of students and teachers may have a long-lasting impact on their mental health, and their learning and teaching performance, if not addressed immediately.

Government's immediate response

16. **After the typhoon struck, the Government launched an unprecedented humanitarian relief effort despite the loss of power and communication in many affected areas**. Official government reports of casualties and damages were available within 24 hours. The National Disaster Risk Reduction and Management Council (NDRRMC) immediately established a regional task force to coordinate the response efforts. In close cooperation with international development partners, the Government delivered relief assistance to more than four million people displaced by the typhoon.

17. **Recognizing the importance of a quick start to the recovery process, the Government prepared in December 2013 the "Reconstruction Assistance on Yolanda (RAY)," a strategic plan to guide recovery and reconstruction in the affected areas.** Using the best available data as of mid-December 2013, RAY provides a preliminary assessment of damages, loss, and needs covering four sectors: infrastructure, economic, social, and the government. It also provides a framework for implementation, including budget estimates for the 2014 reconstruction program. Overall, RAY estimates the value of damaged physical assets, both public and private, at PHP 424 billion (3.7 percent of GDP). It estimates preliminary recovery and reconstruction costs, both public and private expenditure, at PHP 361 billion (3.1 percent of GDP) and proposes a PHP 125 billion (1.1 percent of GDP) budget in 2013 and 2014 to fund the reconstruction effort. To address risks arising from future disasters, the Government is laying the foundation for a Climate and Disaster Resiliency Fund (CDRF). The details of the RAY estimates and the CDRF are discussed further in Part III "Building back better after Typhoon Yolanda," of this Update.

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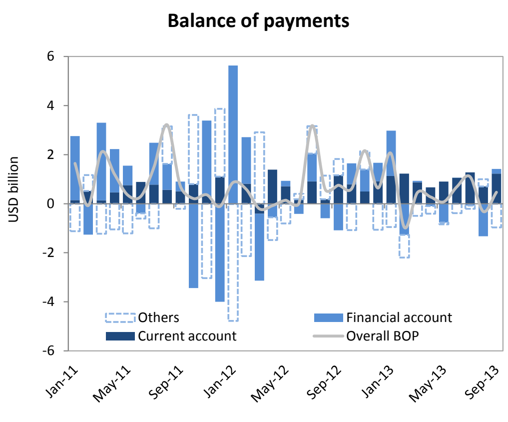
[11] See United Nations Office for the Coordination of Humanitarian Affairs (UNOCHA) report "Philippines: Education cluster: Response to Typhoon Haiyan (Yolanda)" on February 14, 2014 for more discussion.

External accounts

18. **The country's external position remained strong and continued to benefit from resilient remittances and export of services, despite weak merchandise trade.** In Q1 to Q3 2013,[12] the balance of payments recorded a surplus of USD 3.8 billion, equivalent to 1.9 percent of GDP. This was underpinned by a healthy current account surplus, which reached USD 9.1 billion or 4.6 percent of GDP and was nearly double compared to a year ago (Figure 9). Sustained growth of remittances remained the key driver of the current account surplus, while the expansion of services exports also provided support.

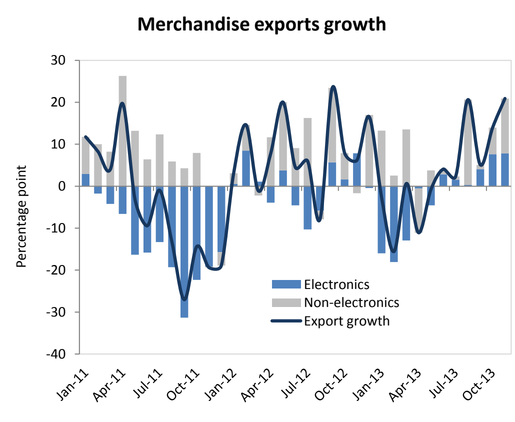
19. **Merchandise trade continued to underperform.** Slower economic growth in key trading partners, such as the US and China, and the shift in demand to tablets and smart phones (which are not fully supported by the local electronics industry) dampened growth of Philippine electronics exports, which fell by 2.5 percent in 2013 (Figure 10). Growth in non-electronic exports, which constitute about 55 percent of total merchandise exports, helped offset the decline in electronic exports. Meanwhile, imports declined by 0.7 percent in 2013. Despite growth in imported consumer goods, the decline in imported capital goods, crude oil, and electronic components and devices (e.g., semiconductors) subdued the growth of imports. Imported electronic parts account for over 80 percent of the value of Philippine electronic exports. While this means that the Philippines is well connected to the global supply chain, the low value-added of electronics exports also means that it provides few jobs to the domestic economy (Box 1).

Figure 9. A healthy current account surplus, sustained by robust remittances and services exports, led to a higher BOP surplus.



Source: *Bangko Sentral ng Pilipinas* (BSP)
Note: Beginning 2012, the balance of payments is compiled using BPM6.

Figure 10. Weak external demand for electronics continued to dampen the growth of merchandise exports.



Source: PSA

[12] This is the latest available data.

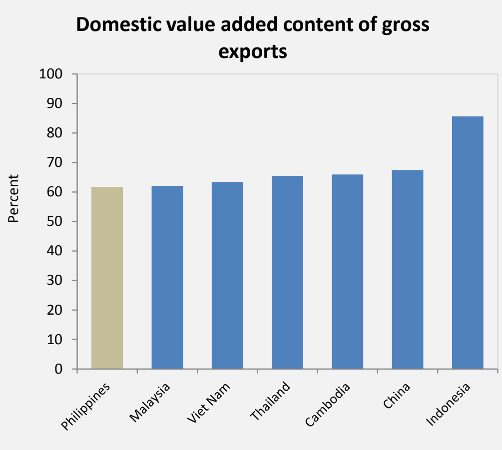
Box 1. Value-added of Philippine exports

In the May 2013 release of the Trade in Value-Added (TiVA) database of the Organization of Economic Cooperation and Development (OECD) and the World Trade Organization (WTO), the Philippines was included for the first time. Launched in January 2013, this new database provides valuable insights on the trade flows of about 40 countries by measuring imports and exports in value-added terms.

Measuring trade flows using value-added provides a more accurate assessment of a country's position in these global supply chains. This matters for a country's industrialization strategy. For instance, the "old" industrial strategy was to build one's own national industrial base (e.g., Korea, Taiwan, US, Germany, and Japan). The "new" industrialization strategy is to join global or regional supply chains and then move up the value-chain. In complex cross-border production processes, the conventional gross trade flow statistics could provide misleading information as values of intermediate goods and services are counted several times in different countries' trade statistics. The TiVA statistics, which were derived using the global input-output tables, avoids multiple counting and provides a decomposition of domestic and foreign content of exports and imports. For instance, while China reports USD 178.96 as exports for every shipment of an Apple iPhone, only 3.6 percent of the total value (or USD 6.50) is attributable to Chinese inputs. The remaining 96.4 percent are receipts from imported goods and services from countries in the iPhone production chain, such as Germany, Japan, Korea, and the US (Xing and Detert 2010). Using value-added flows, instead of gross values, global supply chains and networks can be better analyzed. TiVA statistics can also shed new light on a country's comparative advantage, as the analysis can now distinguish the contribution of and specialization in the value-added parts of the supply chain, in addition to that of the final products.

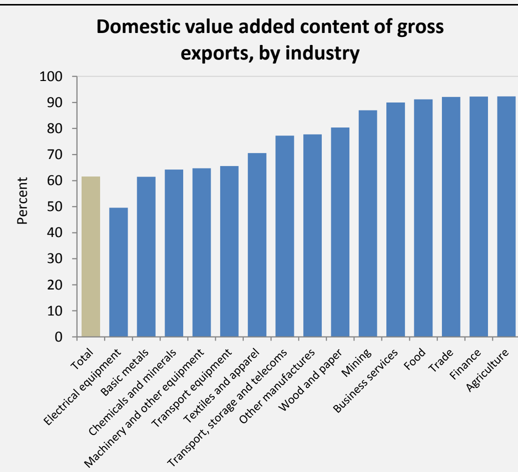
For the Philippines, the TiVA statistics show that of the country's total gross exports, more than one third comprised foreign inputs. The 2009 TiVA shows that the share of domestic value-added (DVA) to gross exports is 61.6 percent. This is broadly in line with other countries in the region (Box Figure 1.1). This suggests a high degree of integration in global value chains.

Box Figure 1.1. The Philippines' DVA is broadly in line with other countries in the region.



Source: OECD-WTO

Box Figure 1.2. Low DVA in most manufacturing industries reflects integration with global supply chain.

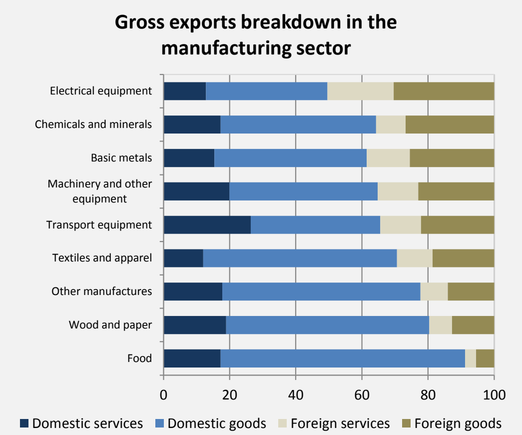


Source: OECD-WTO

Capital-intensive industries, such as electrical equipment, transport equipment, basic metals, and machinery, tend to have lower DVA and are more integrated to the global supply chains (Box Figure 1.2). For instance, gross exports in the electrical equipment sub-sector, which includes the electronic industry, contain about 50 percent in imported inputs, mostly from the US and China. Of the domestic inputs, services (i.e., wages) account for some 13 percent. The majority of capital-intensive manufacturing industries have low shares of domestic services in gross exports (Box Figure 1.3). This also means that these industries provide few jobs for the domestic economy.

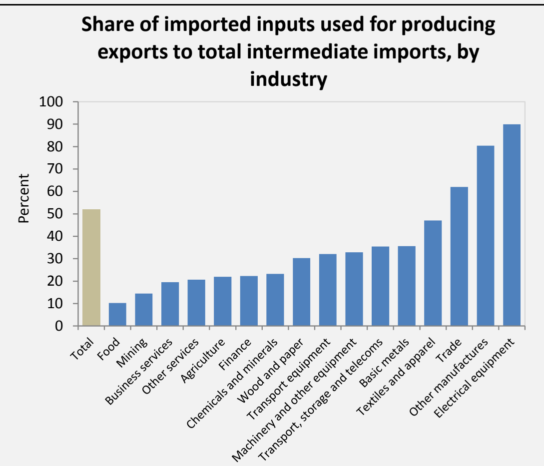
The TiVA statistics also show that half of all imported inputs are directed to export production. Imported inputs account for around one third of total imports. About 50 percent is used in the production of exports and the rest are for the domestic market (Box Figure 1.4). Higher utilization of intermediate imports is seen in highly integrated sectors such as electrical equipment, which uses more than 80 percent of all intermediate imports. This initial assessment suggests that the Philippines is well-positioned to further enhance its participation in global supply chains.

Box Figure 1.3. Low shares of domestic services to gross exports in capital-intensive industries indicate weak employment contribution.



Source: OECD-WTO

Box Figure 1.4. Highly integrated sectors have larger shares of imported inputs to total intermediate imports.



Source: OECD-WTO

Sources:

Organization for Economic Cooperation and Development (OECD) and the World Trade Organization (WTO). 2013. “OECD-WTO Database on Trade in Value-Added: Preliminary results.” s.l.: WTO.

Organization for Economic Cooperation and Development (OECD) and World Trade Organization Organisation Mondiale du Commerce (WTO OMC). 2013. “Trade in value-added: Concepts, methodologies and challenges.” Joint OECD-WTO note. s.l.: OECD.

Organization for Economic Cooperation and Development (OECD), World Trade Organization Organisation Mondiale du Commerce (WTO OMC), and United Nations Conference on Trade and Development (UNCTAD). 2013. “Implications of global value chains for trade, investment, development and jobs.” Prepared for the G-20 Leaders Summit, Saint Petersburg (Russian Federation) September 2013. s.l.: OECD.

World Bank. 2013a. “East Asia and Pacific Economic Update April 2013: A fine balance.” Washington, DC.

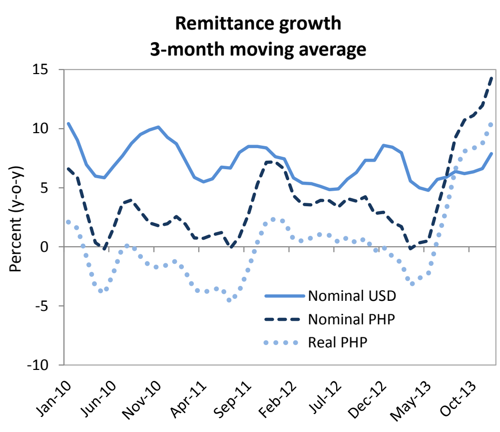
World Bank. 2013b. “Indonesia Economic Quarterly: Pressures mounting” March 2013 edition. Jakarta.

Xing, Y., and Detert, N. 2010. “How the iPhone widens the United States trade deficit with the People's Republic of China.” ADBI Working Paper No. 257, December.

20. **Remittances and the export of services remained robust and were largely unaffected by slower growth in advanced economies.** They remained the key drivers of domestic consumption and have helped cushion the economy from the global slowdown. Cash remittances expanded by 6.4 percent in 2013 (Figure 11), supported by the increasing demand for skilled Filipino workers overseas. In 2012, the deployment of skilled workers, mostly to the Middle East, Singapore, and Hong Kong, reached 1.8 million or a 6.8-percent growth. In addition, continued expansion of bank and non-bank remittance services is also responsible for the increase in remittances sent through official channels. In Q1 to Q3 2013, export of services increased to USD 16.2 billion, 20 percent higher than the same period last year, driven by BPO services.

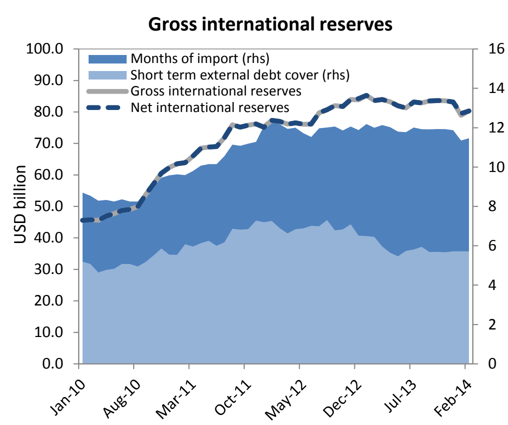
21. **Net foreign capital inflows remained positive despite some outflows of portfolio investments in June, August, and December 2013.** In 2013, net foreign direct investments (FDIs) reached USD 3.9 billion, a 20-percent growth from the same period a year ago. Most of the FDIs went to equity capital investments, which were directed mostly to manufacturing, water supply, sewerage, waste management and remediation, financial and insurance, and real estate. Net foreign portfolio investments (FPIs), on the other hand, recorded higher net inflows of USD 1.7 billion (3.8-percent growth) in the first three quarters of 2013. In Q4 2013, registered-FPIs in the central bank recorded net inflows of USD 1.6 billion

Figure 11. Remittances remained robust on account of stable deployment of skilled workers abroad and increased use of formal channels when sending back remittances.



Source: BSP

Figure 12. Gross international reserves remained at record highs, enough to finance one year of imports.



Source: BSP

22. **Higher inflow of remittances, services exports, and investments contributed to a high level of international reserves.** In February 2014, gross international reserves

remained high at USD 80.3 billion, enough to cover 11.5 months of imports or 5.7 times the country's short-term external liability by residual maturity[13] (Figure 12).

Financial markets

23. **Like other emerging markets, Philippine financial markets experienced large volatilities as investors respond to the planned tapering of the US stimulus program.** The country's stock market was one of the hardest hit, along with Indonesia and Thailand (Figure 13). After reaching a historic peak of 7,392 points in May 2013, sharp foreign sell-off of stocks dragged down the Philippine Stock Exchange Index (PSEi) by nearly 30 percent. The increase in interest rate differentials caused foreign investors to adjust their portfolios, reducing the prices of local bonds. For instance, the bond prices of the benchmark ROP 2032 and ROP 2034 (i.e., government external debt papers) declined by 20 percent (Figure 14). Sovereign spreads reached a high of 229 basis points (bps) in June 2013, a two-fold increase from the beginning of the year, and remained at elevated levels in the remainder of 2013. Treasury bill rates also increased from their record lows in October.[14] The outflow of portfolio investment contributed to the peso's 12-percent nominal depreciation by year-end. However, in real effective terms,[15] the peso has been appreciating relative to its regional competitors (Figure 15) and this could pull down the growth of exports in goods and services (including BPOs) and consumption (via remittances).

24. **Indicative of the country's strong macroeconomic fundamentals, confidence in the domestic economy remained high.** Following the two rating upgrades by Fitch and Standard & Poor's to investment grade, Moody's also raised the Philippines' sovereign credit rating to investment grade with a positive outlook, citing the country's strong economic growth, ongoing fiscal and debt consolidation, political stability, and improved governance.

Prices and monetary policy

25. **CPI inflation remained low, averaging three percent in 2013, at the low-end of the central bank's inflation target of three to five percent** (Figure 16)**.** After dipping to a

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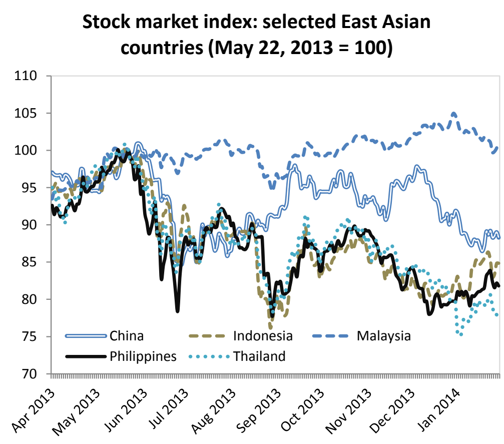
[13] Short-term external liability by residual maturity, as defined by the central bank, refers to external debt with original maturity of one year or less, plus principal payments on medium and long-term loans of the public and private sectors falling due in one year or less.

[14] For instance, the 91-day T-bill rate increased from 0.001 percent to as high as 1.875 percent in early January 2014.

[15] Real effective exchange rate is the nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs.

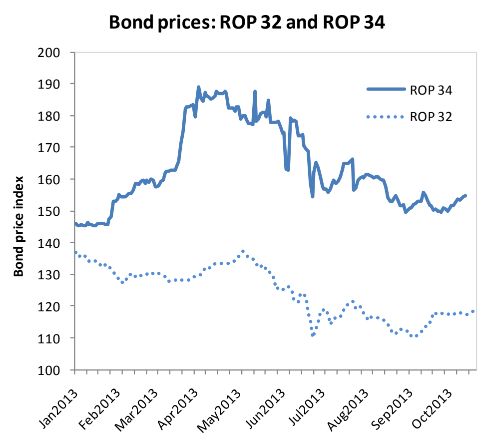
record low of 2.1 percent in August, inflation gradually accelerated in the following months, reaching 4.1 percent in December owing to higher food prices, electricity rates, and fuel prices. Food prices increased by five percent from 1.8 percent in August, given tight supply conditions of most food items caused by weather-related production disruptions and the increase in rice prices beginning June. Retail prices of rice rose by 13 percent due to higher farm gate prices and supply shortages (Figure 17). Non-food inflation, on the other hand, also increased given higher gasoline and LPG prices, and higher electricity rates. The implementation of the sin tax also contributed to higher CPI inflation. Core inflation, however, remained low at 2.9 percent in 2013. In February 2014, CPI inflation remained at 4.1 percent as food supply remained tight in Typhoon Yolanda-affected areas.

Figure 13. Like other East Asian stock markets, the Philippine stock market experienced large volatilities in June, August, and December.



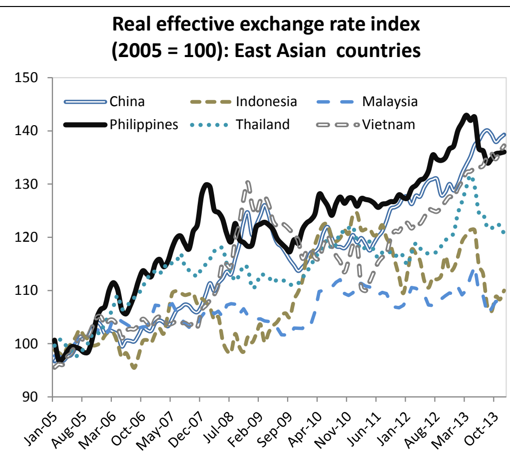
Source: CEIC

Figure 14. Prices of the benchmark bonds fell by 20 percent at the height of the financial market volatility.



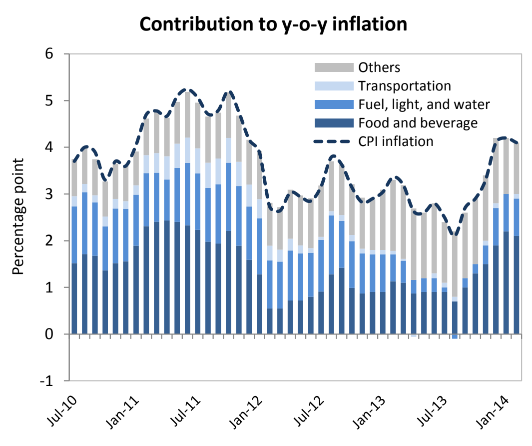
Source: Bloomberg

Figure 15. Yet, the peso remained one of the strongest currencies in the East Asia region in real effective terms.



Source: International Monetary Fund

Figure 16. CPI inflation accelerated beginning August 2013 given increases in the price of food items, electricity, and fuel.

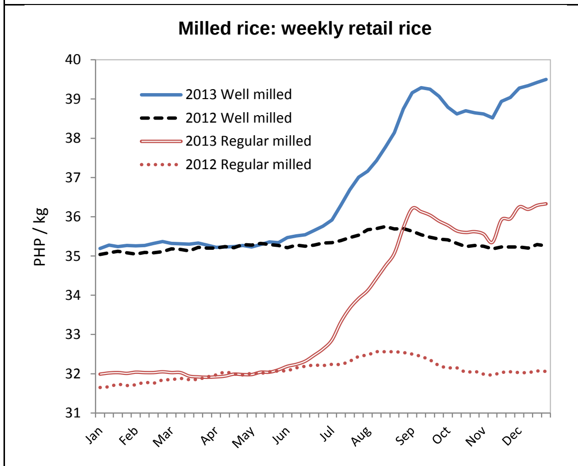


Source: BSP

26. **Given low inflation, monetary policy remained accommodating, with policy rates maintained at record lows.** The Monetary Board kept the overnight borrowing and lending rates at 3.5 and 5.5 percent, respectively, since October 2012. To fuel domestic demand, the rate of the special deposit accounts (SDA) was cut thrice by a total of 150 basis points. Moreover, the Monetary Board tightened rules on the SDA facility by limiting access only to banks' peso trust accounts beginning December 2013. In December, as the implementation of the restriction began, the SDA facility saw a reduction in placements to PHP 1.34 trillion from a record high of almost PHP 2 trillion in April.

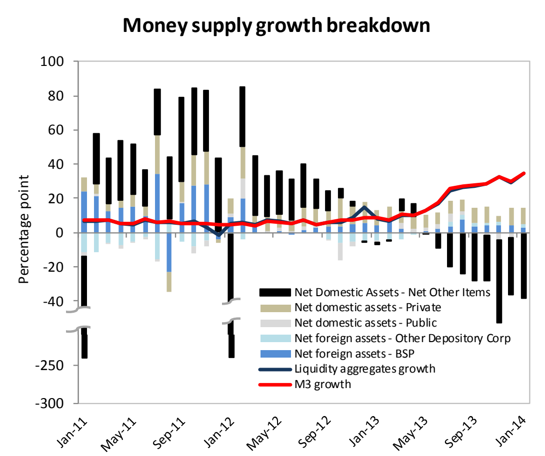
27. **Money supply (M3) growth accelerated to 38.6 percent in January 2014, driven by net foreign asset accumulation and sustained credit expansion in the private sector** (Figure 18)**.** Loans to businesses by universal and commercial banks, which comprise more than four-fifths of banks' aggregate loan portfolio, grew by 16.2 percent. Loans to households, which account for about eight percent of total loans, increased by around 8.9 percent. Loans to real estate expanded rapidly by 45.2 percent in June 2013, increasing the real estate exposure of universal and commercial banks to 21.7 percent.[16] Despite growth in lending, banks' balance sheets remained healthy with the non-performing loans ratio declining to 2.3 percent in January 2014 and the capital adequacy ratio improving to 17.5 percent in September 2013,[17] well above the minimum mandated level of 10 percent.

Figure 17. Retail price of rice surged by 13 percent in recent months.



Source: PSA

Figure 18. Net foreign asset accumulation of the central bank and net domestic asset claims by the private sector drove liquidity growth.



Source: BSP

[16] Exposure to real estate is measured as a percent of the banking system's total loan portfolio.
[17] Latest available data

Fiscal policy

28. **National Government (NG) spending was supported by strong growth in infrastructure spending despite slowdowns in other spending categories.** In 2013, NG spending grew by six percent and was equivalent to around 94 percent of the PHP 2 trillion budget. Improved disbursements in the Department of Public Works and Highways (DPWH) pushed up infrastructure spending by around 15 percent. Subsidies to GOCCs increased significantly, with the PhilHealth program for indigents and the National Housing Authority's housing and resettlement program accounting for the bulk of the increase. Other spending categories, however, decelerated in the last two quarters of 2013.

29. **On the revenue side, overall tax collection continued to improve.** In 2013, NG revenue expanded to PHP 1.7 trillion, or about 12 percent higher than the same period last year. Tax collection improved to 13.3 percent of GDP from 12.9 percent of GDP in 2012, with the Bureau of Internal Revenue (BIR) accounting for more than two-thirds of total tax revenues and collecting 15 percent more taxes. Following the implementation of the "sin tax" law, incremental excise taxes on tobacco and alcohol reached PHP 51.5 billion (0.4 percent of GDP). In contrast to the sustained performance of the BIR, tax collection by the Bureau of Customs (BOC) increased by only five percent in the same period.

30. **Improvement in tax administration measures remained the main vehicle for generating higher revenues.** Through the Run After Tax Evaders (RATE) Program, the number of tax evasion cases under the Aquino Administration totaled to 212 as of January 2013, compared to only 23 in 2010.[18] The BIR targets to increase the number of self-employed individual taxpayers (SEIT) from 402,000 to 1.8 million and to reach a PHP 200,000 average tax collection per SEIT. Key programs to achieve the targets include systematic information sharing with other government offices, and encouraging citizens to report tax evaders, smugglers, and corrupt BIR and BOC officials.[19] Tax compliance is also being improved by increasing the coverage of the withholding tax system such as mandating hospitals and health maintenance organizations to withhold taxes from doctors. In an effort to raise estate tax collections to PHP 50 billion by 2016, the BIR is now strictly requiring tax clearances before changes in ownership of properties can be registered. Finally, the Department of Finance (DOF) and the BIR launched a weekly media campaign, called "Tax Watch" to compare taxes paid by leading establishments and their popularity rankings, as well as taxes paid by various occupations, in a bid to raise tax compliance.[20]

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[18] DOF provides information on RATE cases in http://perangbayan.com/.

[19] Citizens can report officials who are involved in graft, improper action, negligence, lavish lifestyle, and other illegal practices in DOF's portal at http://perangbayan.com/.

[20] An example of this is the "*Is your favorite restaurant a top taxpayer in Pasig City?"* ad in leading newspapers, also available in http://www.dof.gov.ph/?p=8090. Other recent updates on *Tax Watch* are

31. **Rampant smuggling and weak customs revenue collection have led to a revamp in the BOC.** In September 2013, the President replaced all the deputy commissioners with new officials recruited from the private sector and other government agencies. Moreover, the Secretary of Finance has ordered the detail of 27 senior officials of the BOC to the newly established Customs Policy Research Office under the Department of Finance in a bid to clean-up the organization. The reorganization was completed in December 2013 with the appointment of a new BOC commissioner. The new BOC management has outlined the following reforms:[21] i) evaluating and improving the organization and staffing complement of the BOC, ii) using IT systems to automate certain BOC processes and improve interface with trade facilitators (e.g., freight handlers, brokers, and importers), iii) increasing accountability and transparency through the use of a document tracking system and disclosing all customs import entries, iv) timely reporting of monthly collections, and v) comparing collection data with third party data regularly. The Run After the Smugglers (RATS) Program continued to show progress, with 144 cases filed compared to 18 cases in 2010.[22]

32. **With improving public finances, the overall debt burden continues to fall and remains manageable.** In 2013, the Government achieved a small budget deficit equivalent to 1.4 percent of GDP, well-below the target of two percent largely on account of weak spending and supported by some revenue gains. The lower budget deficit was accompanied by favorable conditions, such as the appreciation of the peso in the first half of 2013 and lower borrowing costs. It also reflects progress in reforms to improve the management of GOCCs, leading to record-high receipts of dividends in 2013. NG debt to GDP ratio declined from 51.5 percent of GDP in end-2012 to 49.2 percent of GDP in 2013. A debt sustainability analysis projects that NG debt could continue to trend downwards, with a debt-to-GDP ratio of 46 percent by 2016, barring any unexpected shocks. Standard shocks (i.e., a 0.5 to 1.0 standard deviation) on interest rates and growth would increase the debt stock to between 49.6 and 52 percent of GDP (Figures 19 and 20), levels that are still broadly sustainable.

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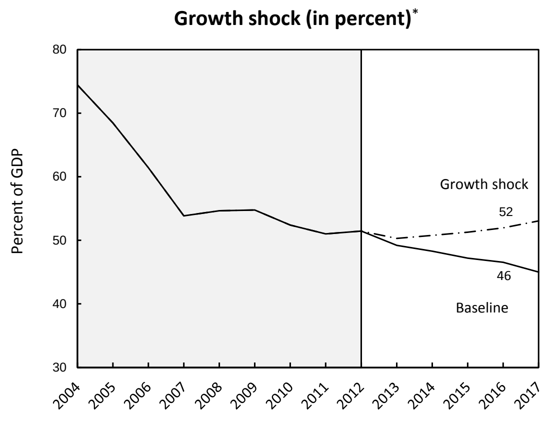
available in the website of the Official Gazette, the official journal of the Republic of the Philippines: http://www.gov.ph/featured/tax-watch/.

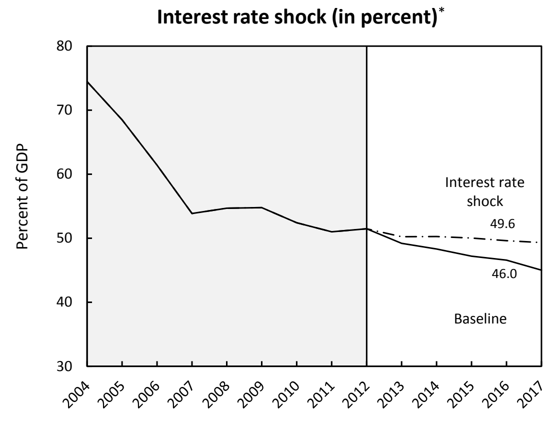
[21] See Department Order 17-2013 for more discussion on the DOF's anti-smuggling agenda.

[22] RATS cases filed are also posted in http://perangbayan.com/.

Figure 19. NG debt to GDP ratio projection with a growth shock.	**Figure 20. NG debt to GDP ratio projection with an interest rate shock.**



Source: World Bank staff calculations
Note: * Represents a one standard deviation shock to growth.
The shaded area represent actual data.



Source: World Bank staff calculations
Note: * Represents a one standard deviation shock to growth.
The shaded area represent actual data.

PROSPECTS, RISKS, AND POLICIES

33. **Amid the challenging global environment and the impact of Typhoon Yolanda, the Philippines is likely to sustain high growth in the medium-term.** The country continues to benefit from strong macroeconomic fundamentals, political stability, and a government committed to reforms. These strong fundamentals will continue to support domestic demand and shield the economy from the impact of the global economic slowdown and financial market volatilities. In the near-term, growth can be sustained by immediately implementing the reconstruction and recovery program to reduce the negative impact of Typhoon Yolanda on the economy. In the medium-term, a comprehensive reform agenda agreed upon by a broad group of stakeholders is needed to support the revival of agriculture and manufacturing and to make business and labor regulations, including social protection, more conducive to job creation. To support these reforms, sustainable increases in investments in health, education, and infrastructure are essential.

Output and demand

34. **Typhoon Yolanda will undoubtedly reduce growth in the near-term, but a speedy reconstruction program can minimize the decline in growth.** Growth is now projected at 6.6 percent in 2014 and 6.9 percent in 2015. The new growth projections assume a decline in household consumption due to loss in livelihood in the typhoon-affected areas. This would be partially offset by humanitarian assistance and reconstruction spending, including rehabilitation and retrofitting of public infrastructure, livelihood restoration, and restoration of urban and rural housing, and settlements. The RAY estimates that reconstruction spending could reach around PHP 90 billion (0.8 percent of GDP) in 2014.

35. **Domestic demand would continue to drive growth in the near-term.** Private consumption, which comprises over 70 percent of GDP, would remain the key driver of overall growth, supported by sustained growth of remittances and BPO revenues, a positive consumer outlook,[23] and strong growth of tourism. Government spending and private investment would provide the remaining sources of growth. The rapid expansion of the local airline industry, reflecting the growth of tourism, would provide strong support for durable equipment, and hence private investment growth. Finally, realization of FDI pledges, which grew by 87 percent to PHP 127 billion (1.1 percent of GDP) in the first three quarters of 2013 would contribute to higher investment spending.

[23] In the Q3 2013 Consumer Expectations Survey (CES) of the central bank, the consumer outlook index for the next three months (i.e., in Q4 2013) increased to 5.7 percent from 4.1 percent, while outlook for the next 12 months remained positive at 15.8 percent.

36. **Over the medium-term, growth of above six percent can be sustained through an acceleration of infrastructure spending.** High growth can be sustained at above six percent if the planned doubling of infrastructure spending from 2.5 to five percent of GDP by 2016, as announced by President Aquino in his 2013 State-of-the-Nation Address, materializes (Box 2). The planned infrastructure investments are ambitious and will require sustained growth in revenues, and focused and improved coordination and collaboration between various government agencies.

37. **Private construction growth would also support medium-term growth given record-low interest rates and improving business and consumer outlooks.** However, to build a stronger foundation for inclusive growth, investments need to shift from a real estate and construction-driven growth to investment driven by durable equipment and infrastructure, as these can better support the revival of manufacturing and create many jobs for the poor.

Box 2. Ramping up infrastructure spending through 2016

Infrastructure spending in the Philippines averaged only 2.1 percent of GDP in the last decade. And although in 2013 the programmed budget for infrastructure slightly increased to 2.5 percent of GDP, the country has yet to match the level and quality of infrastructure spending of its neighbors.[24] To reverse this trend, the Government announced a policy to gradually ramp up infrastructure spending to at least five percent of GDP by 2016.

In 2014, the Government plans to spend more than PHP 400 billion, or around 3.1 percent of GDP on infrastructure. This figure excludes planned reconstruction spending on infrastructure damaged by typhoon Yolanda. The Department of Public Works and Highway (DPWH) receives around PHP 180 billion (44 percent of the total infrastructure budget). This is the highest among the various government agencies, with the bulk going to the department's National Roads and Bridges Program. The second highest allocation (PHP 46 billion or 11 percent) goes to the Department of Education, which plans to complete more than 30,000 classrooms by 2014, among other projects. The Department of Transportation and Communication receives about PHP 28 billion (6.7 percent) to build and rehabilitate communication and transportation infrastructure. The Department of Agriculture (DA) receives PHP 27 billion (6.6 percent). Together with the DPWH, DA plans to build 1,000 kilometers of farm-to-market roads (worth PHP 12 billion) in 2014. To support the tourism industry, PHP 14.4 billion is being allotted to infrastructure leading to various tourist destinations (e.g., 167 kilometers of roads).[25] The challenges facing the tourism industry and efforts to improve tourism road infrastructure are discussed in Special Focus 1.

Beyond 2014, a number of flagship projects have been identified for completion by 2016. These

[24] The Philippines is ranked 96th out of 148 countries under the Infrastructure pillar of the 2013-2014 Global Competitiveness Index. It lags behind Malaysia (29), Thailand (47), and Indonesia (61).

[25] Examples of such infrastructure are i) the Ambangeg Junction National Road, which will improve access to Mt. Pulag, a popular mountain climbing destination, ii) the Island Garden City of Samal Circumferential Road, which leads to the Pearl Farm Beach Resort and Samal Botanical Garden, both in Samal Island, Davao, and iii) access roads leading to Donsol, Sorsogon, which is famous for the whale shark.

include i) the Metro Manila Integrated Transport System, which would help reduce traffic congestion, ii) other key tourism infrastructure under the Sustainable Tourism Destination Infrastructure Program,[26] and iii) the Department of Energy's accelerated *Sitio*[27] Electrification Program, which is expected to benefit 36,000 *sitios.*

Aside from higher infrastructure spending from the budget, the Government plans to accelerate public-private partnerships. As of February 2014, projects that have been awarded include i) the Daang Hari-SLEX Link Road, ii) a 74-hectare property in the Food Terminal Complex in Taguig City to be developed into a new business district, iii) the Ninoy Aquino International Airport Expressway-Phase II, iv) the School Infrastructure Project Batches I and II,[28] v) the automated fare collection system for LRT lines 1 and 2, and Metro Rail Transit 3, vi) the NLEX-SLEX skyway connector, and vii) the modernization of the Philippine Orthopedic Center. Pipeline projects under the bidding stage include i) the Mactan-Cebu International Airport New Passenger Terminal Building Project, ii) Light Rail Transit (LRT) Line 1 South Extension Project, iii) the Cavite-Laguna Expressway, iv) Integrated Transport System (South and Southwest Terminal Projects), and v) the Bulacan Bulk Water Supply Project. An acceleration of the PPP process would help the country realize faster economic growth supportive of a revival of manufacturing.

Finally, the Government aims to sustain infrastructure development beyond 2016. For instance, it plans to adopt a long-term National Transport Policy as a means to develop and improve governance in the transport infrastructure sub-sector. The stability of funds for the maintenance of infrastructure assets would also be ensured by the Government. Under the rail transport sub-sector, an independent rail regulator is identified in the Policy. Under the water sub-sector, the Government plans to improve water efficiency and bring down water tariff for irrigation associations through the wholesale of water.

Sources: Department of Budget and Management, Public-Private Partnership Center, President Aquino's 2013 State-of-the-Nation Address (SONA), 2013 SONA Technical Report, the 2014 Budget Message of President Aquino, and the Philippine Development Plan 2011-2016.

38. **The main sources of risk to near-term economic growth are the slow pace of reconstruction spending and lower-than-programmed revenue collection which could lead to delays in the planned doubling of infrastructure spending by 2016.** Slower pace of reconstruction spending could pull down 2014 growth by up to 0.6 ppt. Lags in reforms to raise tax revenues could undermine a fiscally sustainable acceleration of the ambitious infrastructure spending plans. Slower progress in the planned doubling of infrastructure spending could also pull down the projected growth numbers by up to 0.5 ppt. A simple static analysis shows that GDP growth in 2014 could decline to 6.1 percent should infrastructure spending as a share of GDP remain unchanged at the 2013 level of 2.5 percent of GDP (Table 1).[29] If infrastructure spending increases to 3.1 percent of GDP as programmed, then GDP growth of 6.6 percent is attainable.

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[26] These projects will fall under DOT, DPWH, and DOTC. The implementation of the Sustainable Tourism Destination Infrastructure Program will cost around PHP 63 billion by 2016 according to DOT.

[27] A *sitio* is a subdivision of a *barangay* (village).

[28] This project aims to complete a total of around 20,000 classrooms before 2014 ends.

[29] The model used to generate Table 1 assumes a simple linear relationship between infrastructure growth and overall GDP growth, holding all other variables constant. The estimates, therefore, measure only the direct effects of infrastructure spending on growth and excludes indirect effects, such as the

Table 1. Impact of infrastructure spending on 2014 GDP growth

Infrastructure spending		GDP growth
Percent of GDP	Growth	
2.5	3.5	6.1
2.7	11.4	6.2
2.9	19.6	6.4
3.1	28.3	6.6

Source: World Bank staff estimates

39. **Other downside risks to growth could come from a slower global recovery, the end of quantitative easing in the US, and potential supply "bubbles" in the real estate industry.** Slower recovery in high income countries would translate into lower external demand given the country's strong linkages to the global supply chain for electronic products. While growth in high income countries is projected to improve to 2.2 percent in 2014,[30] there are still uncertainties around its sustainability. However, even if global growth improves, the country's strong exchange rate in real effective terms and the lack of diversification in key exports could undermine growth of external demand.

40. **The scaling back of quantitative easing in the US and problems in other emerging markets would result in higher borrowing costs, lower capital inflows, and a decline in asset prices in the Philippines.** Despite the Philippines' solid macroeconomic fundamentals, the country is exposed to regional contagion as seen in 2013 as a significant share of the financial market assets are held by foreigners. As a result, any portfolio rebalancing by foreign investors on account of problems in other emerging markets is likely to affect the Philippines as well. However, at the macro level, the impact on the Philippines is expected to be manageable, given its strong current account surplus and high international reserves, flexible exchange rate system, and sustainable deficits and debt levels. Nonetheless, at the micro level, there are risks stemming from the rapid credit growth in the real estate sector and increasing leverage of many households and corporates, which can become unmanageable should interest rates rise sharply.

41. **The real estate sector risks come from the rapid expansion of supply, the growing size of shadow banking, and reallocation of investments from special deposit accounts (SDAs) into real estate.** Currently, there are supply concerns in the real estate sector. For instance, in some segments, the number of condominium units in the pipeline is far greater than the average number of units that was built in the last decade.[31] In June 2013, lending to the real estate sector increased by more than 40

private sector's response to public investments (i.e., multiplier effect). The private sector's response to public investment is assumed to be negligible in the short-term.

[30] See the January 2014 edition of the World Bank Global Economic Prospects for more discussion.

[31] See the May 2013 and March 2012 editions of the Philippine Economic Update for more discussion.

percent, and this does not include lending through shadow banking (e.g., in-house financing provided by real estate developers). Shadow banking in the Philippines is estimated at more than a third of the country's total financial assets. This is quite large relative to other developing countries, making it a significant source of risk to financial stability (Box 3). Among the likely reasons for the growth of shadow banking related to real estate transactions are the 20-percent cap on real estate lending by banks and the lack of collateral of would-be-borrowers, both of which can make borrowers find other sources of financing.

42. **Money exiting the SDA facility could further exacerbate speculative growth of real estate, which, together with a rise in interest rates caused by the tapering of quantitative easing in the US, would increase the probability of defaults.** Restrictions in the use of the SDA facility mean that a significant amount of money (PHP 1.5 trillion or equivalent to around 13 percent of GDP) is finding its way into the real economy either in the form of consumption or investment. Thus far, the bulk of this money is not being used for consumption, as indicated by moderate CPI inflation. This only means that the bulk of the money is temporarily parked in savings or is invested. Low interest rates and rapid growth of credit to real estate activities compared to other sectors of the economy suggest that a sizable amount could be invested in real estate. Unchecked growth of real estate lending is worrisome. Even more worrisome is that the inevitable increase in interest rates after the end of quantitative easing could lead to defaults by over-leveraged households and undercapitalized developers, especially those engaged in shadow banking. A systemic default would spell a crisis.

External Accounts

43. **The country's current account is expected to remain in small surplus, on account of robust remittances and higher receipts from services exports despite a projected increase in imports to aid the reconstruction effort.** The current account surplus is projected at around one percent of GDP in 2014. Imports of capital equipment for use in the reconstruction are projected to raise import growth by a further five percent. Higher remittances are expected as OFWs with relatives in the typhoon-affected areas increase the amount remitted back home. The continued deployment of skilled OFWs in other countries would also support remittance growth, despite the slowdown of remittance inflows from high-income economies. Escalating tensions in the Middle East and Eastern Europe could limit deployment of workers and marginally affect overall remittance growth.[32] The BPO industry, meanwhile, would continue to drive

[32] For instance, the recent tension in Egypt and Yemen has forced OFWs in these countries to return back to the Philippines, and has led to a total deployment ban in that country.

growth of services exports, as the industry is projecting to grow by 15 percent annually and provide 1.3 million jobs by 2016.[33]

Box 3. Shadow banking in emerging markets and developing countries

Shadow banking is broadly defined as credit intermediation involving entities and activities outside the regular banking system, and as such raises important policy concerns. It comprises a set of activities, markets, contracts, and institutions that operate partially or fully outside the traditional commercial banking sector and in most cases are either lightly regulated or not regulated at all. Participants in the shadow banking sector typically include a wide range of non-bank financial intermediaries conducting various activities. The Financial Stability Board (FSB)[34] estimates that the size of the global shadow banking system in developed countries amounts to around USD 60 trillion in 2010, equivalent to around 28 percent of the total financial system and about half of total assets in the banking sector, compared to around USD 27 trillion in 2002 (FSB 2011). In emerging market and developing economies (EMDEs), estimates of the total size of the shadow banking are not available, but it is believed to be small but growing relative to the total financial system.

Shadow banking provides benefits to the financial system. Among the benefits provided by shadow banking are: i) alternatives to bank deposits for large investors, especially given the insufficient amounts of insured deposits in the traditional banking system compared to the large size of the cash pool held by institutional investors, ii) specialized expertise in specific functions that enable them to channel resources toward specific needs more efficiently, iii) alternative funding for the real economy, which is particularly useful when traditional banking channels become temporarily impaired, and iv) funding and risk diversification, in particular facilitating credit extension to certain sectors that might otherwise not have access to credit through regular channels, as well as providing investors and banks a range of tools for liquidity, maturity, and credit risk management.

However, shadow banking also poses even greater systemic risks than traditional banking. Because its activities are exposed to similar financial risks as traditional banks but are not subject to the same degree of oversight and regulation, the system may pose even greater systemic risks. These include i) the potential for excess leverage, ii) the amplification of pro-cyclicality, which exacerbates business cycle fluctuations and financial sector instability, iii) the instability of wholesale funding and potential for a "modern-style bank run," iv) transmission of systemic risk from the shadow banking sector to the traditional banking sector, and v) regulatory arbitrage and circumvention, that is, the shadow banking system undermines the effectiveness of regulation to reduce systemic risk, leaving risks in the broader financial system.

Overall, banks dominate the financial systems of many EMDEs, but the shadow banking sector has gained importance in developing countries. In East Asia, traditional banking still dominates the formal financial sector, but non-bank financial intermediation may provide important shadow banking services in some regions. The sector is particularly large in the Philippines and Thailand, taking up more than one-third of total financial system assets and its share has been rising gradually. The size of the shadow banking system is particularly important as it is one of the factors that determine whether it constitutes a significant risk for the entire financial systems.

[33] Source: IT & Business Process Association of the Philippines (IBPAP).

[34] The Financial Stability Board was established to coordinate at the international level the work of national financial authorities and international standard-setting bodies, and to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies (source: http://www.financialstabilityboard.org).

Source: World Bank 2012. "Economic Premise: Chasing the Shadows: How Significant Is Shadow Banking in Emerging Markets?"

44. **As the Philippines is part of the global supply chain, the recovery of merchandise exports is contingent on improvements in manufacturing in key trading partners.** Slower growth in high income countries will continue to adversely affect the country's trade performance. However, improvements in key trading partners' manufacturing sector, such as China, could spur the Philippine export sector. The North American book-to-bill ratio improved to 1.04 in January 2013, indicating a recovery of electronic exports in the coming quarters.[35] Finally, further depreciation of the Japanese yen, following Japan's quantitative easing, could positively impact Philippine exports as the country is an important supplier of parts to Japanese exporters. Risks to export growth could come from the appreciating peso (in real effective terms), which has begun to cause a "Dutch disease" problem. Moreover, increasing demand for new generation "tablet" computers and smart phones, as opposed to "laptop" computers, will reduce demand for Philippine electronic parts, as the majority of parts are used in the assembly of laptop computers, and not tablet computers. To improve prospects for electronics, industries would have to align its business to the new technology or diversify into other products.

45. **Foreign direct investments are expected to increase with stronger confidence in the domestic economy, while the US Fed's gradual withdrawal of monetary stimulus would reduce the inflow of short-term capital**. As discussed earlier, confidence in the Aquino Administration pushed up approved foreign investment pledges to around USD 3 billion (around in Q1 to Q3 2013. If these pledges materialize, then FDI could increase significantly in the near-term. Currently, FDI is projected to reach USD 4.2 billion in 2014. Further improvements in the investment climate can sustainably ramp up FDIs towards USD 5 billion per year in the medium-term. On the other hand, portfolio inflows is expected to wane to around USD 2 billion annually as interest rate differentials become less favorable to the Philippines following the end of the US quantitative easing.

[35] The book-to-bill ratio of the Semiconductor Equipment and Materials International (SEMI) tracks billings (shipments) and bookings (orders) worldwide of North American-headquartered manufacturers of equipment used to manufacture semiconductor devices.

Prices and monetary policy

46. **CPI inflation is expected to accelerate to around 4.5 to five percent, at the high end of the central bank's inflation target of three to five percent.** Upside inflationary pressures could come from higher commodity and oil prices, the latter in part due to tensions in the Middle East and in Eastern Europe, and occasional tightening of local staple food supply due to weather disturbances. High growth of domestic money supply is also a source of inflationary risk, as are post-typhoon reconstruction effort and the planned doubling of infrastructure spending. Finally, the peso's depreciation could add upward pressure to the prices of imported goods.

47. **The country's rapid liquidity growth will remain a key challenge for monetary policy.** The low interest rate environment would support further expansion of bank lending, and hence economic growth. However, the resulting acceleration of money supply could pose significant inflationary risk. The continued outward movement of PHP 1.4 trillion in SDA funds could pose significant upside risk to inflation as they are channeled to consumption and investments. Given this, the central bank would need to continue regular monitoring of the economy for signs of overheating. In particular, concerns about real estate asset bubbles can be mitigated by closer monitoring of real estate prices, bank lending and, more importantly, shadow bank lending to ensure healthy balance sheets. In this regard, the central bank's decision to develop a property price index is welcomed. Moreover, the passage of a revised central bank charter can help strengthen its supervisory role in monitoring possible financial sector stresses.[36]

Fiscal policy

48. **Higher tax revenues are crucial for a fiscally sustainable acceleration of public infrastructure spending.** To support the required increase in public investments, additional tax revenues of around eight percent of GDP relative to 2010 would be needed in the medium-term. This seems to be attainable, considering the current strong leadership in the Government, the substantial gains in tax effort in 2012 largely on account of tax administration, and the country's past experience of successful tax reforms.

[36] A bill amending the central bank charter is currently in Congress. Among its salient provisions are: i) infusion of PHP 150 billion in fresh capital, ii) providing legal protection for central bank officials in performance of their supervisory duties, iii) restoring its power to obtain data from any private person or entity, iv) expanding its supervisory authority to include credit cards companies, money changers, and e-money issuers, and v) lifting bank deposit secrecy when conducting bank examinations.

49. **On tax policy, enacting a fiscal incentives rationalization law should be the top priority.**[37] This would allow the Government to plug systemic leakages in the tax system (which amount to at least one percent of GDP), level the playing field, and raise revenues by up to two percent of GDP over the long-term. The law should strive to put in place key principles for the granting of fiscal incentives, such as: i) a maximum duration followed by automatic withdrawal, ii) clear and measurable criteria for the granting of incentives and the monitoring of their performance during the period when these incentives are in place, iii) automatic withdrawal of incentives if performance standards are not met, iv) full fiscal transparency and annual reporting of a tax expenditure statement, and v) veto power by the Secretary of Finance on both the granting of individual incentives as well as the total value of incentives to be given in any given year. Particular attention is needed in reducing tax incentives for domestic firms, given the high rate of redundancy, and for Philippine Economic Zone Authority (PEZA)-accredited buildings, which often include many establishments that cater primarily to the domestic market and not to exports.[38]

50. **On tax administration, current efforts to improve tax compliance need to be sustained while the overhaul of customs administration needs to be accelerated.** Alongside current efforts to reorganize the BOC (as discussed above), curbing smuggling by inspecting all outward movements of goods from all special economic zones is crucial to plug tax leakages from smuggling, which is estimated by the Department of Finance to reach around two percent of GDP. Collecting just half of the forgone revenues from smuggling, or around PHP 110 billion, can significantly boost the Government's anti-poverty program. For instance, allocating PHP 110 billion to the conditional cash transfer program can potentially eradicate the country's poverty income gap.[39]

51. **In the medium-term, a comprehensive tax reform to lower tax rates, broaden the tax base, and simplify procedures is needed.** Such a reform would enhance the equity, efficiency, and the administrative ease of the country's tax system. This Update's section on the medium-term reform agenda discusses a menu of tax policy and

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[37] In this context, a fiscal incentives rationalization bill has been re-filed in the Lower House. House Bill (HB) 2765 proposes to rationalize and harmonize the fiscal incentive system to improve the country's investment climate, ensure that tax incentives are cost efficient, and raise revenues to provide more fiscal space for government spending. The key provisions of the bill are i) limiting the granting of tax incentives to exporting firms and strategic activities, ii) exemptions of qualified micro and small enterprises (MSMEs) from income taxes, iii) inclusion of a tax expenditure fund (TEF) in the national budget, iv) joint monitoring and review by the DOF, BIR, and BOC of the incentives granted with a formal report submitted to the President, and v) repealing and consolidating over 50 different laws granting fiscal incentives to various sectors.

[38] Many buildings, which house establishments eligible for tax incentives, such as BPOs, apply for PEZA tax incentives. However, tax incentives generally cover the entire building, even if more than 50 percent of the building space is allocated to establishments that are not eligible for tax incentives.

[39] The income gap to bring people out of poverty was PHP 109.4 billion in 2009.

administration options to raise tax effort by eight percent of GDP over the medium-term relative to the tax effort recorded in 2010.

52. **The public's willingness to increase tax compliance will depend much on reforms to improve transparency and accountability of public spending.** The Government has embarked on several reforms to institutionalize evaluation of key government programs and budget items (e.g., CCT, community-driven development, and lump sum funds). These can be complemented by reforms that mandate the public posting of budget reports and harmonizing the budget chart of accounts across agencies. Strengthening the demand side for budget accountability can be promoted through the Open Government initiative and by expanding the community-driven development program. A recently published report by the World Bank on impact evaluation of KALAHI-CIDSS shows that the project increased per capita consumption by 12 percent, produced a nine ppt increase in the proportion of households whose houses are accessible all year long, and improved governance of village assemblies (see Special Focus 2).

53. **Finally, making all lump-sum funds more transparent and accountable, and enacting the Freedom of Information (FOI) bill into law would reinforce the Government's commitment to good governance.** These reforms would allow the public to see more tangible improvements in governance and convince them that their taxes are being spent wisely. These crucial reforms would help make a better case for tax policy reforms to support the Government's goal of attaining more inclusive growth.

BUILDING BACK BETTER AFTER TYPHOON YOLANDA

Reconstruction Assistance on Yolanda (RAY)

54. **Recognizing the importance of a quick start to the recovery process, the Government prepared in December 2013 the "Reconstruction Assistance on Yolanda (RAY)," a strategic plan to guide recovery and reconstruction in the affected areas.** Using the best available data as of mid-December 2013, RAY provides a preliminary assessment of damages, loss, and needs covering four sectors: infrastructure, economic, social, and the government. It also provides a framework for implementation, including budget estimates for the 2014 reconstruction program.

55. **RAY estimates the value of damaged physical assets – both public and private – at PHP 424 billion (3.7 percent of GDP).** The bulk of the damage is found in the housing sector, at almost PHP 300 billion (2.6 percent of GDP). Disruptions to production, sales, and income amount to around PHP 147 billion (1.3 percent of GDP). Total damage and losses combined are estimated at PHP 571 billion (4.9 percent of GDP).

56. **The Government estimates preliminary recovery and reconstruction costs, both public and private expenditure, at PHP 361 billion (3.1 percent of GDP).** Over half of the needs arise in the housing sector at over PHP 183 billion (1.6 percent of GDP). This initial estimate is likely to increase as it covers only 85 percent of the estimated damage, and a "build back better" strategy suggests that recovery costs could be 30 percent higher than the estimated total damage. This implies that housing costs may ultimately exceed current estimates by over PHP 200 billion (1.7 percent of GDP).

57. **RAY proposes a PHP 125 billion budget (1.1 percent of GDP) in 2013 and 2014 to fund the reconstruction effort.** Over 70 percent of this expenditure is budgeted for 2014. Shelter and resettlement programs amount to PHP 73 billion, followed by education and health services at PHP 22 billion, and infrastructure at PHP 10 billion. Smaller but significant amounts are also allocated to crops, livestock, and fisheries (PHP 8 billion), livelihoods and enterprises (PHP 4 billion), local government assets (PHP 4 billion), and social protection (PHP 3 billion).

58. **The cost of the reconstruction program in 2014 is likely to increase as the needs assessment is refined and policy decisions are reached.** For example, RAY's estimate of PHP 3 billion in social protection expenditure in 2013 and 2014 is only around one fifth of the total estimated needs for social protection. Similarly, planned government expenditure on shelter and resettlement in 2013 and 2014 covers only one quarter of the estimated damage. This would leave a large gap to be funded by households – many of which are living in poverty – or by the private sector. As the Government finalizes the nature and extent of its support to the private sector, estimates of industry and livelihood support may also increase.

59. **The RAY proposes that the reconstruction needs will be financed by a combination of government funding and a multi-donor trust fund currently under development.** The 2014 national budget includes PHP 20 billion for a Rehabilitation and Reconstruction Program to address damage caused by Yolanda and other disasters, and another PHP 80 billion for reconstruction from the un-programmed fund (i.e., standby funds approved under the budget law that can be disbursed only if incremental revenues are identified). The Government is also working with the Asian Development Bank and the World Bank to establish a multi-donor trust fund that will mobilize resources from a range of development partners.

Sustainable reconstruction after Typhoon Yolanda

60. **To significantly boost the country's resiliency to natural disasters, the recovery and reconstruction phase needs to be guided by a number of core principles and good practices.** These are summed up as follows: i) assets and livelihoods need to be rapidly restored, ii) infrastructure and physical assets need to be rebuilt to withstand future disasters, and iii) temporary jobs need to be provided to narrow the income gap. Box 4 summarizes 10 important lessons on reconstruction after disasters.

Core principles

61. **The fundamental principle for sustainable reconstruction is that the strategy should explicitly mandate standards for safe and resilient buildings and infrastructure and for risk-informed land-use planning.** Sustainable reconstruction needs to consider the various hazards to which the country is exposed, notably earthquakes (as highlighted by the magnitude 7.2 Bohol earthquake on 15 October 2013), volcanic eruptions, and weather-related hazards (e.g., typhoons, intense rain, storm surge, and flooding). In particular, reconstruction needs to be guided by the following sector-specific principles:

62. ***Public buildings and infrastructure:* for schools, hospitals, emergency evacuation shelters, and municipal buildings, reconstruction provides the opportunity to implement cost-effective resilience measures, strong quality control, and enforcement mechanisms.** Particular attention is needed to develop strategies for operational continuity of lifeline infrastructure during disasters, such as hospitals and schools designated as emergency shelters.

63. ***Housing:* experience from large-scale disasters around the world (e.g., 2004 Aceh tsunami and 2005 Pakistan earthquake) has shown that *in situ* household self-recovery and community-driven housing reconstruction is the most effective approach.** This model is centered on owner-driven housing reconstruction financed by

conditional reconstruction grants provided by the government. Community and homeowner-driven housing reconstruction is 40 percent less expensive than contractor-built housing. With proper training and oversight, it is also faster, has a significant economic multiplier effect, and leads to change in behavior, attitudes, and increased resilience. Construction quality and timeliness can be ensured through performance-based grant installments.

64. ***Livelihoods:* universal, unconditional, and time-bound emergency cash transfers to all affected households can bridge income gaps until livelihoods are restored.** This has proven to be an effective way of shielding affected households from the worst impacts of a natural disaster.

65. ***Monitoring and evaluation:* for transparent and effective reconstruction, tracking both financial and physical progress is essential.** For the government to successfully bridge the gap between relief and medium-term reconstruction, it needs to quickly operationalize financial and physical progress tracking platforms that provide timely feedback on implementation and ensure transparency of the process.

66. ***Disaster risk financing and insurance:* As not all risks can be addressed through structural or land-use planning measures, a robust disaster risk financing and insurance strategy can address residual risk.** Such a strategy at both the government and private levels can help ensure financial resilience for the government and the private sector in the aftermath of a disaster.

Implementing the principles

67. **Applying the core principles of resilient reconstruction requires quality control, strict enforcement, and training.** The wind speed and earthquake provisions of the 2010 Structural Code of the Philippines should provide the “life safety” level of protection for most building structures up to a category five typhoon (wind speed of 250 kph) and a magnitude eight earthquake, if constructed as designed using high quality materials. A recommended priority is to develop and, during reconstruction, pilot better mechanisms for the assurance of construction quality and enforcement of the Structural Code. Experience from Turkey, after the 1999 Marmara earthquake, and other countries has shown that, on average, the benefits of an effective inspection program far outweighs its cost as it only adds one to two percent to overall project costs.

Roads and bridges

68. **Roads and bridges serve as lifelines for evacuation and access for post-disaster responses.** Hence, sufficiently resilient designs are needed to ensure that key routes remain operational and secondary routes can be quickly restored. Moreover, roads and bridges need to be classified strategically based on how critical they are for access. The

planning and design of roads and bridges need to include resilience to location-specific natural hazards, in accordance with their strategic classification.

69. **To facilitate relief operation and reconstruction, reliable information on roads and bridges is needed immediately in the event of a disaster.** Information management systems need to be enhanced to include field data collection through electronic data capture, including spatial geo-coding and images. Doing so would enhance tracking of the physical progress of reconstruction.

70. **Multi-year contracts, which could include emergency reconstruction on a performance basis, in addition to maintenance and rehabilitation of roads and bridges, can be developed and tested in hazard-prone areas.** These can help improve the efficiency and reliability of emergency response and recovery. Successful examples include Australia and New Zealand's multi-year road management contracts and performance-specified road maintenance and rehabilitation contracts in several countries in Latin America.

71. **Rebuilding electricity networks quickly will enable businesses and livelihoods to recover more quickly.** Priority should be given to ensuring the financial viability of the country's electricity cooperatives to enable them to increase capitalization and investment in distribution facilities.

Housing

72. **Housing reconstruction is best implemented when households are given a choice as to where to live and the means of reconstructing their houses.** This means avoiding the creation of unfamiliar processes, such as large-scale socialized housing or center-driven reconstruction programs if that is not normally how households acquire their housing. Allowing communities and home-owners to make their own decision can facilitate local job creation and create opportunities for local home builders to be trained in resilient construction. Moreover, giving households multiple design options to choose from can ensure that their social and environmental needs are preserved.

73. **The Government's role is normally limited to supporting the quick recovery and normal functioning of the market for housing materials.** Even for low income households, most housing is acquired through the market. Two closely related problems in the market for housing materials following a disaster are rising prices and the failure of the supply chain (e.g., material shortages). Rising prices are generally a function of supply chain bottlenecks, although price gouging is not uncommon. To help markets function better, the Government needs to avoid becoming an importer, supplier, or distributor of materials as this would impede private sector recovery and distort the market structure and pricing of materials in the long term.

74. **The 2005 Pakistan earthquake reconstruction provides a good example how the Philippine Government can facilitate the supply chain to remote affected locations.** The Pakistan Government did so by setting up decentralized material hubs on government land, where various private material manufacturers and suppliers were given space to store and sell materials. Local demand was created as a result of home-owners or communities buying from the local market. To ensure a well-functioning market, the Pakistan Government monitored key material prices to ensure that there was no hoarding or price gouging. Moreover, locally-driven reconstruction provided an opportunity for local home builders to be trained on resilient design. Even after eight years following the 2005 earthquake, all new housing construction still follows the disaster resilient designs.

75. **In-depth understanding of exposure to multiple hazards is necessary for risk-informed land-use planning at the community level.** For example, in communities surrounding Mount Merapi in Indonesia, detailed hazard maps were used to inform zoning and land-use restrictions to protect lives and property from future volcanic eruption. The high resolution maps indicate what areas are safe for reconstruction of dwellings and what areas should be used for agriculture and livestock only. A similar approach can be applied to high-risk communities in the Philippines. This requires that citizens and government agencies, both national and local, are able to access robust hazard and risk information (e.g., hazard maps in digital Geographic Information System [GIS] format) and the underlying data produced by technical agencies (e.g., Collective Strengthening of Community Awareness on Natural Disasters [CSCAND] and Project Nationwide Operational Assessment of Hazards [NOAH]).

76. **Finally, the decision to relocate households living in high risk area needs to be weighed against the cost and benefits of relocation, as not all relocations, especially relocations away from jobs, are necessarily welfare-improving.** If households cannot be relocated, priority should be given to helping households design stronger houses and ensuring that high-risk households are aware of emergency evacuation plans.

Livelihoods

77. **Social safety nets (e.g., emergency income support to all affected households) can mitigate the immediate impact of the disaster and bridge the income gap until households resume their livelihoods.** The Government has the infrastructure and mechanisms needed to deliver this type of program efficiently and effectively in a short period of time. It can tap the national household targeting system for poverty reduction (NHTS-PR) to identify poor households and provide them the needed temporary support. Provision of grants can help households restore or replace their productive assets, so that they can restart their livelihood activities as soon as possible. In Pakistan, for example, the Citizen's Damage Compensation Program was designed to provide recovery compensation after the devastating 2010 flood. Good practices included i) using the national poverty database to identify and prioritize the poorest flood-affected

households, and ii) using an automated database for quick registration and immediate disbursement of benefits through an electronic cash card.

78. **Cash and/or training for work and public works programs have proven to be a good option to provide temporary post-disaster employment.** This program can be implemented at the barangay level using local community mechanisms. For example, barangays can be provided a cash block grant to organize small, community-level public works. It is important to consider female household heads' access to these programs as they may not normally qualify because they do not have bank accounts. Public works programs should also provide special training for women to perform roles such as supervision and monitoring.

79. **In the short-term, a combination of guaranteed leasing and lending, and cash for work programs can help micro, small, and medium enterprises (MSMEs) quickly rebuild their productive capability.** Over the medium-term, a combination of technical assistance to improve productivity and the organization of business operations can help facilitate MSME's economic recovery and improve incomes over the long run.

Impact of reconstruction on short-term jobs

80. **While it is difficult to estimate the number of jobs that can be created from these schemes, experience from other countries suggests that a community-driven approach using local labor can create a lot of local jobs and reduce the income gap arising from a disaster.** For instance, based on the number of damaged houses at slightly over one million, a ratio of five workers per house per month could provide over 400,000 jobs over a 12-month reconstruction period. RAY estimates infrastructure needs of over PHP 66 billion, which could provide up to 282,000 jobs over a 12-month reconstruction period.[40] Assuming one worker per affected household in the worst-affected provinces is able to find a job, over 50 percent of households in these provinces would be covered. The remaining 50 percent of households can be supported by credit support, temporary universal cash grants, and calamity loans from the pension system.

Box 4. Reconstruction after disasters: 10 lessons (learnt the hard way)

1. Housing constitutes up to 80 percent or more of the damage caused by major disasters.

2. Building houses takes time. Be prepared for the long-haul and manage expectations accordingly.

3. Land titles often are the biggest bottleneck. This is often due to i) extra-legal or informal tenure, ii) poor land governance, iii) inferior land rights for women, iv) highly unequal land distribution, or v) a combination of these factors.

[40] This assumes that 40 percent of the total cost is labor cost. An average daily wage of P300 per worker is used.

4. The two factors that determine the success or failure of the reconstruction program are i) the damage assessment and ii) the reconstruction policy.

5. Owner-driven reconstruction works best. It is the most empowering and dignified approach, but it requires i) training and technical assistance, ii) updating codes, iii) mechanisms to regulate prices, and iv) financial assistance in installments linked to technical quality.

6. Resettlement is usually unsuccessful often because i) resettlement sites are not socially or culturally appropriate, ii) livelihoods cannot be restored at these sites, and iii) they tend to be environmentally vulnerable. Successful resettlements are those that i) take livelihoods into account, ii) provide fully serviced plots, iii) partner with the community, and iv) are culturally and socially appropriate.

7. Training makes a vital difference, particularly for technical advisors and supervisors, as well owners and builders in the fields, and in the areas of detailed damage assessments, data collection, and information management.

8. Civil society and the private sector can be vital partners in helping to achieve the objectives of a government-led reconstruction program. This partnership works best when relationships are formalized, expectations are managed, and oversight mechanisms are established.

9. Reconstruction can be used to mainstream disaster risk reduction by building in i) disaster resilience, ii) cultural heritage preservation, iii) land tenure and land-use planning, and iv) anti-corruption and financial tracking mechanisms.

10. Institutions matter a lot. They need to have authority, autonomy, political support, a mandate, a policy, and a plan. Effective relationships across institutions are also key including with the military, local authorities, non-government organizations, and donors.

Compiled by Abhas Jha of the World Bank.

Monitoring and evaluating for success

81. **Comprehensive, credible, and timely tracking information is vital to the success of post-Yolanda reconstruction.** Good information provides policy makers with early signals of the effectiveness of the reconstruction program. It ensures that planning is actually implemented and adjustments are made in response to realities on the ground. Reconstruction transparency is increasingly being demanded by citizens who want to make sure taxpayer money and donations are being put to good use.

82. **While the Government has made improvements to its budget framework in recent years, effective monitoring of the financial and physical progress of the reconstruction program is constrained under existing systems.** The Philippines has introduced a Unified Accounts Code Structure (UACS) in the 2014 budget which creates a single set of codes with which to refer to spending projects throughout their lifecycle. This will ultimately make it possible for oversight agencies to follow projects from

budget to execution and is the first step towards an Integrated Financial Management Information System (IFMIS). However, it has yet to be fully adopted by all government agencies. This means that budget allocation and transaction systems remain separate, and there is no consistent reporting approach across the government agencies. In practical terms, tracking Yolanda reconstruction will require new practices and processes. It will be far more complex than simply creating a database to collect existing information.

83. **The Government is committed to an open and accountable process for post-Yolanda reconstruction.** It launched the online Foreign Aid Transparency Hub (FAiTH) within three weeks of the typhoon to track foreign contributions, and the Department of Budget and Management issues regular updates on Calamity Fund releases. It has expressed a desire to also report publicly the progress of the Government's reconstruction and outcomes of allocated public funding.

84. **International experience suggests that massive reconstruction after a disaster provides an opportunity to improve public financial management and accountability.** For instance, after the 2004 Indian Ocean tsunami, concerted efforts led to the creation of the Recovery Aceh Nias database, which was successfully used to track reconstruction aid, monitored 1,700 large reconstruction projects in Aceh, and contributed to efficient implementation.

85. **The best approach to reconstruction tracking is one that builds on existing financial systems and institutional arrangements, rather than creating a stand-alone system.** There are several reasons why this is the case. First, financial information is far more accurate and timely if it is drawn from transaction data, rather than relying on agencies to enter additional information in an unfamiliar system. Second, there are long-term and far-reaching gains to be made by improving the Government's core financial management systems, rather than creating a temporary stand-alone system. Third, the creation of additional and ad hoc reporting requirements adds to agencies' workloads and distracts from core reconstruction efforts.

86. **With a concerted effort, the Government can establish a reconstruction monitoring system and deliver a baseline tracking report in the coming months.** This involves fast-tracking the implementation of the "back-of-the-house" systems, including i) finalizing the mapping between UACS and its predecessor New Government Accounting System (NGAS), ii) building an electronic ticketing system for releases from the National Disaster Risk Reduction and Management Fund, and iii) requiring agencies to adopt electronic transaction accounts.

87. **Finally, the Government can extend some of its recent transparency measures to the reconstruction process.** Participatory audits and official audits by the Commission on Audit (COA) have already been implemented for other flagship programs and can easily be extended to reconstruction. The Government's new Open Data platform

(data.gov.ph) can be used to disseminate information on progress in rebuilding after Yolanda, for example in the form of a Reconstruction Watch portal.

Disaster risk financing and insurance framework

88. **Typhoon Yolanda has underscored the extreme vulnerability of the Philippines to weather-related disasters amplified by climate change.** The Philippines has historically suffered from a high rate of natural disasters, but climate change is giving rise to even more frequent and more forceful weather-related disasters. Severe storms have now become the "new normal."

89. **Yolanda was the last, and most severe, of several natural disasters in 2013. This series of events has tested the adequacy of the three existing sources of post-disaster financing in the Philippines.** The first source, the National Calamity Fund (recently renamed the National Disaster Risk Reduction Fund), was largely depleted before Yolanda occurred. The second and third sources were the NG agencies' Quick Response Funds and LGUs' Local Calamity Funds, but information is not available on the extent to which these have contributed to the Yolanda response. However it is clear that the Government's reserves were soon exhausted. The Government made two additional reallocations in 2013 to support the immediate response effort for Yolanda. These allocations were funded from savings in the 2013 budget. In total, the Government allocated an extra PHP 33 billion to disaster response in December 2013, dwarfing the original allocation of around PHP 11 billion[41] at the national level in 2013 for disaster response.

90. **The Government is exploring a package of new measures, including a Climate and Disaster Resiliency Fund, to ensure that the Philippines is well-equipped to withstand and respond to major disasters like Yolanda in the future**. Work has begun on developing an integrated strategy for increasing resilience to climate change impacts and natural disasters at four levels:

- At the household level, by exploring options to provide disaster insurance to vulnerable households and safety nets to the poorest so that they can quickly restore their livelihoods after a disaster.
- At the local level, by developing mandatory disaster insurance for local governments.
- At the national level, by proposing additional insurance and investment mechanism to build resilience and ensure against catastrophic shocks.

[41] This includes the initial 2013 appropriations to the National Calamity Fund (PHP 7.5 billion) and agency Quick Response Funds (totaling PHP 3.7 billion). The World Bank estimates the response portion of Local Calamity Funds at PHP 5.7 billion in 2013, which would bring the total national reserves for disaster response to PHP 16.9 billion.

- At the international level, by engaging in international partnerships to support increased resilience.

91. **This integrated package aims to promote financial resilience of the Government, the private sector and individuals, as well as physical resilience of buildings and infrastructure**. Proposed measures are directed at improving resilience at three levels: i) promoting greater micro-insurance coverage at the individual and MSME level, ii) requiring all local government units to insure their assets against disaster and to contribute to a pooled insurance fund, and iii) creating an off-budget Climate and Disaster Resilience Fund (CDRF) at the national level. The CDRF would comprise two complementary but separate parts: a Response Contingency Fund (RCF) and a Resilience Fund (RF). The RCF would provide a fiscal buffer to fund large-scale disaster responses beyond the scope of the annual budget. This buffer could be a combination of fiscal reserves and purchased disaster insurance, depending on the risk retention preferences of the Government. The second component, the RF, would steadily upgrade public infrastructure throughout the country to better withstand the impact of natural disasters.

92. **The CDRF has the potential to greatly improve the sustainability of the Philippines' disaster risk management framework.** The RCF would institutionalize funding arrangements for large-scale disasters and ensure that other budget priorities are not compromised when disasters strike. The RF would reduce the human and economic costs of disasters.

93. **As the proposal is further developed, a number of policy and implementation questions need to be resolved.** First, there are a number of existing government programs that aim to build resilience, including the new People's Survival Fund and the Local Disaster Risk Reduction Funds (LDRRFs), which are required to devote 70 percent of their annual funding towards preparedness and risk mitigation. The new CDRF should ideally form part of a single coherent disaster risk management framework, rather than forming another layer on top of existing funds. Second, because the CDRF is a long-term instrument for adapting to the effects of climate change, its success will rely on the Government's ability to "lock in" or ensure the sustainability of both domestic and international sources of revenue. Third, significant further work is needed to flesh out the operational details of the policy, including the magnitude of the funding requirements and eligibility rules for expenditure from both funds.

MEDIUM-TERM AGENDA: WORKING TOGETHER TO ADDRESS THE JOBS CHALLENGE

Development challenge	Response of the government
"The most crucial failure of Philippine development strategy lies in its employment record." (Krugman et al. 1992)	*"A government that prioritizes jobs that empower the people and provide them with opportunities to rise above poverty" (excerpt from President Aquino's "Social Contract" with the Filipino people)*

94. **The central policy challenge facing the Philippines is how to accelerate inclusive growth – the type that creates more and better jobs and reduces poverty**. So far this has proven to be elusive, mainly because of the country's long history of policy distortions that have slowed the growth of agriculture and manufacturing in the last six decades. Instead of rising agricultural productivity paving the way for the development of a vibrant labor-intensive manufacturing sector and subsequently of a high-skill services sector, the converse has taken place in the Philippines. Agricultural productivity has remained depressed, manufacturing has failed to grow sustainably, and a low-productivity, low-skill services sector has emerged as the dominant feature of the economy. Lack of competition in key sectors, insecurity of property rights, complex regulations, and severe underinvestment by the government and the private sector have led to this growth pattern, which is not the norm in the East Asia region. More importantly, this anomalous economic growth pattern has not provided good jobs to the majority of Filipinos and has led to a substantial out-migration of many of its best and brightest people.[42]

The jobs challenge

95. **The Philippines faces an enormous jobs challenge.** Good jobs — meaning jobs that raise real wages and bring people out of poverty — need to be provided to around 10 million Filipinos who were either unemployed[43] (three million) or underemployed[44]

[42] For instance, the exodus of Filipino scientists and engineers increased from about 10,000 in 1998 to about 25,000 in 2009 according to the Philippine Overseas Employment Administration.

[43] Unemployment is defined to include workers who are 15 years old and over, and are reported as: i) without work and currently available for work and seeking work, or ii) without work and currently available for work but not seeking work for the following reasons: a) tired/believe no work is available, b) awaiting results of a job application, c) temporarily ill/disabled, d) bad weather, and e) waiting for rehire/job recall.

[44] Underemployment is defined to include all employed persons looking for more work. Visible underemployment includes persons working less than 40 hours per week while invisible underemployment includes persons working 40 hours or more per week.

(seven million) as of 2012, and to around 1.15 million potential entrants to the labor force[45] every year from 2013 to 2016. That is a total of around 14.6 million jobs that need to be created by 2016. In addition, better jobs need to be provided to another 21 million Filipinos who are informally employed.[46] All in all, informal workers comprise about 75 percent of total employment or 28 million.[47]

96. **Every year in the last decade, only about a fourth of the potential entrants to the labor force get good jobs.** Of the 1.15 million potential entrants to the labor force, slightly less than half have college degrees. Of the 500,000 college graduates every year, 240,000 can be absorbed in the formal sector, such as business process outsourcing (BPO) (52,000) and manufacturing (20,000). About 200,000 find jobs abroad, and around 60,000 will be unemployed or exit the labor force. The remaining 650,000 entrants, of which around half have high school degrees, have no other option but to find or create work in the low-skill and low-pay informal sector.

97. **Higher growth can provide more Filipino workers with good jobs.** Under the current high growth scenario and the removal of key binding constraints in fast-growing sectors (e.g., skills constraint so that the BPO industry can accelerate its annual growth from 20 to 30 percent, and power and other constraints so that the manufacturing sector can see a doubling of employment), the formal sector will be able to provide good jobs to around 2.2 million people in the next four years (or 550,000 every year between 2013 and 2016), or around double the current figure.

98. **But the majority of Filipino workers would still be left out.** By 2016, around 12.4 million[48] Filipinos would still be unemployed, underemployed, or would have to work in the informal sector, where moving up the job ladder is difficult for most people.[49] Addressing this jobs challenge requires meeting a dual challenge: expanding formal sector employment even faster while rapidly raising the incomes of those informally employed.

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[45] The labor force is defined to include persons 15 years old and over, who are either employed or unemployed. Examples of persons who are not included in the labor force are full time housewives, students, and retirees.

[46] This is operationally defined to include all self-employed workers (excluding employers), unpaid family workers, and wage workers with no written contract, social insurance, or protection from dismissal using the 2008 Informal Sector Survey (ISS) of the National Statistics Office (NSO).

[47] This estimate is not far from the estimate of the Employers Confederation of the Philippines, which put the number of informal workers at 77 percent of total employment (Ortiz-Luis 2008).

[48] This is calculated as follows: 10 million + (1.15 million x 4 years) – (0.55 million x 4 years) = 12.4 million.

[49] The informal sector is not necessarily equivalent to bad jobs. Nor can all jobs in the formal sector be considered good jobs. Moving to a formal sector job is not always the better choice. People can choose to work in the informal sector and can still be better off. Jobs created in the informal sector are as important as jobs generated by big firms. What can be bad about the informal sector is when workers want to move up the job ladder but cannot do so because of structural barriers.

99. **This section tells the Philippine story as seen through the jobs lens.** It analyzes the policy distortions that led to the country's weak employment record, highlights the unique window of opportunity where government, business, labor, and civil society can work together and agree on an agenda on job creation, and outlines a number of recommendations which reform coalitions can consider to put the country on an irreversible path of inclusive growth and address the jobs challenge.

The Philippine development story

100. **The Philippines enjoys a wide range of assets to draw upon for its development.** Government, business, and academia benefit from world-class talent, and the large number of Filipino workers overseas reflects international demand for its highly competitive labor force. Being located in the dynamic East Asia region, the private sector is well-positioned to exploit trade and investment opportunities. The country benefits from political stability, a free press, and an active civil society that has been an important agent for change. It is also currently benefiting from sound macroeconomic policies and a popular government that many see as committed to improving the lives of the people.

101. **In spite of its strengths, the country has so far not lived up to its potential.** Opportunities to raise people's income are limited. There are concerns about the quality of education and healthcare services, and thus of the quality of the labor force going forward. Agriculture remains largely backward and unproductive. Manufacturing is stagnant and offers very few jobs. Only a small segment of the services sector, notably the BPO industry, is rapidly creating good jobs.

102. **One of the main reasons for the country's subpar performance on inclusive growth, when compared with other countries in the region, is its historically weak economic growth record.** Although the country's average growth record of 4.1 percent in the last three decades is comparable to global performance, it is considerably lower than the 6.5 percent growth of its more dynamic East Asian peers over the same period. In per capita terms, Philippine growth is much lower at around 1.4 percent, given its historically higher population growth rate of 2.7 percent. While there have been a few growth spurts, the country has rarely been able to sustain growth at above five percent for an extended period of time, again in contrast to its neighbors.[50]

[50] Between 1946 and 2002, the country's growth record was boom-and-bust. Rapid growth during the period of postwar recovery was not sustained in the 1950s, as the country looked inward for its sources of growth. In the 1960s, export promotion led to higher growth but the largely protected domestic economy could not sustain it. The 1970s saw higher growth as a result of large-scale investment in infrastructure, but this debt-driven growth also could not be sustained and in 1983 resulted in the country's worst debt crisis. Growth accelerated in the mid-1990s as the government promoted exports, foreign direct investment, and domestic competition. However, the 1997 Asian Financial Crisis brought the country to

103. **Another reason for the lack of inclusive growth is the country's lack of structural transformation.** Despite a head start in manufacturing compared to its neighbors, the Philippines failed to industrialize fully. Instead, the share of manufacturing to GDP has stagnated at around 25 percent since the 1960s even as other countries steadily increased theirs and eventually surpassed the Philippines before moving on to growth driven by high-skill services. The share of manufacturing employment to total employment hardly rose above 10 percent. In other words, the Philippines "missed" a crucial step in the structural transformation process: the rise of manufacturing and the associated successful job creation in urban areas.

104. **In the absence of a rapidly growing manufacturing sector, the services sector became the catch basin that absorbed excess labor from agriculture.** The services sector has been the largest employer since 1997. However, more than three quarters of the services sector is composed of low-pay or low-skill jobs, such as petty retail trade and public transportation, and as such, there has been no corresponding significant increase in productivity in the services sector.

105. **This pattern of growth has resulted in a much lower pace and quality of job creation relative to the country's potential, as well as those of other countries at similar levels of development.** Unemployment and underemployment rates have remained stubbornly high at around 8 and 20 percent, respectively. Males, workers with higher educational attainment, and the youth have the highest incidences of unemployment, while the poor have the highest incidence of underemployment. Average real household income in 2009 was lower than in 1997. Informality is also very high. Around 75 percent of workers do not have written contracts, social insurances, or access to severance pay. These informally employed workers face varying degrees of vulnerabilities to income or price shocks.

106. **The lack of good jobs among low-income earners has contributed to slower progress in reducing poverty and inequality.** Between 2003 and 2012, poverty incidence hardly declined. In December 2013, the National Statistical Coordination Board (NSCB) reported that poverty incidence of the population barely improved from 26.3 percent in 2009 to 25.2 percent in 2012 (Figure 5),[51] suggesting that gains from higher growth are not fully benefiting the poor. The middle class[52] is relatively small at around 15 percent of the population, of which about a third resides or works abroad. This slow progress in reducing poverty, despite higher growth in the same period, points

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its third recession in just 15 years. Finally, between 2003 and 2012, the country generated higher per capita growth of above three percent, however, this has yet to translate into significant job creation and poverty reduction. Growth has largely benefited the top 20 percent of Filipinos.

[51] The decline in the poverty incidence is statistically insignificant according to the NSCB.

[52] Households with wage and entrepreneurial income of at least PHP 30,000 (or about USD 700) after tax are considered to be middle class and up.

to deeper structural problems, which manifest themselves in a pattern of economic growth that makes poverty reduction stubbornly difficult. Moreover, inequality has worsened in the last three decades, indicating a growth pattern that does not benefit the poor as much as it benefits the rich.

107. **With limited domestic job opportunities, about 10 million Filipinos and their families have left the country for better opportunities abroad.** The huge outmigration of many of the country's best and brightest is as much an outcome of the lack of adequate employment opportunities at home as it is a demonstration of the global competitiveness of Filipinos. This huge outmigration has led to skill shortages (quality-adjusted) in some occupations, such as engineers and nurses. Huge remittance inflows have caused a Dutch Disease problem, driving up the real exchange rate and making manufacturing and services exports less competitive.

What went wrong in the Philippines?

108. **The country's lack of structural transformation is explained by persistent policy distortions that have slowed the growth of agriculture and manufacturing in the last six decades.** In agriculture, these include protectionist policies, such as the rice self-sufficiency policy at any cost, large subsidies for inputs, and distortions in institutions that prevent broad and secure access to land by small landholders. The latter is evident in high degree of landlessness, which has not been brought down significantly by decades of agrarian reform. Quite ironically, agrarian reform has created significant uncertainties among beneficiary smallholders, as well as large farmers, who are potential targets for land redistribution. Insecure property rights have undermined private investment incentives and, combined with low public investment, has reduced agricultural productivity and increased food prices. High prices of food and agriculture inputs (e.g., corn and sugar) have in turn contributed to high statutory minimum wages and high production costs in downstream agribusiness, manufacturing, and services. These have raised the cost of living, reduced employment, and dampened real income.

109. **In manufacturing, many industries stagnated or declined.** Since the 1930s, protectionist policies (i.e., an overvalued peso, high tariff walls, preferential loans and tax incentives to cronies without accountability), uncompetitive practices, and a small consumer base, have contributed to the decline of Philippine manufacturing. With the exception of food manufacturing and electronics, the rest of the manufacturing subsectors either stagnated or declined. The bulk of manufacturing value-added has come from capital-intensive industries such as electronics while labor-intensive manufacturing such as garments, footwear, and furniture continued to decline.

110. **Decades of underinvestment also contributed to the slow growth of agriculture and manufacturing.** From close to 30 percent of GDP in the 1970s, investment in physical capital declined to about 20 percent of GDP in the last decade. In the public

sector, low tax effort and weak public investment management generally limited public infrastructure spending to less than 2.5 percent of GDP annually. Maintenance of existing infrastructure was likewise constrained. The relatively long foreign investment negative list has limited foreign direct investment growth that could have contributed to job creation and a reduction in wealth concentration by the elite. Investment in human capital also suffered major setbacks. The country's public education and health systems remain underfunded and have held back the development of the country's labor force.

111. **The private sector's reluctance to invest and create jobs also reflects the country's weak investment climate.** Among the investment climate constraints, corruption has been viewed as the biggest concern, followed by infrastructure deficiencies, and inefficient government bureaucracy. Costly business and labor regulations have also contributed to weak investment and job creation.

112. **Among business regulations, the most problematic issues are in starting, operating, and closing a business, paying taxes, and accessing finance.** Philippine business regulations are complex and are among the costliest in the East Asia region. Cumbersome regulations and procedures in starting and operating a business deter new firm entry and business expansion. Complying with tax regulations is costly given their complexity. Firm entry and expansion are also constrained by limited access to finance. This issue weighs heavily for micro, small, and medium enterprises (MSMEs).

113. **Although Philippine labor regulations are not the biggest constraints to growth and employment generation, they have nevertheless imposed substantial costs to some firms and have contributed to the decline of the manufacturing sector.** Among labor regulations, firms find the complex legal framework, high minimum wages, high *de facto* cost of dismissal, the legalistic dispute settlement system, and restrictions in the use of flexible contracts as major constraints to business expansion. There is evidence that the country's more rigid labor regulations relative to its neighbors have led to the closure of many labor-intensive firms or have hindered their expansion, leaving many Filipinos with much fewer job options.

A window of opportunity to create more and better jobs

114. **Today, a window of opportunity exists to accelerate reforms that will create more and better jobs.** The country is benefiting from strong macroeconomic fundamentals, political stability, and a popular government that many see as committed to improving the lives of the people. It also stands to benefit from the global and regional economic rebalancing and the strong growth prospects of a dynamic East Asia region. Aging populations elsewhere are also offering new opportunities to the country's young and dynamic labor force. In addition, sectors that had previously been dominated by monopolies, such as telecommunication and air transport, are now demonstrably benefiting from past reform efforts that opened them up to competition.

115. **The Aquino Government has demonstrated that it is not afraid to tackle vested interests in areas that had previously been too sensitive to reform.** Several reforms have successfully started, notably in public financial management, tax policy and administration, anti-corruption, and social service delivery. The government now needs to maximize the chances that the country will follow a more inclusive growth path and meet the jobs challenge by accelerating reforms to protect property rights, promote more competition, and simplify regulations to trigger more private investments by firms of all sizes, while sustainably ramping up public investments in infrastructure, education, and health.

Working together towards a jobs agenda

> "There is no simple, clever, or painless solution… even an adequate solution will demand sacrifice… [that] should be fairly apportioned… [G]overnment should aim for a solution that is not only effective but also just [to] foster solidarity and understanding of the national predicament… [T]he measures proposed by government must be seen to result from a judicious weighing of alternatives, a coherent program, and to have been guided by economic principles and a concern for equitable burden sharing" (de Dios et al. 2004).[53]

116. **Many stakeholders agree that the current window of opportunity marks a critical juncture in the country's history.** As discussed in the previous section, the foundations needed for the country to achieve more inclusive growth are in place. However, the extractive nature of some of the country's political and economic institutions, which Acemoglu and Robinson, in their book "Why Nations Fail,"[54] define as institutions that undermine incentives and block opportunities in order to create wealth and opportunities for a narrow subset of the population (i.e., the elite), poses significant challenges to achieving lasting inclusive growth.

117. **To put the country on an irreversible path of inclusive growth, broad reform coalitions — that is, multi-sectoral groups composed of many interests that address diverse options — are crucial.**[55] To ensure that reforms are sustained, broad coalitions at all levels of society are needed, because first, they must adopt a strategy for winning

[53] de Dios et al.'s (2004) landmark paper on the need for fiscal reforms is a reminder of the need to work together to achieve this grand objective.
[54] See Acemoglu and Robinson (2012) for more discussion on extractive and inclusive economic and political institutions.
[55] This follows the recommendation of the World Development Report on Jobs (World Bank 2012), which recommends the need for an engagement strategy involving a deeper analysis of the options and buy-in by key stakeholders when constraints on job creation can neither be removed nor offset easily.

which appeals to a wide segment of society (i.e., an inclusive strategy), and second, because the presence of broad coalitions makes it difficult for one sub-group (e.g., the elite) to dominate and create a new extractive regime. Without broad coalitions, reforms made under a strong president can be reversed, as the country's history had shown. In practice, such coalitions are hard to sustain because some stakeholders may be much more organized than others (e.g., tobacco lobby, political dynasties). However, in the absence of a crisis to rally stakeholders around a common goal, the success of the Aquino Administration in generating confidence and economic growth, and the obvious advantages for everyone to see such growth continue beyond this administration, suggest that a basis for broad-based coalitions is present. Strategically forging these reform coalitions should be a high priority of the government and its partners.

118. **To support President Aquino's Social Contract[56] with the Filipino people, government, business, and labor, supported by civil society, need to engage in deeper social dialogue[57] and partnership, and agree on an agenda on job creation**. As the dominant member of the tripartite system, it is important for the government to make the first move of reaching out to all workers and businesses to signal that it is serious and fully committed to change.

119. **At the heart of this agreement should be the promotion of the welfare of *all* workers, not just the minority of formal wage and salaried workers benefiting from current labor regulations and anti-competitive structures.** To arrive at a true partnership, a necessary first step would be to broaden the membership of the current tripartite system to include workers who are largely left out of the consultation and policymaking process — the rural and informal sector workers who comprise the majority of workers and who have been negatively affected by the country's extractive institutions. By expanding the tripartite representation to reflect the composition of the entire labor force, the President's Social Contract can be better supported.

120. **A win-win agreement to create more and better jobs needs to balance trade-offs between labor and business.** Achieving this requires the social partners to work in the interest of the collective good — that is, jobs for *everyone*. This will require a careful

[56] The Social Contract is elaborated in the Philippine Development Plan (PDP), Philippine Labor and Employment Plan (PLEP), and the President's 22-Point Labor and Employment Agenda. The overarching goal of the 22-Point Agenda is to invest in human resources to make Filipinos more competitive and employable while promoting industrial peace based on social justice.

[57] This is not to say that social dialogue is not happening. There are good examples of industry-level social dialogue. For example, the Banking Industry Tripartite Council (BITC) adopted in December 2011 a voluntary code of good practices, which gives importance to social dialogue. Social dialogue in the banking industry includes informing, consulting, and holding dialogues with affected employees and unions on any proposed program of outsourcing, including discussions on alternative adjustment measures. The BITC model can be replicated in other industries and the country as a whole.

balancing of trade-offs,[58] proportional sharing of responsibilities based on the ability to shoulder the reform cost, short-term sacrifices on all sides, and mutual cooperation among the social partners that transcends the issues of rights, labor standards, and wages, to issues of productivity and competitiveness so that more people can benefit.

121. **Given the diverse nature of the reform coalitions, it is important for any coalition to first agree on the key principles of reform.** These principles could include fairness, economic openness, efficiency, and simplicity. Based on these principles, the coalitions could then agree on how each tripartite member would broadly contribute to job creation.[59] The report recommends that the tripartite members agree on the following responsibilities:

Government

122. **For its part of the agreement, the government needs to enact policies that can broaden and strengthen reform coalitions and create reform beneficiaries who will have a vested interest in continuing the policy.** These policies could include i) reducing food prices, ii) reducing the cost of doing business, iii) improving delivery of government services, and iv) empowering citizens to hold the government accountable. Reforms to reduce food prices could include a) reforming the National Food Authority, b) liberalizing food imports, and c) investing more in rural infrastructure and irrigation so that food prices can fall without farm profits falling. Reforms to reduce the cost of doing business could include a) accelerating investments in infrastructure and social services, in particular health, education and social protection, b) committing to an accelerated implementation of plans that have been on the table for years, such as simplifying business regulations, and c) enhancing competition to level the playing field, raise quality, and lower prices. Reforms to improve the delivery of government services could include a) internal reforms such as civil service and organizational reforms, b) reform of inter-governmental fiscal relations, and c) electoral reforms. Reforms to empower citizens to hold the government accountable could include scaling up Bottom-Up Budgeting, community-driven development, conditional cash transfer, Open Data, and Open Government programs. Finally, the government would also need to lead by example, especially with regard to labor policies.

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[58] Balancing trade-offs is important. For example, the Magna Carta for Women (Republic Act 9710) may protect and benefit women who are currently employed, but in the long run this may lead to lower employment of women, as employers need to pay women more in benefits and can decide to hire more men when faced with a pool of male and female applicants who are all equally qualified.

[59] At the outset, the coalitions need not choose specific sectors to reform, as tackling even a few entrenched sectors can take a long time and can easily drain the energy and capital for reform (as the sin tax debate showed). As reform momentum grows with larger coalitions and with incremental successes, the coalitions can then choose to tackle specific entrenched sectors.

Business

123. **As a community, businesses of all sizes need to embrace the principle of a level playing field for all, in the interest of accelerating inclusive growth.** This means actively supporting the government's reforms to reduce barriers to entry and maximize competition, particularly in sectors currently dominated by monopolies and oligopolies. This also means that business associations, chambers, and professional groups should help the government ensure compliance of its members with basic duties such as paying correct taxes and adhering to other business and labor regulations.

124. **In addition, businesses need to extend their corporate social responsibility to their own employees, especially with regard to core labor standards.** These include ensuring that workers' rights, such as freedom of association, compliance with minimum labor standards, and fair and equitable treatment of employees, are protected, guaranteed, and fully supported in work premises. To promote mutual trust and understanding, employers would need to make the first move to engage employees in meaningful dialogue on various labor issues. Businesses would also need to enhance transparency in their operations. Some unions recognize businesses' need to be flexible to remain competitive and are willing to cooperate with management especially if management is fully open and transparent about its true financial conditions. To improve workers' productivity, industry associations need to work more closely with their members, the government, labor organizations, the academe, and civil society organizations to provide training, upgrade skills, and improve job matching, especially for workers in the informal sector.[60] Finally, linking workers' pay to productivity would send a strong signal that employers value the contribution of their workers.

125. **When firms make big sacrifices and reach out to their employees, workers would be in a better position to understand management's need for more flexible work contracts.** These arrangements would enable firms to adapt quickly to changing business needs, remain competitive, and ensure that future employment prospects of workers are not constrained by firms' inability to expand due to less flexible labor regulations.

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[60] There is ongoing dialogue between employer groups, the government, and schools, but the large mismatch between available skills and available jobs indicates that more can be done to ensure that students have the right skills demanded by businesses when they graduate. A good example to follow is the BPO industry's provision of training (e.g., English language proficiency and critical thinking training) to its workers and prospective hires. In addition, the industry provides scholarships and job opportunities to deserving students. This training program has been instrumental in ensuring skills upgrading and employability of around 800,000 young Filipinos working in the BPO industry today.

Labor

126. **As food prices fall and job opportunities increase, labor groups can respond by recognizing valid forms of flexible work contracts and reducing calls to hike minimum wages to facilitate the creation of more jobs.** These would allow businesses to adapt better to the changing environment, remain competitive, hire more workers during expansion years, and retain qualified workers during slowdowns. At the same time, these would encourage entrepreneurs to set up new businesses and spur job creation to benefit the majority of workers who are without good and stable jobs. Moreover, millions of workers who face job insecurity from the use of the rotating five-month contract stand to see better job security with longer-term contracts. While some organized labor might be affected by this transition, this trade-off needs to be weighed against the potential benefits that could accrue to the majority of workers in the informal sector. In the end, this would help secure long-term employability for everyone and not only for workers in the organized sectors. To minimize costs to those who will be affected, government effort to improve social protection is critical.

223. **Successful implementation of an agreement such as the one discussed above can help the Philippines restart its structural transformation by reviving agriculture, supporting manufacturing, and creating better jobs in services.** In the process, more productive jobs would come in place of less productive jobs. This "creative destruction" where productive jobs replace less productive jobs would allow the country to move from the current low-level equilibrium of high growth but high poverty and weak employment, to a high-level equilibrium of high, sustained, and more inclusive growth, with more and better job creation, and faster poverty reduction.

The reform agenda for job creation

127. **There is no simple and effortless solution for creating more and better jobs, as this is linked to resolving deep-seated structural issues in the economy. Only a comprehensive reform agenda that is owned and supported by broad coalitions can foster a business environment conducive to private sector job creation by firms of all sizes.** Built on the principles of fairness, economic openness, comparative advantage, efficiency, and simplicity, a comprehensive reform agenda to support the revival of agriculture and manufacturing and to make business and labor regulations, including social protection, more conducive to job creation is proposed for consideration by the reform coalitions. To support these reforms, government commitment to increase

investments in health, education, and infrastructure through reforms in public finance is essential.[61]

Agriculture and rural development

128. **The development of the rural sector is a crucial first step for the country to provide more and better jobs for the poor.** Three quarters of the poor are found in rural areas, and agriculture employs most of the poor. This means that agriculture can play a key role in efficiently reducing poverty. In turn, productivity improvements in agriculture can help the country expand its manufacturing sector through lower minimum wages (as transmitted by lower food prices) and input costs. The key recommendations are as follows:

- **Investment and productivity can be improved by securing long-term individual property rights.** In rural areas, this means ensuring that farms of all sizes have clear property rights (e.g., individual titles instead of collective titles) so that they have better incentives to invest. In urban areas, this means simplifying and decentralizing the lengthy and onerous procedures of acquiring land, which continue to prevent the majority of the population from obtaining secure rights to their property. Securing property rights requires: i) developing a zoning plan for all types of land (i.e., agricultural, industrial, urban, conservation, etc.), and ii) beginning the process of systematically and administratively adjudicating the property rights of various claimants by going from plot to plot and determining in a transparent and participatory way who owns the plot, and immediately issuing a title administratively. With secure property rights to land, small family farms can see more gainful employment, raise household income, and use their own savings, including sweat equity, to increase farm investment and improve productivity. Through strong local multiplier effects of family farms, the growth of this sector can then serve as an impetus for the growth of and job creation in the non-farm sector.

- **Farm productivity and household income can be enhanced by increasing investment in agricultural public goods and support services instead of subsidizing farm inputs**. In the last three years, although rice has remained a strong focus of public expenditure, the government has avoided large-scale input subsidies (e.g., crop subsidies, mechanization, and postharvest equipment) that benefit only a few farmers and instead has increased the budget allocation to public goods and services supporting productivity enhancement, such as irrigation, farm-to-market roads, bridges, electrification, market access and

[61] Many of these recommendations have not changed over the last 25 years. This report stock-takes, synthesizes, and connects previous recommendations from over 20 years of World Bank analytical work, and also adds new recommendations on labor and social protection, and selected sectors.

information, extension services, and research and development, which can benefit all farmers. This positive shift needs to be sustained and institutionalized. With sustained focus on delivering quality public goods, production and marketing costs would fall, allowing farmers to raise their income even as retail prices fall. Moreover, the focus on public goods can help promote a more diversified and productive agriculture sector that would allow the country to reduce dependence on traditional crops, such as rice, corn, coconut, and sugarcane.

- **Liberalization initiatives can be pursued in the area of marketing and logistics to further reduce food and input prices, and encourage more economic activity and job creation.** In the rice sector, for example, the government would need to allow full importation of rice by the private sector, shift from a quota to a tariff system, and reduce the import tariff gradually while refocusing the National Food Authority to respond to natural calamities and food emergencies. Reducing import tariffs on corn, sugar, flour, and poultry, and other highly protected food products would also benefit the majority of Filipinos in terms of lower food prices. To reduce logistics costs, competition in domestic shipping and ports should be enhanced, with the Philippine Ports Authority divesting itself of its port operations and focusing on its regulatory mandate.

- **Clusters and value-chain development approach can be used in delivering public goods and support services to connect smallholders and agribusiness.** Agriculture has significant vertical linkages with downstream manufacturing. Shifting the developmental approach from production to a cluster and value-chain approach can therefore promote a more diversified agriculture, improve farm income, and create more rural jobs.

Support to manufacturing

129. **The manufacturing sector can be reinvigorated by increasing competition in the economy and investing more in infrastructure.** Having more contestable markets can spur investment from both domestic and foreign sources, bring down the cost of manufacturing inputs and logistics, provide workers in agriculture and informal services with better jobs in manufacturing, and increase real household income through lower consumer prices. The key recommendations are as follows:

- **First, an explicit competition policy is needed to combat ongoing and potential anti-competitive practices that are not sanctioned under the existing legal framework.** The principle of fair competition needs to be at the heart of this policy. This can be achieved in two steps. In the short-term, the principles and key provisions for a fair competition policy can be established through an executive order (EO). In the medium-term, an explicit anti-trust law should be enacted. To enforce this policy, a strong and independent competition (or antimonopoly) authority is needed. This office would need to have statutory independence, be adequately funded and fiscally autonomous, and be led by senior executives who are appointed for fixed terms. The government's resolve to enhance competition by creating the Office for Competition in the Department of Justice to investigate monopolistic behavior is a step in the right direction. Strengthening this office through legislation would have to be pursued.

- **Priority should be given to enhancing competition in key sectors of the economy where there is huge potential for reducing poverty and creating jobs for the poor and vulnerable (directly or indirectly). These are ports, shipping, water utility, power, and air transport**. Enhancing competition in ports and shipping essential in lowering food and input prices, improving producers' access to markets, and raising the incomes of farmers in less developed regions, such as in Mindanao. Enhancing competition in the water utility sector would help improve access to clean and affordable water, thereby improving health outcomes and raising worker productivity especially in rural areas. Enhancing competition in the power and air transport sectors would help spur the growth of manufacturing and tourism.

- **In addition to promoting domestic competition, more foreign participation would facilitate technology transfer and innovation, create more jobs, and raise productivity of workers.** This entails i) amending the economic provisions of the 1987 Constitution by removing the explicit rigidity imposed on natural resources, public utilities, mass media, educational institutions, and the practice of professions, and giving the prerogative to impose such restrictions to Congress, as is the case in the other sectors, and ii) allowing more foreign ownership in key sectors such as telecommunications, shipping, financial services, and media sectors. These sectors are likely to have the largest gains from competition, capital, technology, and improved governance.

- **In tandem with liberalization, regulatory capacity needs to be strengthened.** The independence and competence of important regulatory bodies and the justice system need to be ensured, and political and judicial interference in regulatory decisions, such as the reversal of decisions, need to be limited. These can be achieved by i) clearly defining the role of regulatory bodies including provisions to limit conflict of interest, ii) ensuring some degree of fiscal autonomy and adequate expertise to avoid politicization of decisions and allow them to execute their mandates freely, iii) reducing discretionary powers of regulators through the establishment of clear and rule-based procedures and policies, and iv) conducting regular regulatory assessments.

Business regulations

130. **Simplifying rules and regulations in business registration and licensing, entry and exit, paying taxes, and access to finance are needed to encourage rapid growth of businesses of all sizes and encourage movement of small firms to the formal sector and in the process increase their productivity and market access.** The copious amount of red tape not only hinders investment and entrepreneurship, they also provide fertile ground for rent-seeking and corruption, which are detrimental to businesses. Priority should be given to addressing the top three concerns in the Doing Business Report: i) starting, operating, and closing a business, ii) paying taxes, and iii) accessing finance.

- **Starting a business can be simplified by harmonizing and streamlining procedures.** The Philippines' business regulatory system currently requires 16 procedures to start a business. The government needs to consider reducing these procedures to around nine, which would put the Philippines at par with regional comparator countries. This could include i) harmonizing and streamlining procedures among national government agencies and local government units (LGUs) to avoid overlaps and redundancies, ii) removing steps that can be verified by government offices at the back end, and iii) reducing requirements whose purposes are not fully justified. Full implementation of the Philippine Business Registry and the Business Permit and Licensing System would also facilitate business startup. Improving transparency of business regulations can provide better understanding, especially among incipient firms, of the different registration, licensing, and taxation processes, and can help reduce transaction costs.

- **Moving toward a simplified tax regime for micro and small businesses is warranted to reduce compliance costs and encourage movement of firms to the formal sector.** The administrative complexity of complying with tax obligations is among the top complaints voiced by MSMEs and a frequent excuse for remaining in the informal sector. The simplified system could include the following: i) using simplified tax forms, registration requirements, and payment processes, ii) reducing requirements for bookkeeping and financial reporting, iii) integrating the tax filing and payment systems of the national and local government units so that taxpayers need to file and pay only once, and iv) combining the value-added tax (VAT), percentage tax, and income tax into a single business tax on turnover for small and micro firms.

- **Access to finance, especially for MSMEs, can be improved** by i) ensuring that the public credit bureau commences operation soon, ii) replacing the mandated system of lending to MSMEs with a system of credit guarantees, iii) strengthening the collateral system by completing the cadastral titling of all lands in the country and establishing a central registry for land titles, iv) improving the legal and regulatory framework for secured transactions to increase financing secured by movable property (such as receivables and inventory) as alternative to real property, and v) enhancing the role of cooperatives.

Labor regulations

131. **There is scope for making labor market regulations more responsive to job creation, especially for small and labor-intensive firms.** Labor market regulations need to be crafted to achieve a fair balance between i) businesses' need to be competitive and workers' right to adequate protection, and ii) the need to provide jobs to the majority of unemployed or underemployed workers in the informal sector and the need to safeguard workers in the formal sector from abuse. With these objectives and tradeoffs in mind, the following recommendations are proposed:

- **Simplifying and rationalizing labor regulations are necessary first steps to improve enforcement and compliance and to increase coverage, protection, and equitable application of the law.** The Department of Labor and Employment (DOLE) has begun a comprehensive review of the Labor Code. It would be useful for the review to consider: i) consolidating all labor regulations, including department orders and court jurisprudences, into one volume, ii) ensuring consistency across regulations, iii) simplifying rules to reduce compliance cost for businesses and labor groups, and iv) updating obsolete laws to reflect changing economic conditions. The regulatory capacity of DOLE and its attached agencies would also need to be strengthened to ensure that the intended coverage and protection of labor regulations are not eroded by noncompliance.

- **There is a need to define and enforce *valid* forms of flexible work contracts and the conditions for their use with due regard to the protection of workers.** When necessary, for example during a recession or when demand is depressed, employers would benefit from the use of flexible contracts, such as subcontracting and outsourcing non-core business lines, and temporary reduction in wages and benefits to remain competitive and retain qualified workers. The use of flexible work contracts can open up employment opportunities to millions of informal sector workers when businesses expand and hire more workers to meet their business exigencies. Flexible contracts that exceed the six-month rule can even improve job security for millions of workers working under various short-term contracts, such as the rotating five-month contracts.

- **Rationalizing the labor dispute settlement system would reduce business and employee uncertainties, and encourage business expansion, job creation, and skills accumulation.** Among cases that require formal proceedings, the goal should be to reduce legalism and excessive requirements, in order to speed up the pace of dispute resolution. Among cases that can be resolved outside the court, priority should be given to promoting alternative forms of dispute settlement. The number of potential disputes could be reduced by educating workers and employers on core labor regulations and on the observance of due process when terminating employees.

- **Procedural barriers that hinder freedom of association and collective bargaining need to be reduced, and alternative forms of organization for informal workers need to be promoted.** Procedures and conditions are necessary to safeguard against spurious labor groups, but they should not hinder legitimate groups from fully exercising their fundamental rights. For informal sector workers, alternative forms of organization should be promoted and government can play an important role by improving and rationalizing its various assistance programs for informal workers.

Social protection

132. **Some workers will be affected by the process of "creative destruction," where more productive jobs replace less productive jobs.** This can be mitigated by having in place an adequate program of social protection to ensure that job losses do not unduly affect workers' ability to retain skills and find employment in the future. An effective social safety net system can also encourage risk-taking, which would promote entrepreneurship and job creation. The following recommendations are proposed, some of which are already in place but would benefit from further strengthening.

- **An empirically-informed social dialogue on minimum wage setting is essential to improve the current system.** Three issues could be discussed in the social dialogue: i) whether or not to adopt a simplified minimum wage system (e.g., one or a few minimum wage rates rather than the current 200 plus wage rates across the country) that would be strictly enforced without exemptions, ii) at what level minimum wages should be set for it to be more effective in protecting the poor, and iii) how the minimum wage would apply to non-wage workers who are largely paid on a piece rate basis. Based on the evidence presented, the social dialogue could consider two options: One option would be to i) simplify the minimum wage regime by limiting the number of minimum wage rates to at most two per region (i.e., agriculture and non-agriculture), ii) lower the rate to better align it with the minimum living threshold, and iii) remove all exemptions. This option would increase the coverage of the minimum wage, especially among informal sector workers, and make it a more effective anti-poverty tool. Another option would be to retain the simplified wage regime as in the first option but allow for limited exemptions if minimum wage levels cannot be reduced. With complementary reforms to promote collective bargaining, the minimum wage rate could be adjusted less frequently, say, every three years, instead of every year.

- **To enhance income protection for the poor, the government could make public works a regular social protection program.** Worldwide, public works, when properly designed, are effective in providing income support to the poor. In the Philippines, public works program beneficiaries can be selected using the National Household Targeting System for Poverty Reduction (NHTS-PR). Furthermore, public works could be managed at the community level in a more effective manner by closely collaborating with community driven development and Bottom-Up Budgeting projects.

- **Moving toward universal social insurance and health care coverage for *all* workers can enhance social protection.** Among wage and salaried workers, the government would need to enforce the law on mandatory social insurance and health coverage. To improve compliance among small firms, the government could explore the possibility of harmonizing the registration and collection of taxes, and Social Security System (SSS) and Philhealth (Philippine Health Insurance Corporation) premium contributions to reduce compliance cost. Among self-employed and other informal workers, there is a need to reduce the financial and administrative burden when availing of existing social protection schemes to facilitate enrollment of the poor and vulnerable. For low-income households, coverage could be expanded and targeting improved by using the NHTS-PR. As subsidies may increase the fiscal burden, the fiscal cost of such a program would need to be estimated and managed.

- **Enhancing training programs can improve *ex ante* risk mitigation.** Improving the Technical Vocational Education and Training (TVET) System and job-matching programs can mitigate *ex-ante* risk for workers and address unemployment. Job-related social protection programs, such as scholarships for TVET programs (e.g., cash for training program), can be better targeted to poorer and more vulnerable workers by using the NHTS-PR. In addition, job and skills matching can be improved by deepening partnerships with firms and enhancing job intermediation services, such as those provided by the various Public Employment Service Offices (PESOs), and by strengthening engagement and collaboration with LGUs to help PESOs become fully operational and functional.

Infrastructure, education, and health

133. **To complement the proposed structural reforms, the government would need to invest more in education, health, and infrastructure to create an environment conducive to increasing productivity and competitiveness.** A high-case scenario calls for spending an additional 2.5 percent of GDP in infrastructure and an additional five percent of GDP in social services, for a total of 7.5 percent of GDP over the next decade. This would bring the national government spending level to around 25 percent of GDP, which is more in line with the spending patterns of the country's neighbors, and

facilitate the creation of good jobs by the private sector. The priorities per area are as follows:

- **On infrastructure, investments would need to focus on projects that have strong employment, income, and poverty impacts.** These "inclusive infrastructure" include fast-tracking pipeline and ongoing project in ports, the arterial road and expressway system, the urban commuter system, mass housing, and agriculture infrastructure as discussed earlier.[62] In tandem with increasing investment spending levels, improving infrastructure management is also essential.

- **On basic education, priority would have to be given to achieving universal primary education and expanding secondary net enrollment by increasing actual spending for basic education and improving the quality of education.** Actual spending levels can be increased by providing a bigger budgetary allocation to the Department of Education and improving agency absorptive capacity. The quality of education can be improved by enhancing curriculum and teaching methodology (e.g., use of vernacular in primary education) and improving the procurement of teaching inputs, such as classrooms, teachers, and learning materials. Over the medium term, with a bigger budget and improved institutional capacity, efforts can be focused on ensuring the successful implementation of the K to 12 Program.

- **On health, priority would have to be given to scaling up health interventions to meet public health and poverty alleviation goals, and expanding the coverage and improving the fiscal and institutional sustainability of public health insurance.** The government is moving toward universal healthcare coverage, beginning with the poor, to be followed by the informal sector workers, using the well-established NHTS-PR. This reform is a very good start and needs to be sustained. Continuous improvement in the coverage and quality of healthcare can help reduce total out-of-pocket costs and ensure that the most important asset of most Filipinos, their labor, is not compromised when they get sick, allowing them to continue accumulating skills to improve their future employability.

Public finance

134. **To finance higher spending on infrastructure, education, and health, complementary reforms are needed in public financial management (PFM), taxation, and statistics.** Increasing investment in physical and human capital require policies to strengthen PFM and increase tax revenues efficiently and equitably. Enhancing official

[62] Details are discussed in the main text.

statistics is needed to improve evidence-based policymaking. Successful PFM reforms, including strengthening the demand side for better PFM (by promoting Open Data, Open Government, and accelerating participatory budgeting such as Bottom-Up Budgeting and community-driven development), and evaluating their development impact would allow the public to see more tangible improvements in governance and convince them that their taxes are being spent wisely. These crucial reforms would help make a better case for tax policy reforms. Successful implementation of public sector reforms would allow the country to increase public investment and pro-poor spending to create an environment that is conducive to attracting more investments and creating better jobs.

Tax policy and administration

135. **To support the required increase in public investments, additional tax revenues of around eight percent of GDP would be needed in the medium term.** This seems to be attainable, considering the current strong leadership in government, the substantial gains in tax effort in 2012 largely on account of tax administration, and the country's past experience of successful tax administration. On tax policy, the following priority legislations are recommended:

- Rationalize tax incentives to plug systemic leakages in the tax system, level the playing field, and raise revenues. Particular attention is needed in reducing tax incentives for domestic firms, given the high rate of redundancy.

- Levy a national surtax on real properties to improve the equity of the tax system. This reform should include updating property values to reflect market prices. The impact of higher property tax can be partly offset by lowering the rate of the capital gains tax and transfer tax and abolishing the estate tax, which in practice is very difficult to collect.

- Over the medium term, a comprehensive tax reform program is needed to simplify and improve the efficiency and equity of the tax system toward a more broad-based and low-rate tax regime.

136. **On tax administration, measures to improve tax compliance and reduce revenue corruption could include:**

- Reengineering and simplifying procedures and processes required of micro and small enterprises, followed by full automation of all tax processes to facilitate taxpayer compliance and improve governance.

- Strengthening real-time monitoring of revenue performance at disaggregated levels to minimize tax leakages.

- Issuing an executive order mandating all government agencies and selected private sector groups (e.g., electric and phone companies, and professional associations) to provide third-party data to the BIR and BOC to improve tax audits.

- Further enhancing the integrity of revenue officials by, for example, requiring the public posting of net worth of top revenue officials on official websites (following the example of DOLE and the NLRC[63]) to send a strong signal to the public that the revenue agencies are committed to good governance.

- Enhancing internal and external audits (i.e., by the Commission on Audit) of BIR and BOC activities, in particular the adherence of the BIR and BOC to their own audit rules, to improve transparency and accountability of tax administration.[64]

- Institutionalizing the recording and public reporting of key performance indicators to allow the public to track the performance of the BIR and BOC.

- In BOC, strengthening efforts to curb smuggling by inspecting all outward movements of goods from special economic zones.

Public financial management (PFM)

- **Ongoing reforms to improve PFM would need to be further strengthened and institutionalized.** The government has embarked on several reforms to institutionalize evaluation of government programs and budget items (e.g., CCT, lump sum funds), improve agencies' absorptive capacities, and enhance transparency and accountability of the budget process, such as public posting of budget reports and harmonizing the budget chart of accounts across agencies. These reforms need to be further strengthened and institutionalized.

Statistics

- **In the immediate term, priority can be given to improving household statistics to help the country resolve its poverty and jobs problems faster.** The current set of household surveys can be re-engineered into a more harmonized set in order to provide more timely and useful poverty and employment data. The goal

[63] See, for example, data posted on the websites of DOLE (http://www.dole.gov.ph/fndr/bong/files/2010%20SALN%20OF%20OFFICIALS%20(WEBSISTE)%207-15-11.pdf)
and NLRC (http://nlrc.dole.gov.ph/?q=node/91).
[64] An existing executive order (EO 38 of 1998) authorizes COA to audit the BIR's compliance with its own audit rules. This law needs to be enforced.

should be to produce provincial estimates of employment and poverty and to reduce the processing time by at least 50 percent.

- **This can be followed by ensuring that the new Philippine Statistics Authority (PSA) would have enough resources to meet the growing demand for quality statistics.** First, the Philippine Statistical Development Program would need to be updated to show clear priorities. This could be followed by formulating a sector medium-term expenditure framework to provide policymakers with information on how much quality statistics would cost. These two foundational reforms would help the statistical system make a stronger case for more resources to meet the growing demand for better, timely, and more useful statistics.

A three-tracked implementation

137. **In sequencing the reform program, a three-track approach can be considered to produce early results and build momentum for the more difficult reforms.**

- **The first track involves decisively implementing key reforms.** Reforms in this track can be, in principle, supported reasonably by broad coalitions and generally do not need legislative change. They may require an executive order.

- **The second track involves accelerating the present reform agenda** of improving governance, increasing investments, and improving social service delivery. Continued successful implementation of these reforms can provide the momentum and public support for implementing the politically more difficult reforms.

- **The third track involves seizing the window of opportunity to lay the foundation for the more difficult reforms that would reverse decades of policies that have undermined the economy's capacity to generate more and better jobs.** Past attempts at these reforms were rather difficult because they tried to open the economy to competition and new ideas and therefore ran into powerful vested interests that favored the status quo. For the country to create more and better jobs, the status quo must change. While these reforms will take time to bear fruit and even surpass the horizon of the current administration, it is important that they begin today with a sense of urgency, through a formal policy pronouncement.

Priority reforms by track

Track 1 - Decisively implement the following reforms *Reforms in this track can be, in principle, supported reasonably by broad coalitions and generally do not need legislative change. They may require an executive order.*	Track 2 - Accelerate ongoing reforms *This track is about moving current reforms faster and giving more focus on existing initiatives and programs.*	Track 3 - Laying the foundation for the more difficult reforms *These reforms are difficult and will take time to be completed. They will need legislative changes. However, decisive action can be taken now to start the process.*
Agriculture		
Fully transfer importation of rice and other commodities to private sector by abolishing import licenses.	Increase spending on agricultural infrastructure (e.g., farm-to-market roads, irrigation) and improve delivery of services (extension services, R&D).	Replace rice import quota with a uniform tariff and gradually reduce tariff over the medium term. Reform NFA by removing its marketing function and focusing its mandate on regulation and emergency stocking.
Land (crosscutting)		
Update schedule of market values at LGU level annually, beginning with highly urbanized cities (see also "national surtax on property"). Adopt and strictly enforce zoning regulations in a systematic and consistent way.	Implement land reform program using a more community-driven and decentralized approach. Accelerate the systematic and administrative adjudication of property rights in rural and urban land, plot by plot.	Improve land administration by passing an effective Land Administration Reform Act and National Land Use Act.
Support to manufacturing		
Enhance competition in ports and shipping, including reviewing mandate of PPA and relaxing cabotage provisions. Reduce Foreign Investment Negative List. Enhance competition in the water utility sector to improve health outcomes and worker productivity.	In power, fast-track implementation of the power retail market and increase competition in power generation to reduce power rates. Further liberalize air transport (open skies).	Formulate an overarching competition policy, including enacting an anti-trust law and creating an independent competition authority. Amend economic provisions of the constitution to increase foreign participation and FDI. Reduce tariffs on key agriculture and manufacturing inputs such as cement and chemicals.

Business regulations		
Improve MSME finance – operate credit bureau, support cooperatives development, move from mandated credit to credit guarantees.	Fully implement the online PBR and BPLS possibly through an incentive program to fast-track implementation at the LGU level.	Review and simplify business regulations. MSME finance – implement lending based on movable assets.
Labor and social protection		
Expand TESDA-industry partnerships for training programs. Rationalize dispute settlement system. Regularly update the National Household Targeting System for Poverty Reduction (NHTS-PR). Target systematically all social protection programs using NHTS-PR (e.g., rural poor, UHC, and disaster-related support).	Expand universal social and health insurance. Extend CCT to high school. Commence annual estimation of poverty at national level, and triennial estimation at provincial level. Institutionalize public works program.	Define and enforce valid forms of flexible contracts, including an expanded apprenticeship program. Reform Labor Code.
Investment		
Implement the Tourism Roads and Infrastructure Plan (TRIP) network plan. Prioritize key constraint infrastructure projects: 1. NLEX-SLEX connector 2. Shift to dual airport system	Complete the TRIP network plan. Improve urban commuter system: 1. Increase number of LRT trains 2. Rationalize public bus transport system Implement Metro Manila Flood Master Plan (e.g., modernize pumping stations, weather resilient infrastructure).	Review and revise public investment planning, execution and monitoring process.
Public finance		
Implement government financial management information system, including treasury single account. Modernize statistics through the new Philippine Statistics Authority.	Improve customs administration to control smuggling, including increasing control over special economic zones. Strengthen participatory budgeting at LGU level, following principles and lessons learnt through existing Bottom-Up Budgeting and community driven development programs. Implement Open Government across all agencies and adopt Open Data platform.	Enact fiscal incentives rationalization bill. Enact a national surtax on property (see also "land"). Increase excise tax on petroleum. Further raise the excise tax of alcohol and tobacco. Start comprehensive tax administration reform program to simplify tax processes, especially for MSME.

SPECIAL FOCUS 1

Philippine tourism industry challenge

Despite a range of natural endowments and a highly service-oriented culture, the number of international tourists to the Philippines has been lower than potential (Van der Weide 2010). The Aquino Administration has set itself an ambitious target of increasing the number of foreign tourists to 10 million and domestic tourists to 56 million by 2016, from the current 4.3 million and 41 million, respectively, in 2012.[65] But public infrastructure bottlenecks figure prominently as a binding constraint for a more widely developed tourism sector across the Philippine archipelago. Many of the country's prospective tourism destinations still cater to a more intrepid traveler. Flight, road, and sea connections to potential destinations frequently remain challenging and time consuming, certainly when compared to regional competitors such as Thailand, Malaysia, Indonesia, and Vietnam.

Beyond the "It's More Fun in the Philippines" campaign, the Government of the Philippines is taking a number of concerted actions to improve its tourism infrastructure. As part of the 2012 and 2013 budgets, it has allocated PHP 17 billion (about USD 400 Million or about 0.2 percent of GDP) for its Tourism Roads Infrastructure Program (TRIP).[66] Further growth in the TRIP program is projected for 2014. The TRIP program is notable for both its innovative way of prioritizing infrastructure upgrade by the Department of Tourism (DOT), while focusing effective implementation by the Department of Public Works and Highways (DPWH) (World Bank 2013).[67] Its explicit focus is on improving "last mile" access to promising Tourism Development Areas (TDAs) identified under the National Tourism Development Plan (NTDP) 2011-2016. Under the NTDP, investments in tourism-related public infrastructure are expected to increase significantly to a total of PHP 74 billion.

TRIP focus

The TRIP program is consistent with the Philippines' overarching objective of increasing public infrastructure investments from under 2.5 percent of GDP in 2012 to

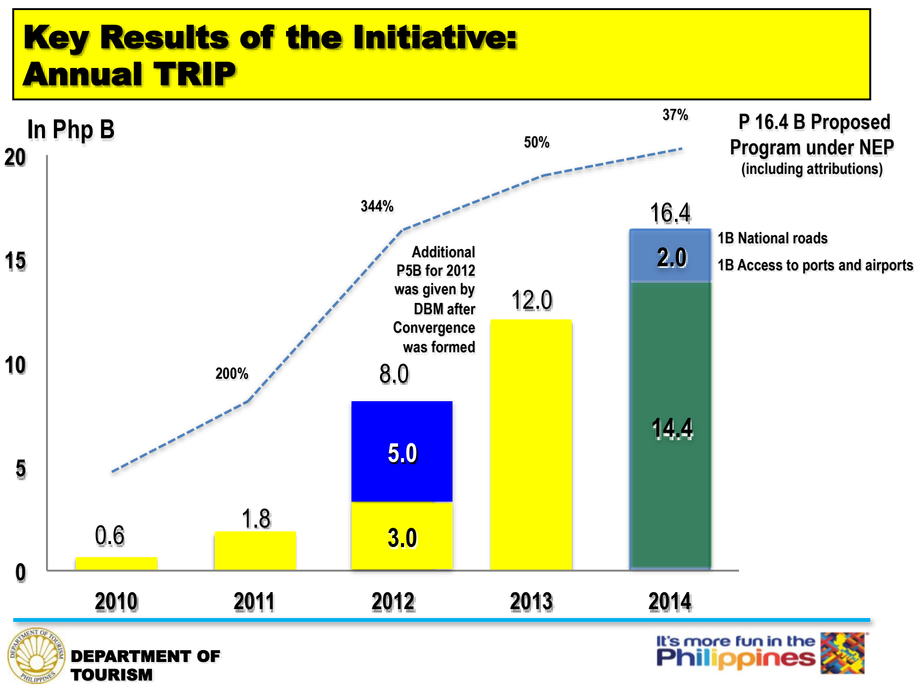
[65] Source: Department of Tourism (DOT) Secretary Jimenez's presentation to Arangkada Philippines Second Anniversary Forum: Realize the Potential! on February 26, 2013 at the Rizal Ballroom, Makati Shangri-La - See more at: http://www.investphilippines.info/forum/national-tourism-development-plan-by-tourism-sec-jimenez/#sthash.Bj0i7f94.dpuf.

[66] Source: Presentation of DOT to the Tourism Coordinating Council, April 19, 2013.

[67] The TRIP was conceptualized and implemented with support from the USAID under the Economic Growth Hubs Project in 2011 and now under the five-year Advancing Philippine Competitiveness (COMPETE) Project (2013-2017).

at least five percent in 2016. The TRIP program illustrates the Government's efforts to enhance the prioritization of public infrastructure investments for enhancing the competitiveness of industries that appear to be especially promising in terms of job creation and poverty reduction. The TRIP investments have been prioritized based on local tourism development potential, and implemented by the DPWH as the government's public infrastructure implementation agency. TRIP "last mile" investments notably seek to improve local last mile infrastructure for tourism. Budget allocations to TRIP increased from 2010 to 2014 as the TRIP network notably spans beyond the national road network (Figures 1.1 and 1.2).[68] Currently, TRIP encompasses 256 projects, of which 207 are on-going while 49 are new spending. Through the 2013 General Appropriations Act (GAA), there are 207 projects with 245 contracts. Inclusive tourism development is defined as the development of the sector across the archipelago that generates both jobs and livelihood, and helps reduce extreme poverty.

Figure 1.1. TRIP national budget allocations



Connectivity – defined as the ability for international and domestic tourists to conveniently and competitively reach destinations across the Philippine archipelago – remains a challenge. The TRIP program is making a concerted effort to tackle this challenge. However, success will require the successful implementation of a number of

[68] The Philippines national road network spans about 31,000 km. The DPWH Secretary has committed to paving all these roads by 2016. An additional 170,000 roads are under provincial, city, municipal, and barangay responsibility. TRIP is upgrading about 2,000 roads, many of which are currently under LGU jurisdiction.

additional interventions. First, airports and seaports must link up with last mile connectivity if they are to attract tourists to existing and prospective destinations. Both in Metro Manila and across the archipelago, notably airport infrastructure will require significant upgrading. Second, the conditions need to be in place for realizing local demand linkages to tourism, notably in the agricultural sector. While “tomatoes to tourists” may be discounted as a new tourism slogan, its realization could have significant livelihood impacts for rural producers. Domestic services to tourists promise to be both labor intensive, and draw in production and progressive production refinement well beyond tomatoes.

The TRIP program has made a notable start to enhancing the competitiveness of the Philippine tourism industry. The success of the industry will however depend on both hard and soft infrastructure. Concerning the TRIP, a collective effort will need to be made to ensure roads are both being implemented and ultimately sustained. Given that a large share of TRIP roads are under local jurisdiction, addressing the issue of sustainability will become critical in the future. At the same time, air and seaports will need to be geared up to effectively service existing and emergent tourism destinations.

If rural demand linkages are to be leveraged, feeder connectivity, including farm to market roads, will also need to be enhanced. The TRIP program has instigated a “One Step” convergence program between DOT and the Department of Social Welfare and Development (DSWD). The program will select a short list of demonstration municipalities that have a high potential propensity of benefiting from tourism, as well as the potential of reducing poverty and enhancing poverty alleviation through tourism demand. Ideally agencies such as the Department of Agriculture (DA) will also work closely with the OneStep program to pilot this type of convergence.

Beyond infrastructure, successful inclusive tourism development in the Philippines will depend on a number of factors beyond connectivity. First, the human capital to respond to growing tourism demand will be critical. The Philippines already enjoys a very strong reputation as a service-oriented culture, although this will need to be closely aligned to various market segments and notably international tourism expectations. Public goods in this area could include notably education and training.

The Province of Bohol illustrates some of the implementation specifics of the TRIP program. Sixteen projects have currently been identified in the province. Fourteen of these are enhancing national roads (Figure 1.3). In this regard, Bohol stands in contrast to the overall national TRIP portfolio, where projects are more on upgrading local government roads. Eighteen contracts are currently being implemented in association with the TRIP project segments (Figure 1.4).

TRIP promises to significantly improve accessibility of tourism destinations across the archipelago. Going forward, the key challenge will include making sure the newly built roads are adequately maintained. While DPWH remains responsible for maintaining the national roads, LGUs will need to ensure that TRIP roads under their responsibility are effectively maintained. Contracts will also need to be prioritized in such a way that full travel segments are completed.

While the TRIP network will be important to enhance tourism flows to promising destinations, wider potential poverty reduction impacts of the program will depend on exploiting demand linkages notably to rural producers. Another layer of secondary connectivity, including farm to market roads, is likely to play an important part in promoting such prospective developments. Beyond physical roads infrastructure, market information and sales channels are also likely to build opportunities for having the poor benefit from tourism development. Towards this end the DOT has also been putting in place a monitoring and evaluation platform to access the impact of the TRIP program, as well as supporting convergence efforts.

Figure 1.2. Map of TRIP projects and national roads

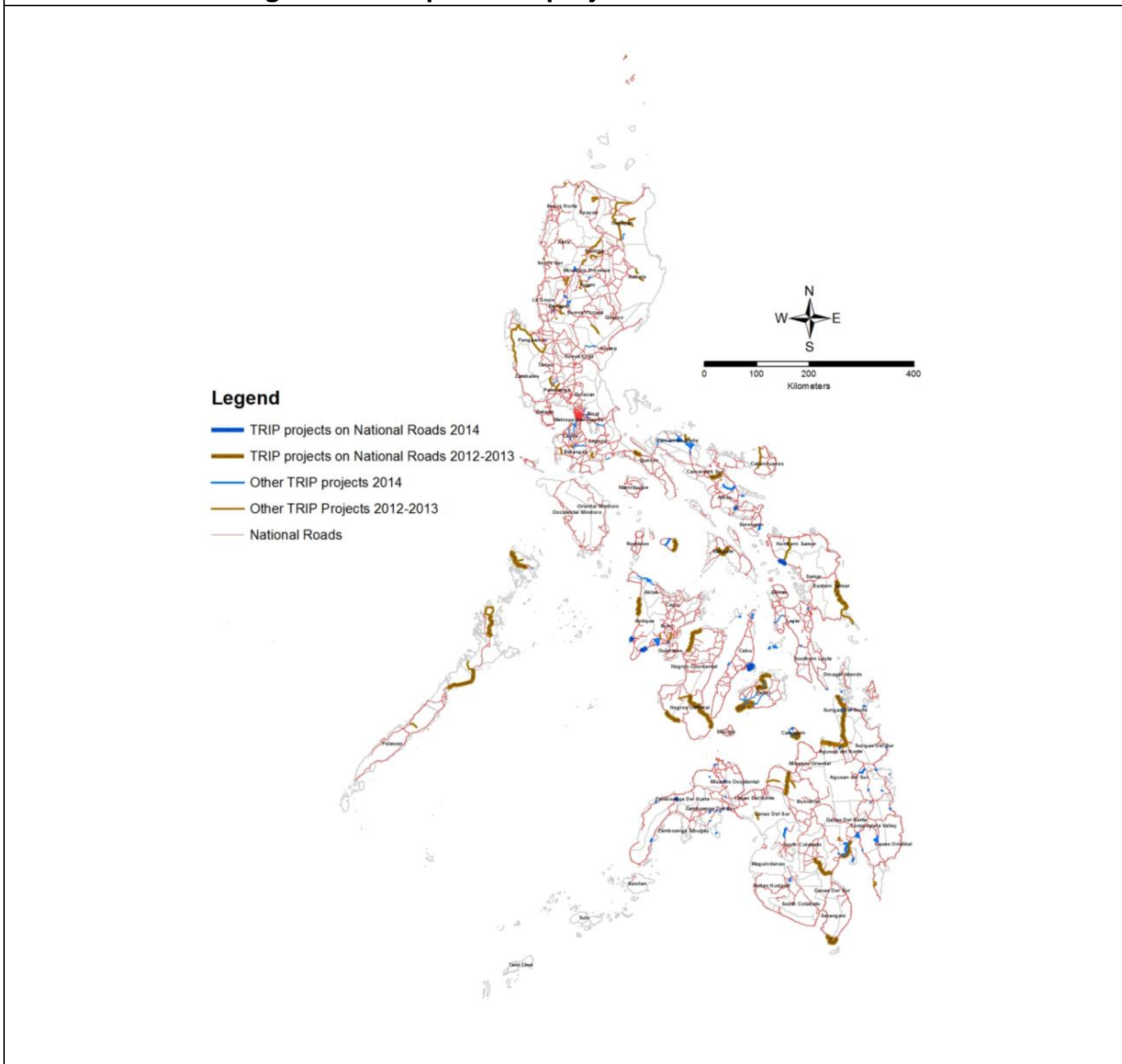
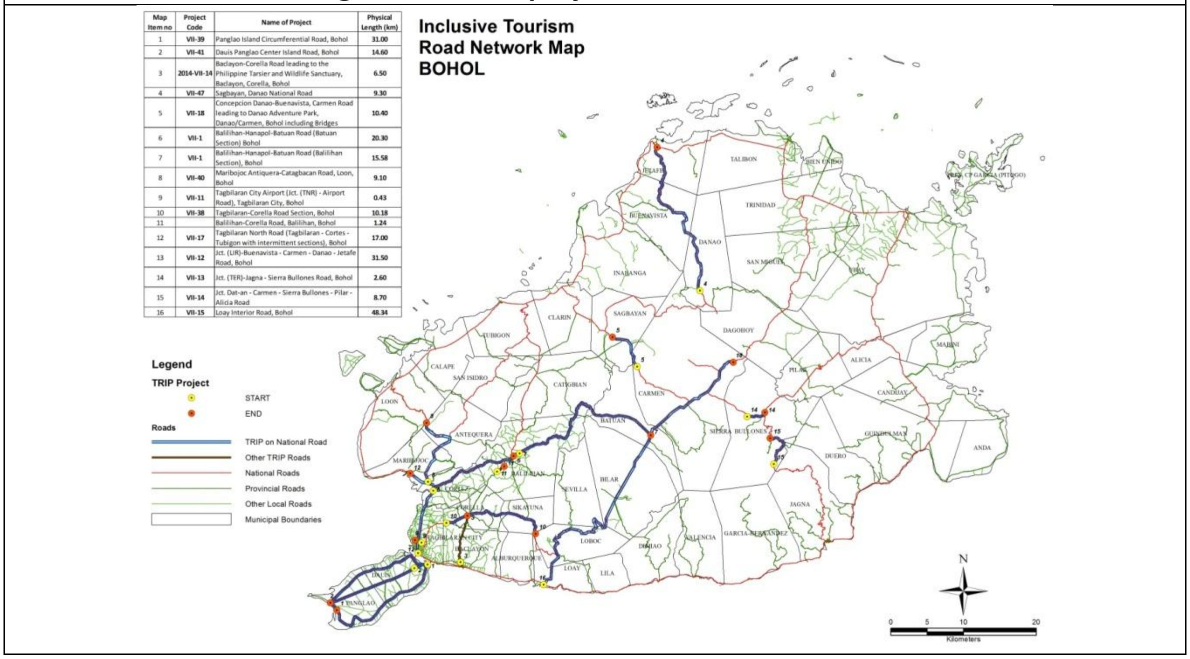
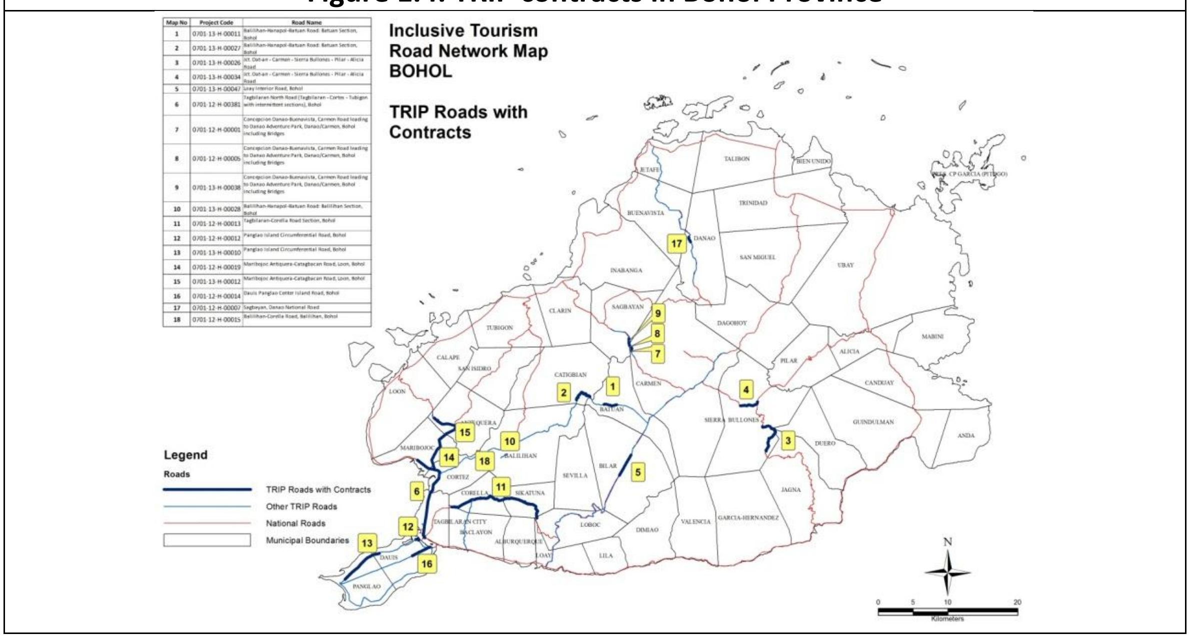


Figure 1.3. TRIP projects in Bohol Province



Map Item no	Project Code	Name of Project	Physical Length (km)
1	VII-39	Panglao Island Circumferential Road, Bohol	31.00
2	VII-41	Dauis Panglao Center Island Road, Bohol	14.60
3	2014-VII-14	Baclayon-Corella Road leading to the Philippine Tarsier and Wildlife Sanctuary, Baclayon, Corella, Bohol	6.50
4	VII-47	Sagbayan, Danao National Road	9.30
5	VII-18	Concepcion Danao-Buenavista, Carmen Road leading to Danao Adventure Park, Danao/Carmen, Bohol including Bridges	10.40
6	VII-1	Balilihan-Hanapol-Batuan Road (Batuan Section) Bohol	20.30
7	VII-1	Balilihan-Hanapol-Batuan Road (Balilihan Section), Bohol	15.58
8	VII-40	Maribojoc Antiquera-Catagbacan Road, Loon, Bohol	9.10
9	VII-11	Tagbilaran City Airport (Jct. (TNR) - Airport Road), Tagbilaran City, Bohol	0.43
10	VII-38	Tagbilaran-Corella Road Section, Bohol	10.18
11		Balilihan-Corella Road, Balilihan, Bohol	1.24
12	VII-17	Tagbilaran North Road (Tagbilaran - Cortes - Tubigon with intermittent sections), Bohol	17.00
13	VII-12	Jct. (LIR)-Buenavista - Carmen - Danao - Jetafe Road, Bohol	31.50
14	VII-13	Jct. (TER)-Jagna - Sierra Bullones Road, Bohol	2.60
15	VII-14	Jct. Dat-an - Carmen - Sierra Bullones - Pilar - Alicia Road	8.70
16	VII-15	Loay Interior Road, Bohol	48.34

Figure 1.4. TRIP contracts in Bohol Province



Map No	Project Code	Road Name
1	0701-13-H-00011	Balilihan-Hanapol-Batuan Road: Batuan Section, Bohol
2	0701-13-H-00027	Balilihan-Hanapol-Batuan Road: Batuan Section, Bohol
3	0701-13-H-00026	Jct. Dat-an - Carmen - Sierra Bullones - Pilar - Alicia Road
4	0701-13-H-00034	Jct. Dat-an - Carmen - Sierra Bullones - Pilar - Alicia Road
5	0701-13-H-00047	Loay Interior Road, Bohol
6	0701-12-H-00381	Tagbilaran North Road (Tagbilaran - Cortes - Tubigon with intermittent sections), Bohol
7	0701-12-H-00001	Concepcion Danao-Buenavista, Carmen Road leading to Danao Adventure Park, Danao/Carmen, Bohol including Bridges
8	0701-12-H-00005	Concepcion Danao-Buenavista, Carmen Road leading to Danao Adventure Park, Danao/Carmen, Bohol including Bridges
9	0701-13-H-00038	Concepcion Danao-Buenavista, Carmen Road leading to Danao Adventure Park, Danao/Carmen, Bohol including Bridges
10	0701-13-H-00028	Balilihan-Hanapol-Batuan Road: Balilihan Section, Bohol
11	0701-12-H-00013	Tagbilaran-Corella Road Section, Bohol
12	0701-12-H-00012	Panglao Island Circumferential Road, Bohol
13	0701-13-H-00010	Panglao Island Circumferential Road, Bohol
14	0701-12-H-00019	Maribojoc Antiquera-Catagbacan Road, Loon, Bohol
15	0701-13-H-00012	Maribojoc Antiquera-Catagbacan Road, Loon, Bohol
16	0701-12-H-00014	Dauis Panglao Center Island Road, Bohol
17	0701-12-H-00007	Sagbayan, Danao National Road
18	0701-12-H-00015	Balilihan-Corella Road, Balilihan, Bohol

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SPECIAL FOCUS 2

Impact evaluation of the KALAHI-CIDSS

This special focus section publishes the executive summary of the report: "Philippines: The KALAHI-CIDSS impact evaluation: a revised synthesis report."[69]

The KALAHI-CIDSS (Kapit-Bisig Laban sa Kahirapan – Comprehensive and Integrated Delivery of Social Services) was set up in 2002 to alleviate rural poverty. The program, following a community-driven development (CDD) approach, aims to achieve this by providing resources to poor rural municipalities to invest in public goods and by reviving local institutions to enhance peoples' participation in governance. KALAHI-CIDSS originally targeted the poorest 25 percent of municipalities in 42 of the poorest provinces. As of December 2010, the project had covered 4,583 *barangays* (villages) in 200 municipalities and supported 5,645 sub-projects, worth PHP 5.7 billion (about USD 140 million)[70] and benefiting about 1.26 million households.[71] Communities follow very detailed participatory processes to secure resources for planning and implementation of public investments.

A rigorous impact evaluation was designed in 2003 to evaluate general impacts on poverty reduction, social capital, empowerment, and governance. Quantitative and qualitative data were collected in 2003, 2006, and 2010 on a broad range of indicators from a sample of KALAHI-CIDSS municipalities and of comparable municipalities that did not receive project support. The report presents the main results from the final quantitative and qualitative impact evaluations as well as from other studies that were carried out throughout project implementation.

Available data indicate that participation rates in project activities were relatively high, suggesting that households and locally elected officials in targeted municipalities see value in the KALAHI-CIDSS approach. About 80 percent of households in treated municipalities indicated being aware of the project and three in every five of them expressed their satisfaction with the project. Locally elected officials also viewed the project in a positive light, with 75 percent of local government units (LGUs) officials indicating being satisfied with the project. Respondents identify infrastructure improvement, better access to services, and community empowerment as key project benefits. Feedback from barangays that were not prioritized by the Municipal Inter-

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[69] The full report can be accessed at http://documents.worldbank.org/curated/en/2013/01/17473607/philippines-kalahi-cidss-impact-evaluation-synthesis-report.

[70] The exchange rate is USD 1 = PHP 40.6 on 25 January 2013.

[71] A barangay is the lowest administrative unit in the Philippines; corresponding to a village.

Barangay Forum (MIBF), and therefore did not receive sub-project financing, was more negative.

The KALAHI-CIDSS was designed to minimize the risk of elite capture and it appears to have been successful in doing so. At the national level, the program directed resources to some of the poorest municipalities in the country, identified through a ranking process undertaken by Dr. Arsenio Balisacan of the University of the Philippines School of Economics.[72] At the local level, available evidence indicates that project processes were not subject to elite capture, at least in its most malign form. First, barangay captains do not appear to be a driving force behind proposals put forward in the MIBF. Their preferences and those of community members are equally represented in community proposals. Second, the impact evaluation reveals that, within municipalities, KALAHI-CIDSS targeted the poorest and best-organized villages, suggesting that better off and connected individuals and villages did not receive a disproportionate share of project benefits.

The project had a positive impact on household consumption. Specifically, per capita consumption increased by about 12 percent as a result of the project, which is consistent with findings from the evaluation of the Kecamatan Development Program (KDP), a similar CDD project in Indonesia. Those impacts are stronger for households that were classified as poor in 2003, which experienced a 19 percent increase in per capita consumption. The impacts on per capita consumption are associated with a six percentage point decline in the probability that households are classified as poor. There is some evidence that individuals, especially women, are more likely to be employed as a result of the project which could explain how per capita consumption increased.

The project also had a positive impact on accessibility. Specifically, a nine percentage point increase in the proportion of households whose house is accessible year-long can be attributed to the project. This is associated with greater mobility. Households in treatment areas were going to the municipal center more regularly as a result of the project. However, no effects were detected on other measures of access to basic services, including access to improved water sources, sanitation, and use of health facilities. In addition, the program led to a decline in school enrollment.

Results from the qualitative evaluation indicate that the project led to changes in how village assemblies (a feature of the lowest level of local government) are perceived. Prior to project implementation, they were, at best, considered avenues for reporting, while now they tend to be seen as mechanisms for participation, transparency, and accountability. This change seems to be partly driven by a new breed of village leaders. Indeed, especially in villages that received financing for a sub-project, some of the

[72] PEU team's note: Dr. Balisacan is now the secretary of socio-economic planning and director-general of the National Economic and Development Authority.

village volunteers have been empowered. This new pool of leaders can effectively engage elected village officials. They are considered to be more service-oriented and committed than previous village leaders and, in some cases, they have been elected to village office. Ensuring the sustainability of those impacts once project implementation has ended appears more challenging, however.

The quantitative evaluation was able to detect positive impacts on the proportion of households willing to contribute money to projects that benefit the community and on the proportion of respondents who thought that most people in the village are willing to help if need be. No impacts were detected on other measures of barangay governance and social capital, such as group membership or trust levels.

Finally, findings from the evaluation suggest areas for improvement. First, despite significant investment in water systems in treatment municipalities, no impacts on access to water systems were detected. Further qualitative field work suggests that it is due to the fact that some of the sub-projects were unable to reach all community members and some barangays did not manage to adequately maintain the investment. This, in turn, may be the result of project resources being allocated on a per barangay, rather than on a per capita, basis, which in some cases led to limited per capita allocations. The evaluation also showed that the key impact on increased consumption levels is stronger on poorer households, suggesting that it might make sense to vary municipal allocation by poverty levels (adjustments were incorporated into the new national CDD program).

Second, there are challenges in sustaining empowerment and barangay-level governance impacts, and in affecting improvements in municipal-level governance. This could require greater LGU involvement and better integration of project processes with the local planning cycle, along the lines currently being followed by the *Makamasang Tugong* initiative. Further, findings from the qualitative study suggest that the project was relatively successful at empowering project volunteers but that the broader citizenry was not as positively affected.

Third, while a large proportion of barangays in targeted municipalities receive at least one sub-project during the three cycles, some do not. Project volunteers who engaged in the relatively time consuming KALAHI-CIDSS processes and did not manage to get a project for their barangay, might be reluctant to engage in similar processes in the future.

Table 2.1. KALAHI-CIDSS impact evaluation report card

Key indicators	Sign	Size*	Comments/explanation
Household welfare			
Per capita consumption (log)—Overall	Positive	Medium	
Per capita consumption (log)—poor households	Positive	Medium	
Per capita consumption (log)—non-poor households	None		
Poverty levels	Negative	Small	Poverty levels are lower as a result of the project
Non-food share to total Consumption	Positive	Small	
Labor force participation	Positive	Small	Stronger for women
Access to services			
Year-long road access	Positive	Medium	Stronger in prioritized barangays
Visits to health stations	None		
Access to water	None		Issues with sub-project maintenance
School enrollment	Negative	Small	Low level of investments in sample barangays
Social capital and local governance			
Contribution to community projects	Positive	Medium	
Others are willing to help	Positive	Small	

* ***Size refers to the difference in the changes between baseline and end line in the treatment and control groups, taking into account the baseline value of the relevant indicator.***

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DATA APPENDIX

Table A.1. Key economic indicators (2011 to 2016)

	2011	2012	2013	2014	2015	2016
		Actual			Projection	
Growth and inflation	(in percent of GDP, unless otherwise indicated)					
Gross domestic product (percent change)	3.6	6.8	7.2	6.6	6.9	6.5
Inflation (period average)	4.6	3.2	3.0	5.0	4.5	4.0
Savings and investment						
Gross national savings	24.8	21.4	21.4 [1]	21.8	23.4	24.4
Gross domestic investment	20.5	18.5	19.4	20.8	22.2	22.9
Public sector						
National government balance (GFS basis) [2]	-2.1	-2.4	-1.6	-2.2	-2.5	-2.3
National government balance (Gov't definition)	-2.0	-2.3	-1.4	-2.1	-2.4	-2.2
Total revenue (Gov't definition)	14.0	14.5	14.9	15.2	15.6	16.0
Tax revenue	12.3	12.9	13.3	13.6	14.0	14.3
Total spending (Gov't definition)	16.1	16.8	16.3	17.3	18.0	18.2
National government debt	51.0	51.5 [3]	49.2	48.3	47.2	46.0
Balance of payments [4,5]						
Merchandise exports (percent change)	-6.3	8.5	4.1	7.0	8.0	8.5
Merchandise imports (percent change)	2.4	5.1	7.9	12.0	8.0	9.0
Remittances (percent change of USD remittance)	7.2	6.3	6.4	6.5	5.6	5.1
Current account balance	3.2	2.9	2.0	1.0	1.2	1.5
Foreign direct investment (billions of dollars)	1.9	2.0	3.9	4.2	4.5	5.5
Portfolio investment (billions of dollars)	4.1	4.7	2.5	2.0	2.0	3.0
International reserves						
Gross official reserves (billions of dollars) [6]	75.3	83.8	83.2	85.3	86.2	86.6
Gross official reserves (months of imports) [7]	11.1	11.9	11.0	10.2	9.6	8.9
External debt [8]	27.2	28.8 [3]	27.7 [1]	27.5	27.0	26.4

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

Notes:

1 Projection only.

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

3 Includes the PHP55.6 billion on-lending to Power Sector Assets and Liabilities Management (PSALM) Corporation, net of which results in a ratio of 50.9 percent.

4 Using BPM5

5 Except for foreign direct investment, values for 2013 are projections. Actual full-year data are not yet available.

6 Includes gold

7 World Bank definition

8 World Bank definition. The difference with central bank data is that it includes the following: i) gross due to head office/branches abroad and offshore banking units of foreign banks operating in the country, ii) long-term loans of non-banks obtained without central bank's approval, and iii) long-term obligations under capital lease agreement.

Table A.2. National government cash accounts (GFS basis) (2009 to 2013)

	2009	2010	2011	2012	2013	
					Actual[1]	Programmed
	(in percent of GDP, unless otherwise stated)					
Revenue and grant	14.0	13.4	14.0	14.5	14.9	14.6
Tax revenue	12.2	12.1	12.3	12.9	13.3	13.5
Net income and profits	5.2	5.4	5.9	6.1	NA	6.4
Excise tax	0.7	0.7	0.7	0.7	NA	0.8
Sales taxes and licenses	2.7	2.4	2.4	2.7	NA	2.8
Others	0.6	0.7	0.7	0.7	NA	0.7
Collection from Customs	3.1	2.9	2.7	2.7	2.6	2.9
Nontax revenue[2]	1.7	1.3	1.6	1.6	1.6	1.1
Grant	0.00	0.0	0.0	0.0	0.0	0.0
Total expenditure	17.9	17.0	16.1	16.9	16.4	16.7
Current expenditures	14.3	13.8	13.3	13.6	NA	13.1
Personnel services	5.2	5.2	5.1	5.1	NA	5.2
MOOE	2.1	2.0	2.1	2.4	NA	2.7
Allotment to LGUs[3]	2.5	2.4	2.4	1.9	NA	2.0
Subsidies	0.2	0.2	0.5	0.5	NA	0.4
Tax expenditures	0.6	0.5	0.3	0.5	NA	0.2
Interest payment	3.7	3.4	3.0	3.1	NA	2.8
Capital outlays	3.4	3.1	2.6	3.2	NA	3.2
Net lending	0.2	0.1	0.2	0.3	0.1	0.1
Balance (GFS definition)	-3.9	-3.6	-2.1	-2.4	-1.6	-2.1
Balance (GOP definition)	-3.7	-3.5	-2.0	-2.3	-1.4	-2.0
Primary Balance (GFS)	-0.3	-0.2	0.8	0.7	1.5	4.3
Memorandum items						
Privatization receipts (PHP billions)	1.4	0.9	0.9	0.0	0.0	0.0
CB-BOL interest payments (percent of GI	0.2	0.1	0.1	0.1	0.1	0.1
Nominal GDP (PHP trillion)	8.0	9.0	9.7	10.6	11.5	11.9

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

1 "NA" means full year data are not yet available at the time of publication.

2 Excludes privatization receipts (these are treated as financing items, in accordance with GFSM).

3 Allocation to Local Government Units excludes capital transfers which are included in capital outlays.