

# **PHILIPPINE ECONOMIC UPDATE**

## **ACCELERATING REFORMS TO MEET THE JOBS CHALLENGE**

**May 2013**

Poverty Reduction and Economic Management Unit  
East Asia and Pacific Region

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**Document of the World Bank**

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## PREFACE

The *Philippine Economic Update* provides an update on key economic and social developments, and policies over the past 6 to 12 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 macroeconomy 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 Economist and Task Team Leader), Paul Mariano (Research Analyst), and Joseph Louie Limkin (Research Analyst), under the guidance of Rogier van den Brink (Lead Economist).

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The findings, interpretations, and conclusions expressed in this *Update* are those of World Bank staff and do not necessarily reflect the views of its management, Executive Board, or the governments they represent.

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## EXECUTIVE SUMMARY

**The Philippine economy expanded by 6.6 percent in 2012, exceeding most expectations, including the government's own target of 5 to 6 percent.** Higher growth was driven by strong private consumption and construction, and the recovery of public spending and net exports. Philippine growth in 2012 was the highest among the ASEAN-5 countries. With higher public and private construction spending, the ratio of fixed capital to GDP (net of intellectual property products) increased from 18.7 percent of GDP in 2011 to 19.3 percent of GDP in 2012.

**The pace and efficiency of national government spending improved remarkably in 2012.** Total disbursements grew by 14.1 percent to reach PHP 1.78 trillion, equivalent to 16.8 percent of GDP. The highest increases were seen in infrastructure spending, and maintenance and other operating expenditures. With a more efficient bidding, implementation, and payment system, infrastructure spending increased by 58 percent. Maintenance and other operating expenditures grew by 28 percent and reflected higher allotments to social services, such as the conditional cash transfer program, and economic services, such as irrigation.

**Higher government spending was matched by a significant increase in revenue collection, with a strong contribution from improved tax administration.** Total tax revenues grew by 13.2 percent and tax effort increased from 12.3 to 12.9 percent of GDP—the highest increase in decades attributable to improved tax administration.

**The medium-term growth prospects for the Philippines are good.** The country has weathered the impact of the financial crisis and global slowdown quite well in the last four years, given its strong macroeconomic fundamentals—the result of past and on-going reforms in the financial and public sectors. The country's strong growth prospects, robust external accounts, and improving fiscal condition earned it its first ever investment grade credit rating in March 2013, followed by another upgrade in May 2013. With stronger economic reforms, the Philippines can see sustained growth of above 6 percent in the medium-term. Risks to growth will primarily come from a slower global recovery, domestic reform lags caused by increased resistance to reforms, and possible asset price bubbles in the real estate sector and the stock market.

**GDP growth is projected at 6.2 percent in 2013, driven by domestic demand.** As in previous years, private consumption would provide the basis for growth. Sustained increase in investment, particularly in construction, and higher public spending, would provide an extra boost. Growth in exports would hinge on the recovery of electronics exports and higher growth of non-electronics. The economic growth projection of 6.4 percent in 2014 would depend on the ability of the government to further increase infrastructure spending and the private sector to increase investment spending.

**Moving forward, the government needs to focus its attention on generating higher, sustained, and more inclusive growth—the type that creates jobs and reduces poverty.** With almost 10 million unemployed or underemployed Filipinos as of end-2012, around 1.1 million

potential entrants to the labor market each year, and poverty incidence that hardly declined between 2009 and 2012, the country faces the enormous challenge of providing good jobs to 14.4 million Filipinos through 2016. Sustaining high GDP growth of above 5 percent will be able to provide good jobs to around 2.2 million Filipinos between 2013 and 2016. However, by 2016, that still leaves 12.4 million Filipinos who will have no other option but to work abroad, work in the informal sector, or create jobs for themselves.

**There is no silver bullet for creating more and better jobs, as it is linked to resolving deep-seated, structural issues in the economy. Only a comprehensive reform agenda implemented across sectors can foster a business environment conducive to private sector job creation by firms of all sizes.** Meeting the jobs challenge requires expanding formal sector employment even faster, while rapidly raising the incomes of those informally employed. The following thematic reform areas deserve the highest priority: i) simplifying business rules and regulations to encourage the growth of firms of all sizes, ii) enhancing competition in the economy, giving priority to sectors with the greatest potential in creating jobs, such as agriculture, and iii) securing property rights on land for both rural and urban dwellers and businesses. To better sustain these reform efforts and to increase their chances of success, the government will need to continue to invest more, and more efficiently, in health, education, and infrastructure.

**Higher investments can be sustained by institutionalizing reforms in public finance.** In this regard, a comprehensive program of tax policy and administrative measures should be pursued to raise tax revenues by up to 8 percent of GDP. The government's medium-term target of an additional 3 percentage points of GDP by 2016 is on the right track. Higher revenues need not be equated with higher tax rates as tax administration can be improved substantially. For instance, in the first quarter of 2013, the Bureau of Internal Revenue announced a campaign to boost tax collection from self-employed and professionals (SEPs) such as doctors, lawyers, and traders. The government estimates that only about 403,000 out of 1.8 million SEPs paid taxes and the average income declared by SEPs is not far from the income of a minimum wage worker. Successful implementation of this campaign can generate up to 2 percent of GDP in tax revenues without raising tax rates.

**A unique window of opportunity exists today to accelerate reforms that will help create more and better jobs.** The country is benefiting from strong macroeconomic fundamentals, political stability, and a popular government that is committed to improving the lives of the people. It also stands to benefit from the global economic rebalancing and strong growth prospects of the East Asia region. Several reforms have successfully started, notably in public financial management, anti-corruption, and social service delivery. With stronger economic reforms, especially in areas that will have more impact on the lives and jobs of the poor, the government can put the country on an irreversible path of inclusive growth and meet the jobs challenge.

## RECENT ECONOMIC AND POLICY DEVELOPMENTS

### Output and demand

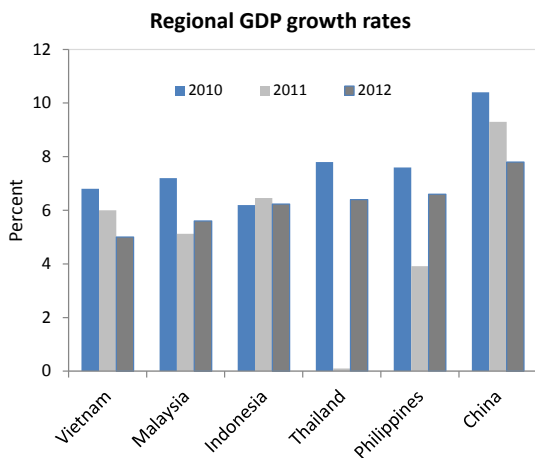
- 1. The Philippine economy expanded by 6.6 percent in 2012, exceeding most expectations, including the government's own target of 5 to 6 percent.** Higher growth was driven by strong private consumption and construction, and the recovery of public spending and net exports. Philippine growth in 2012 was the highest among the ASEAN-5 countries (Figure 1).
- 2. Private consumption, which comprises over 70 percent of GDP, drove GDP growth.** Private consumption grew by 6.1 percent and contributed 4.3 percentage points (ppt) to overall growth (Figure 2). Private construction also performed well, growing by 8.6 percent. It contributed 0.5 ppt to GDP growth as demand for residential and office space accelerated. Overseas workers' remittances remained an important driver of private consumption, and lately, private investment in housing and real estate.<sup>1</sup> Moreover, the sustained growth of the business process outsourcing (BPO) industry has created a new middle class which is also starting to drive private consumption, notably the consumption of non-essential miscellaneous goods and services<sup>2</sup> (Figure 3), and investment in housing and real estate.
- 3. The recovery of public spending in 2012 also gave the economy a boost.** Public construction made a strong comeback, with growth exceeding 32 percent following an almost equal contraction in 2011 (Figure 4) and growth in public consumption improving from 1 percent in 2011 to 11.8 percent in 2012. Together, they contributed 1.6 ppt to overall growth. The recovery of public spending reflects improvements in line agencies' budget absorptive capacity, as well as gains from institutional reforms undertaken in 2011 to improve transparency and cost-effectiveness of infrastructure spending.
- 4. With higher construction spending and growth in durable equipment purchases, the ratio of fixed capital to GDP (net of intellectual property products) increased from 18.7 percent in 2011 to 19.3 percent of GDP in 2012.** Among durable equipment purchases, significant gains were recorded in transport equipment (Figure 5), which pushed durable equipment growth to 5.7 percent. However, when changes in inventory and intellectual property products (two other components of total capital formation) were included, total investment-to-GDP ratio in the same period fell significantly from 21.7 to 19.4 percent of GDP. Special Focus No. 1 discusses some issues surrounding the measurement of capital formation and the national accounts in general.

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<sup>1</sup> According to the Consumer Expectations Survey of the *Bangko Sentral ng Pilipinas*, around 12 percent of surveyed households in 2012 used remittances to buy real estate properties.

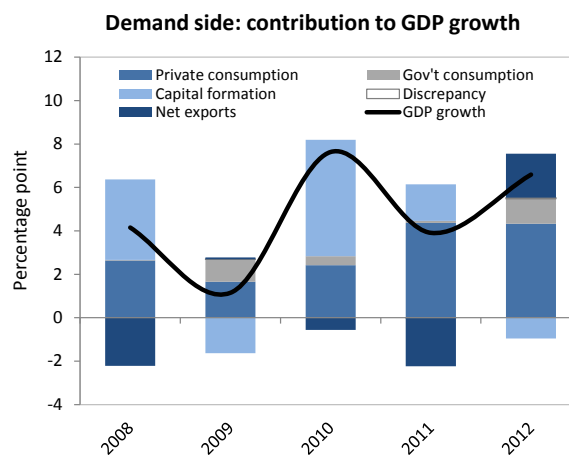
<sup>2</sup> This expenditure category of the national income accounts includes non-basic goods such as electronic items, household appliances, clothing and footwear, and recreation activities.

**Figure 1. Philippine growth in 2012 was among the highest in the region.**



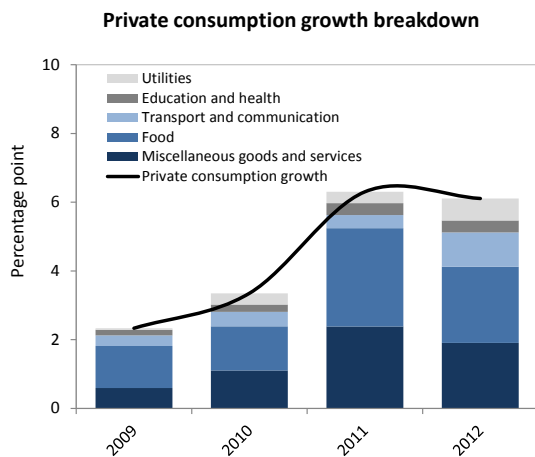
Source: World Bank East Asia and Pacific (EAP) Economic Update

**Figure 2. Private consumption continued to drive overall growth.**



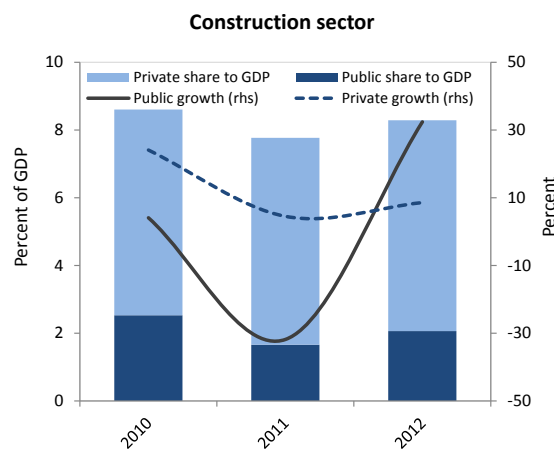
Source: National Statistical Coordination Board (NSCB)

**Figure 3. The growing share of non-essential consumption to total private consumption growth reflects the growing middle class.**



Source: NSCB

**Figure 4. The recovery of public construction drove overall investment growth.**



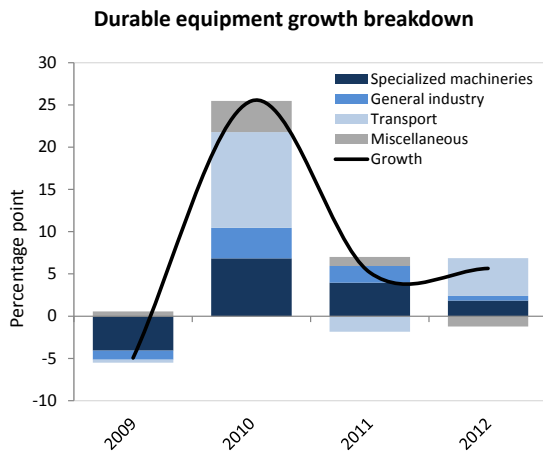
Source: NSCB

5. **The recovery of net exports was lifted by weak import growth.** Merchandise exports grew by 8.4 percent in 2012, driven by growth in non-electronics exports, such as metal components, tuna, and bananas. The country's main export, electronic components, had not fully recovered as of end-2012. The BPO industry continued to drive growth in non-factor services. With subdued merchandise import growth of 2.6 percent, the contribution of net exports to GDP growth turned out quite well at around 2 ppt.

6. **On the production side, the services sector was the main engine of growth.** The sector expanded by 7.4 percent in 2012 and contributed 4.2 ppt to overall growth (Figure 6). Within the services sector, all sub-sectors, with the exception of government services, grew by more

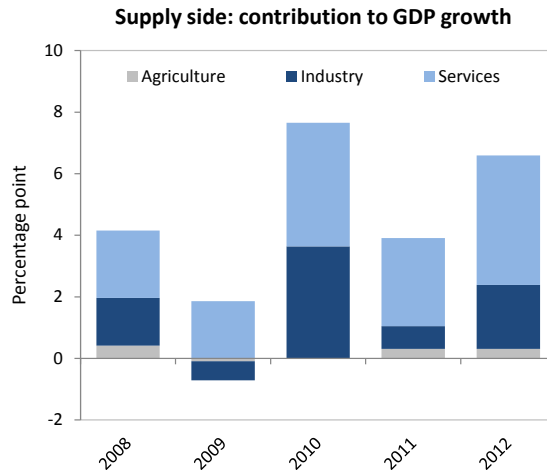
than 7 percent. The transportation, communication, and storage (TCS) sub-sector recorded the highest growth at 9.1 percent. Performance was strong across all industries with the exception of air transport. The strong performance of i) trade, ii) real estate, renting, and other business activities, and iii) other services sub-sectors reflected to a large extent the impact of the BPO industry, which grew by 18 percent in revenue terms in 2012 to USD 18 billion and is estimated to have provided a total of about 800,000 direct jobs and over 3 million indirect jobs.

**Figure 5. Growth in durable equipment gained from higher demand for transport equipment.**



Source: NSCB

**Figure 6. The services sector remained the main engine of growth on the production side.**

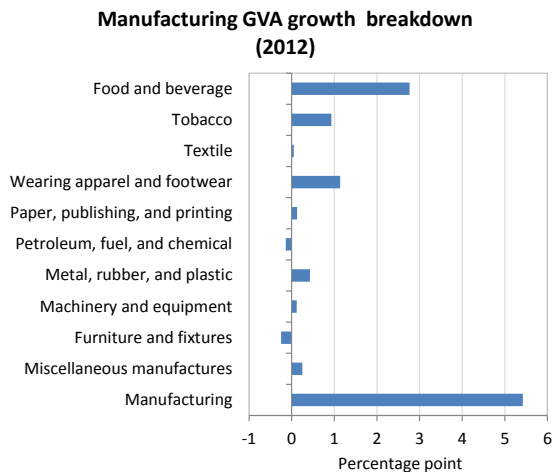


Source: NSCB

**7. Agriculture and manufacturing turned in solid growth numbers.** Growth in the agriculture and fishery sector decelerated to 3.5 percent in 2012 from 4.5 percent in 2011 despite high growth in the production of some major crops. *Palay* (paddy rice), corn, and pineapple recorded impressive growth of above 6 percent given better weather conditions for the most part of 2012. Super Typhoon *Pablo*, which hit Mindanao in December 2012, did not disrupt food production in a major way. However, banana production was badly affected. Manufacturing growth accelerated to 5.4 percent in 2012, reflecting strong demand for food, wearing apparel, and tobacco products (Figure 7). Higher tobacco production reflected the frontloading of the production of cigarettes in fourth quarter of 2012 (Q4 2012) to avoid paying higher excise taxes beginning January 2013. Value-added growth in electronic parts was muted by weak external demand. Overall, labor-intensive manufacturing grew faster than capital-intensive manufacturing, which is good for jobs (Figure 8). However, its share to total manufacturing gross value-added is low at only around 7 percent.

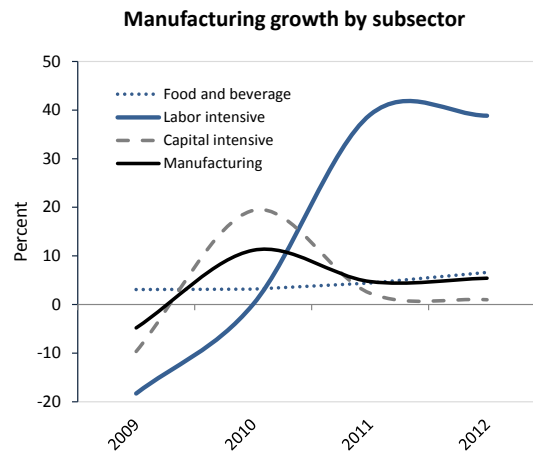


**Figure 7. Strong demand for food, wearing apparel, and tobacco products drove growth of the manufacturing sector.**



Source: NSCB

**Figure 8. Growth of labor-intensive manufacturing was higher than capital-intensive manufacturing, but its share to total manufacturing value-added is very low.**



Source: NSCB

## Employment

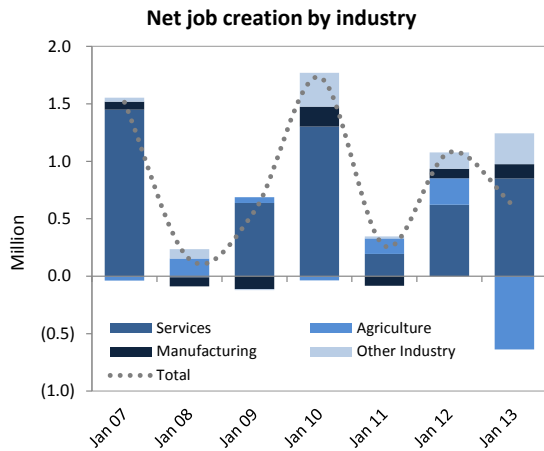
8. **Higher economic growth in 2012 has yet to translate into jobs and poverty reduction, mainly due to the weak job performance of agriculture.** The latest round of the Labor Force Survey (LFS) in January 2013 estimated that net job generation declined to 606,000 from 1.1 million a year ago, or almost 50 percent lower. Agriculture actually shed 637,000 jobs, while manufacturing, other industries, and services recorded net job creation of 125,000, 268,000, and 851,000, respectively (Figure 9). Most workers in the services sector are informally employed.<sup>3</sup> In recent years, net job creation has fallen short of the increase in the working age population (i.e., the potential labor force) indicating that the economy remains hard pressed to provide good jobs to majority of Filipinos (Figure 10).

9. **The lack of jobs has resulted in high unemployment and underemployment rates, and higher numbers of discouraged workers, which manifests itself in lower labor force participation.** In January 2013, the labor force participation rate declined to 64.1 percent from 64.3 percent a year ago, suggesting an increase in the number of discouraged workers.<sup>4</sup> The unemployment rate abated to 7.1 percent but the underemployment rate increased by almost 2 ppt to 21 percent (Figure 11). The high share of food expenditure to total consumption (around 36 percent, the highest among comparator countries in the region) suggests that falling real wages, and not job mismatches, is the primary reason for the rise in underemployment (Figure 12).

<sup>3</sup> Informal workers include all self-employed workers (excluding employers), unpaid family workers, and wage workers with no written contract, social insurance, or protection from dismissal.

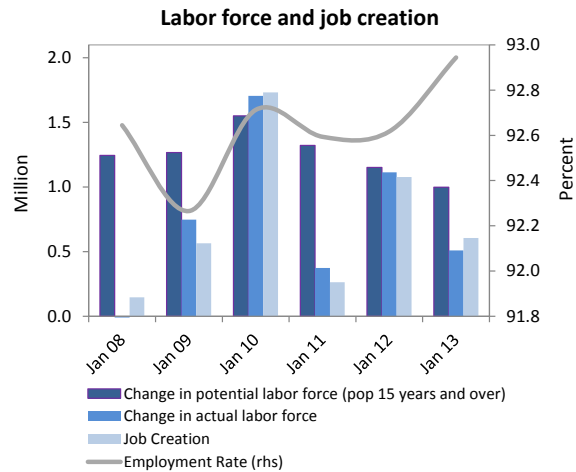
<sup>4</sup> Discouraged workers are those who are not available for work and not actively searching for work because they are tired of looking for work or believe that no work is available.

**Figure 9. Only about 600,000 jobs (on a net basis) were created in January 2013.**



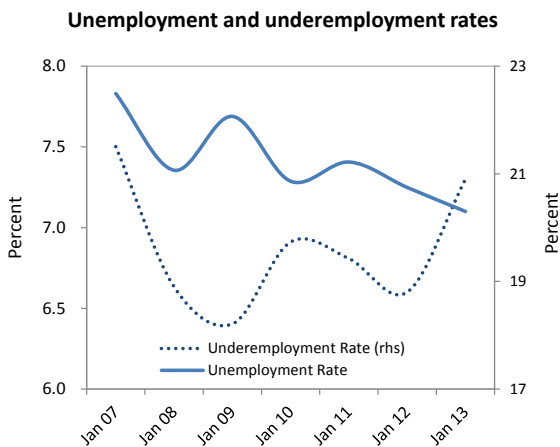
Source: National Statistics Office (NSO)

**Figure 10. Net job creation in January 2013 was significantly lower than the change in the potential labor force.**



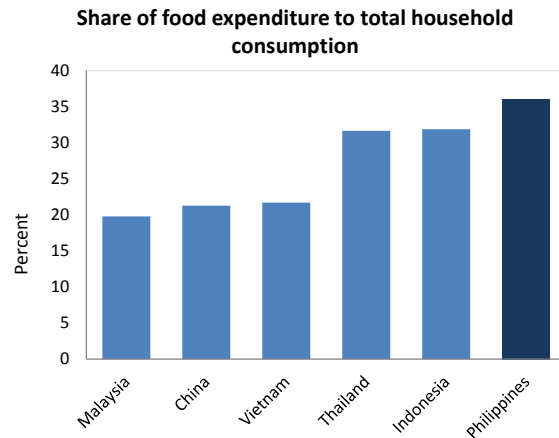
Source: NSO

**Figure 11. The unemployment rate abated but the underemployment rate increased remarkably.**



Source: NSO

**Figure 12. The Philippines has the highest share of food expenditure as a share of total household consumption among regional comparators.**



Source: United States Department of Agriculture Economic Research Service

**10. The incidence of poverty hardly changed between 2009 and 2012.** In April 2013, NSCB released preliminary estimates using data from the first half of 2012 which shows that poverty incidence of the population hardly declined from 28.6 percent in 2009 to 27.9 percent in 2012<sup>5</sup>, suggesting that gains from higher growth is not benefiting the poorest Filipinos. Spatial disparity across regions remains high with poverty incidence in the Autonomous Region in Muslim Mindanao exceeding 50 percent while the National Capital Region having a poverty incidence rate of 5.4 percent.

<sup>5</sup> The decline in poverty incidence is statistically insignificant according the NSCB.

11. **With almost 10 million unemployed or underemployed Filipinos as of end-2012, around 1.1 million potential entrants to the labor market each year, and poverty incidence that hardly declined between 2009 and 2012, the country faces the enormous challenge of providing 14.6 million Filipinos with good jobs in the next four years** (see Box 1 for more discussion). Sustaining GDP growth of above 5 percent will be able to provide good jobs to around 2.2 million Filipinos between 2013 and 2016. However, by 2016, that still leaves 12.4 million Filipinos who will have no other option but to work abroad, work in the informal sector, or create jobs for themselves.

### **Box 1. The Philippine jobs challenge**

**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<sup>6</sup> or underemployed<sup>7</sup> in 2012 and to around 1.1 million potential entrants to the labor force<sup>8</sup> every year from 2013 to 2016. That is a total of 14.4 million jobs that need to be created through 2016. In addition, better jobs need to be provided to another 21 million Filipinos who are informally employed. All in all, informal workers comprise about 75 percent of total employment.<sup>9</sup>

**Every year in the last decade, only a fourth of the new entrants to the labor force get good jobs.** Of the 1.1 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 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 600,000 new 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.

**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

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<sup>6</sup> 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.

<sup>7</sup> Underemployment is defined to include workers working less than 40 hours or working 40 hours or more per week but still looking for work.

<sup>8</sup> The labor force is defined to include persons 15 years old and over, who are either employed or unemployed. Persons who are not working and are not available for work during the reference week and persons who are not available and are not looking for work because of reasons other than those mentioned in the definition of unemployed persons are not part of the labor force. The labor force does not include housewives, students, disabled or retired persons, and seasonal workers.

<sup>9</sup> This estimate is not far from the estimate of the Employment Confederation of the Philippines (ECOP), which put the number of informal workers at 77 percent of total employment (Ortiz-Luis 2008).

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 can see a doubling of employment), the formal sector will be able to provide good jobs for around 2.2 million people in the next four years (or 550,000 every year between 2013 and 2016).

**But the majority of Filipino workers will still be left out.** By 2016, around 12.4 million<sup>10</sup> Filipinos would still be unemployed, underemployed, or would have to work in the low-pay informal sector.

**To create good jobs for the 12.4 million, a comprehensive package of reforms is needed** to create a business environment conducive to private sector job creation, in particular job creation by small and medium enterprises. Addressing this jobs challenge requires meeting a dual challenge: expanding formal sector employment even faster, while rapidly raising the incomes of those informally employed. The enormity of the challenge underscores the need to commence a wide-ranging set of reforms today. These reforms are discussed in the section on medium-term reform agenda.

Source: World Bank. 2013 (forthcoming). "Philippine development report: creating more and better jobs."

## External accounts

12. **The country's external accounts continued to strengthen, due to higher remittance and capital inflows, a narrower trade deficit, and falling external debt service relative to the size of the economy.** The full year balance of payments in 2012 reached USD 9.2 billion and was equivalent to 3.7 percent of GDP.<sup>11</sup> Both the current and financial accounts recorded healthy surpluses of around USD 7 and 6 billion, respectively (Figure 13).<sup>12,13</sup> Gross international reserves (GIR) posted a record-high of USD 83.8 billion in end-2012, an amount that can cover 11.9 months of imports and 6.3 times the country's short-term external liability by residual maturity (Figure 14).<sup>14</sup> External debt service also declined from 7.4 percent of GDP in end-2011 to 6.9 percent of GDP in end-2012. The country's strong economic growth, robust external balances, and improving fiscal position have led Fitch Ratings to raise in March 2013 its sovereign credit rating for the Philippines to "BBB-" from "BB+", giving the country its first-ever investment-grade rating. Standard & Poor's followed in early May, upgrading the country's

<sup>10</sup> Calculated as: 10 million + (1.1 million x 4 years) – (0.5 million x 4 years) = 12.4.

<sup>11</sup> Beginning 2012, the balance of payment is compiled using the 6<sup>th</sup> edition of the Balance of Payments and International Investment Position Manual (BPM6). The figures in this report still use BPM5 to ensure comparability with historical data. BPM6 data are provided as footnotes.

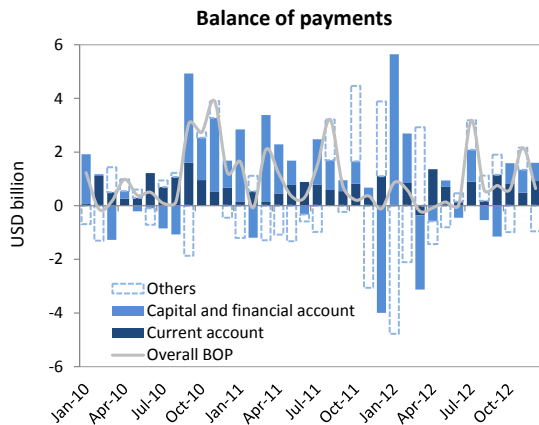
<sup>12</sup> The current and financial account surpluses using BPM6 are USD 7.1 and 5.7 billion, respectively.

<sup>13</sup> Net unclassified items amounted to USD -3.6 billion (USD -4.2 billion using BPM6).

<sup>14</sup> In April 2013, GIR stood at USD 83.2 billion, slightly lower than in 2012.

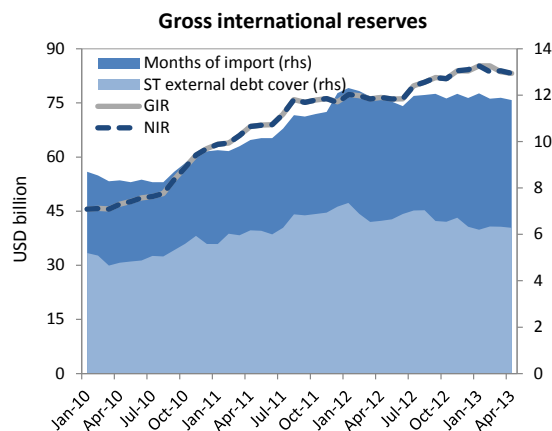
credit rating to “BBB-” with stable outlook and citing the country’s strengthening external position, moderating inflation, and declining reliance on foreign currency debt.

**Figure 13. Strong remittance and capital inflows sustained large foreign exchange surpluses.**



Source: *Banako Sentral na Pilipinas* (BSP)

**Figure 14. Gross international reserves reached almost USD 90 billion in early 2013.**



Source: BSP

**13. Remittances remained the key driver of the country’s healthy external accounts and fast-growing economy.** In nominal dollar terms, cash remittances grew by 6.3 percent in 2012, reaching a record high of USD 21.4 billion or 8.5 percent of GDP (Figure 15). Growth in remittances has gradually slowed since reaching a peak of around 30 percent in 2005, reflecting the weaker global economy and stabilization of remittance growth.<sup>15</sup> Despite this slower growth and the appreciation of the peso, remittances continued to provide important support to the domestic economy. The US remained the top source of remittances, accounting for 42.6 percent, followed by Canada (9.2 percent), Saudi Arabia (8.1 percent), and the United Kingdom (5 percent). With the exception of Saudi Arabia, these countries consist mainly of permanent migrants, as opposed to contract workers. In 2012, about 1.8 million Filipinos (6.7 percent higher than a year ago) were deployed to work abroad. The high level of deployment, despite host countries’ weaker economies, attests to the premium foreign employers put on Filipino workers.

**14. The country’s trade in goods deficit declined to USD 14.8 billion (5.9 percent of GDP)<sup>16</sup> in 2012, as export growth outpaced import growth** (Figure 16). Merchandise exports grew by 8.5 percent<sup>17</sup> in 2012, following a sharp contraction in 2011. Electronic parts, which used to be the country’s top export, continued to take a backseat in 2012 as it declined by 5.2 percent.<sup>18</sup>

<sup>15</sup> Remittance growth further eased to 3 percent in March 2013, the lowest since August 2009.

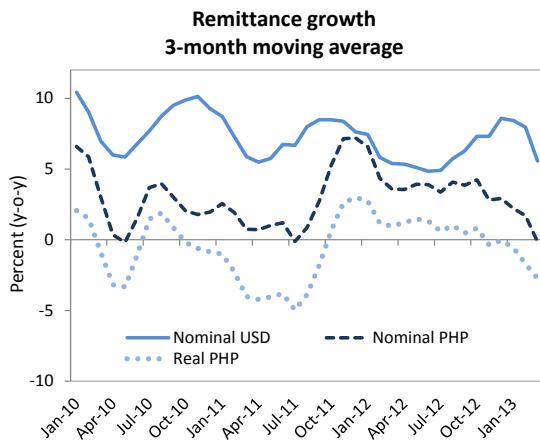
<sup>16</sup> USD 15.1 billion (6.2 percent of GDP) using BPM6

<sup>17</sup> 21 percent using BPM6

<sup>18</sup> 14 percent using BPM6

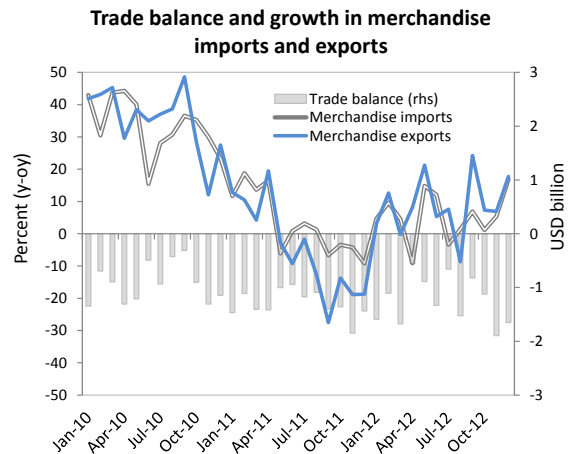
Non-electronics exports grew by 22.3 percent<sup>19</sup> and now account for more than 50 percent of total merchandise exports (Figure 17). However, the 2012 growth in merchandise exports was not sustained in early 2013. Preliminary data from the National Statistics Office (NSO) shows that total merchandise exports declined by 6.2 percent in Q1 2013 as exports of semiconductor and electronics parts fell by 30.3 percent, more than offsetting the healthy growth in non-electronics exports. These trends suggest that the country needs to further diversify its export basket or move up the electronics value-chain (e.g., tablet parts and components) to improve the overall export growth prospect and create more manufacturing jobs.

**Figure 15. Remittances continued to perform strongly in 2012 and supported the growth of domestic demand.**



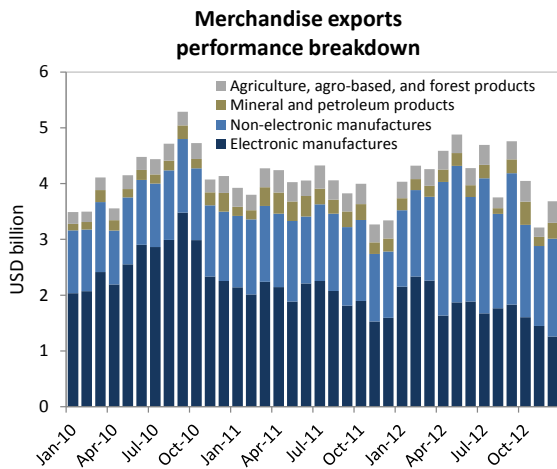
Source: BSP

**Figure 16. The trade deficit narrowed in 2012 as exports grew much faster than imports.**



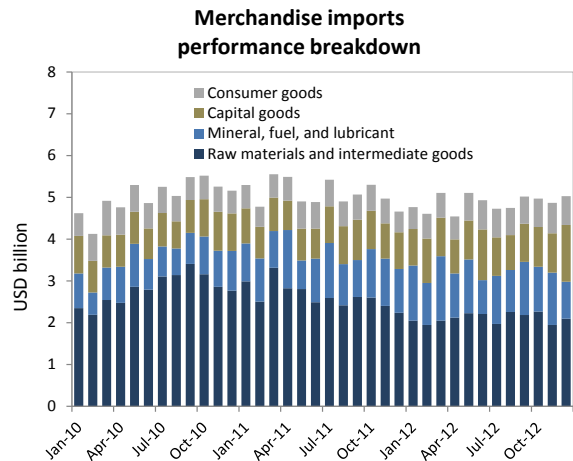
Source: BSP

**Figure 17. Merchandise exports have yet to recover to its pre-crisis levels.**



Source: BSP

**Figure 18. Merchandise import growth was flat in 2012.**



Source: BSP

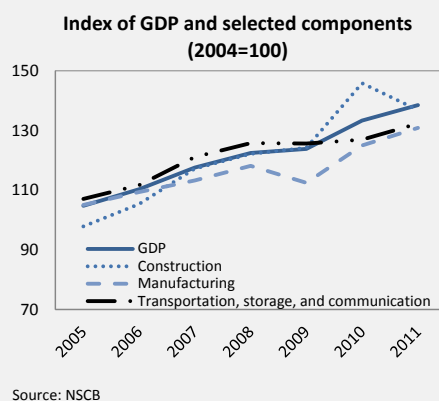
<sup>19</sup> 25.7 percent using BPM6

15. **Imports slowed down despite a fast-growing economy.** Despite a fast-growing economy and the peso's appreciation, which reduces the price of imported goods, imports grew by only 5.1 percent<sup>20</sup> in 2012 (Figure 18). Growth of raw materials and intermediate goods imports stood at 5.9 percent,<sup>21</sup> much lower than in 2011, indicating that manufacturing growth and electronics exports in 2013 will be limited. Imports of capital goods, after recording an average growth of only 2.7 percent in the previous 10 years, grew by 17.8 percent,<sup>22</sup> supporting a potential expansion of domestic investment in the near-term. An apparent anomaly is the negative growth of petroleum imports in volume terms. Crude oil imports by volume fell by 3.4 percent in 2012, while the previous 10 years saw an average contraction of 3.1 percent. That the economy can grow by 5 percent on the average in the last decade, when imports of petroleum products fell, suggests that there are statistical issues or smuggling is systemic<sup>23</sup> (Box 2).

### Box 2. Falling demand and supply of oil amid higher GDP growth

**The Philippine economy has been growing by an average of 5.2 percent since 2005.** The components of GDP that rely on oil as key input also exhibited respectable growth. On the expenditure side, growth of construction averaged 4.8 percent. On the production side, the manufacturing and the transport, storage, and communications (TCS) sectors saw average growth of 4 and 4.1 percent, respectively (Box Figure 2.1). Overall, the economy almost doubled in size in nominal terms between 2005 and 2011. At the same time, the number of vehicles increased by over 40 percent.

**Box Figure 2.1. GDP and component growth have been rising.**



<sup>20</sup> 11.3 percent using BPM6

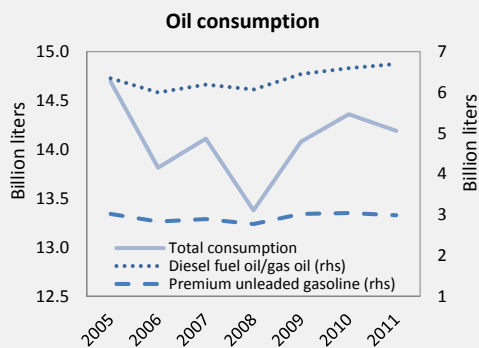
<sup>21</sup> 4.9 percent using BPM6

<sup>22</sup> Similar to BPM6

<sup>23</sup> The Philippine Daily Inquirer, citing industry sources, reported on April 2, 2013 that smuggling accounts for a third of petroleum products and the government loses around PHP 30 billion every year. Two major oil firms concede that smuggling is systemic.

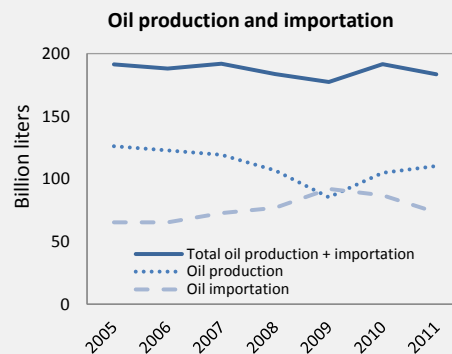
However, oil consumption and supply did not grow at commensurate levels. Total oil consumption was generally flat or declining (Box Figure 2.2). Looking at the two categories of oil with the largest shares, the level of gasoline consumption has been fairly constant from 2005 to 2011, while diesel consumption declined before 2008 and has been rising since then. The supply side also tells the same story—total supply (i.e., production plus imports) was largely flat or declining (Box Figure 2.3).

**Box Figure 2.2. However, total oil consumption has been flat or falling.**



Source: Philippine Statistical Yearbook (PSY) 2012

**Box Figure 2.3. The supply side also shows a generally flat or declining oil supply.**



Source: PSY 2012

The fall in the demand and supply of oil can be explained by several factors. First, the country could have shifted to more energy-efficient technology, or renewable sources of energy. Second, there could be significant issues with the statistics. And third, smuggling could be systemic. The first reason does not fully explain the problem well, as the share of oil to total energy supply has been fairly constant at around 33 percent from 2006 to 2011. The second reason is plausible, as is the third reason, especially in light of significant discrepancies between what the Philippines reports as oil imports and what partner countries report as oil exports to the Philippines. For instance, the difference for refined oil products can reach as high as 25 percent in some years (source: World Integrated Trade Solutions).

16. **The financial accounts recorded sizable foreign portfolio investment (FPI) inflows in 2012 but not foreign direct investment (FDI).** Gross inflows of FPI reached USD 4.7 billion in 2012 (equivalent to about 1.9 percent of GDP) as a result of the growing interest rate differential between advanced markets and the Philippines. In contrast, FDI continues to lag behind other countries in the region. At USD 2 billion in 2012, FDI inflows to the Philippines are the lowest among the original ASEAN countries,<sup>24</sup> which received a total of USD 102 billion. Investors continue to cite the lack of infrastructure, high cost of doing business, and corruption as primary reasons for not investing in the Philippines.

<sup>24</sup> The original ASEAN countries include: Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.



## Prices and monetary policy

17. **CPI inflation averaged 3.2 percent in 2012, a deceleration from 4.6 percent in 2011, and was at the low end of the central bank's target of 3 to 5 percent** (Figure 19). Core inflation of 3.7 percent in 2012 reflected the moderate price growth of non-volatile goods. Food prices grew by 2.3 percent in 2012, as generally good weather ensured ample food supply throughout the year. Lower electricity rates and fuel prices in Q4 tempered utilities and transportation inflation, and overall inflation in 2012.

18. **Philippine monetary policy in 2012 and through Q1 2013 remained accommodating.** Monetary policy easing in advanced economies, as well as the surge in capital inflows, has led the central bank to cut the interest rate on the special deposit account (SDA)<sup>25</sup> in January, March, and April by 50 basis points (bps) each. The rates across all tenors now stand at 2 percent, lower than the reverse repurchase (RRP) rate of 3.5 percent.<sup>26</sup> The interest rate cut has yet to translate into a reduction in the total amount placed in the SDA, which stood at PHP 1.9 trillion in end-March 2013 compared to PHP 1.7 trillion in end-2012. To further increase flexibility of monetary policy, the Monetary Board is considering the implementation of a corridor policy on interest rate setting.<sup>27</sup>

19. **The surge in capital inflows, as well as continued growth in remittances, has put pressure on the peso to appreciate.** The peso appreciated by 6.2 percent in 2012 and 0.34 percent in Q1 2013. At around PHP 40.7 per USD 1 as of end-March 2013, it is the peso's strongest performance since February 2008. The strong peso has come at a cost to the central bank, recipients of remittances and exporters, including the BPO. The central bank lost some PHP 45 billion in 2012 due to the weakening of the value of its international reserves (the loss grows to PHP 95 billion if negative carryover from sterilization is included). Thus far, overseas Filipinos have adjusted the amount of remittances they send home to meet the peso equivalent needed by their families, and the BPO industry continues to perform well as unit labor cost is still low. However, key exports such as electronics were affected. To reduce pressures on the peso, the national government has adjusted its domestic and foreign financing mix to 90-10 in favor of domestic borrowings.

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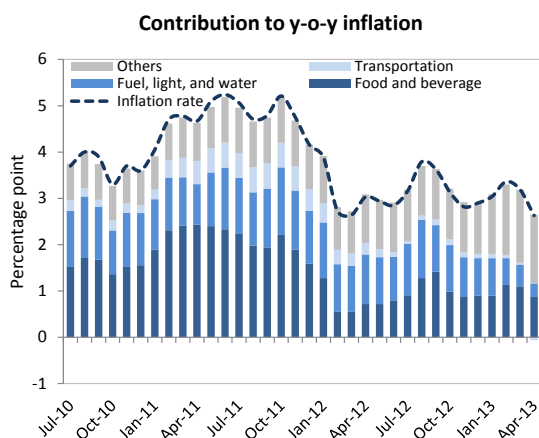
<sup>25</sup> A special deposit account (SDA), as defined by BSP, is a fixed-term deposit to the central bank by banks and supervised financial institutions.

<sup>26</sup> With the possibility of funds moving from SDA to the higher yielding RRP, the central bank indicated that it might restrict foreign banks and trust entities from transacting in the RRP facility.

<sup>27</sup> Most central banks maintain interest rates within some range around their policy target rate using a corridor system. Interest rates are constrained through the central bank offering to take an unlimited amount of deposits at some base rate while offering to lend funds (with collateral) at some higher rate. Open market operations are used to inject or withdraw liquidity in order to guide market overnight rates within the corridor through time. Appropriately designed and implemented, corridor systems help maintain rates at a level consistent with the desired stance of the central bank while also helping to manage short term interest rate volatility.

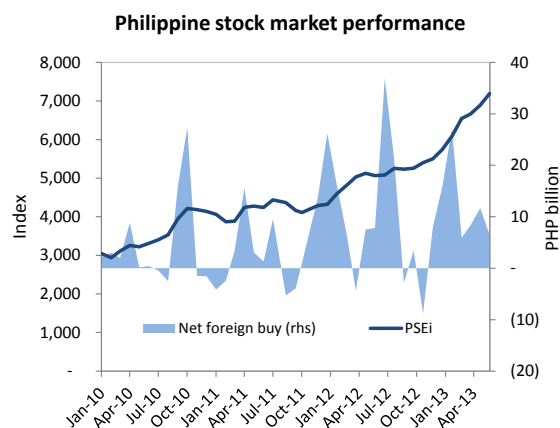
20. **Falling interest rates, strong capital inflows, and a positive outlook for the domestic economy boosted the Philippine financial markets to new records.** The stock market continued to rally, with the main index reaching a record high of more than 7,350 points in early May 2013, a 70 percent increase from end-2011 (Figure 20). Net foreign buying reached PHP 53 billion in the first four months, a more than two-fold increase from the same period last year. The policy rate cuts in 2012 and the SDA rate cuts in early 2013 brought down interest rates further. The government's borrowing costs have also fallen to record lows. In April, the rates of the 91-day, 6-month, and 1 year T-bill rates eased to 0.04, 0.22, and 0.31, respectively, and the 20-year T-bond rate fell to 3.3 percent. The two credit rating upgrades to investment grade are expected to bring down borrowing costs even further and boost the peso bonds market. Money supply (M3) in March 2013 continued to expand, growing by almost 11.4 percent to reach PHP 5.1 trillion.

**Figure 19. CPI inflation decelerated in 2012 as key commodity and food prices abate.**



Source: BSP

**Figure 20. The stock market index more than doubled in the last three years.**



Source: Philippine Stock Exchange (PSE)

## Budget and fiscal policy

21. **National government spending improved in 2012 due to enhanced pace and efficiency.** Total disbursements grew by 14.1 percent to reach PHP 1.78 trillion, equivalent to 16.8 percent of GDP. The highest increases were seen in infrastructure spending, and maintenance and other operating expenditures. With a more efficient bidding, implementation, and payment system in the Department of Public Works and Highways, infrastructure projects were rolled out at a faster pace, with spending increasing by 58 percent. Infrastructure spending in 2012 was equivalent to 2.4 percent of GDP, up from 1.6 percent of GDP in 2011. The increase brought the utilization rate to 84 percent of the programmed budget for infrastructure, much higher than 66 percent in 2011. Maintenance and other operating expenditures grew by 28 percent and reflected higher allotments to social services, such as the conditional cash transfer program (PHP 43 billion), and economic services, such as irrigation (PHP 23 billion).

22. **Higher spending was matched by a significant increase in revenue collection, primarily from improved tax administration measures.** The government continues to improve tax administration as the primary means of generating more tax revenues. Total tax revenues grew by 13.2 percent and tax effort increased from 12.3 to 12.9 percent of GDP—the highest increase in decades that can be attributed to improved tax administration. In Q1 2013, the Bureau of Internal Revenue (BIR) announced a campaign to boost tax collection from self-employed and professionals (SEPs) such as doctors, lawyers, and traders. The BIR estimates that only about 403,000 out of 1.8 million SEPs paid taxes and the average income declared by SEPs is not far from the income of minimum wage workers. The BIR is also working to increase collection of estate taxes and using more third party information to improve tax audits. The government targets an increase in tax collection from SEPs to 2.1 percent of GDP from less than 0.2 percent of GDP. The Bureau of Customs (BOC) continues to curb smuggling through its “Run After the Smugglers” (RATS) Program and through new measures such as the creation of import maps and limiting certain commodities to particular ports. On trade facilitation, BOC plans to upgrade its current systems with the integrated Philippine Customs System (i-PCS)<sup>28</sup> and the Enhanced Customs Transit System (ECTS).<sup>29</sup> It is also pushing for the passage of the Customs Modernization Bill,<sup>30</sup> which will make the Philippines compliant with international standards in customs administration. On tax policy, following the passage of the sin tax law last year, the government is now pursuing reforms in mining taxation and the rationalization of fiscal incentives.

23. **Overall, the country’s fiscal stance remains sustainable.** The national government deficit of 2.3 percent of GDP in 2012 is sustainable given strong economic growth and lower interest burden. A deficit of up to 2.7 percent of GDP would still be broadly sustainable and justified if incremental expenditure is spent on productive activities, such as infrastructure and social services, and if revenues also increase commensurately. The projected trajectory of the national government debt exhibits a downward trend, with the debt ratio falling from 51.4 percent of GDP<sup>31</sup> in 2012 to 48 percent of GDP in 2015, barring any unexpected shocks. Figures 21 and 22 illustrate a gradually declining national government debt ratio, as well as broad resiliency to a variety of standard shocks (i.e., a 0.5 to 1.0 standard deviation [SD] in growth and interest rate will increase the debt stock to between 47.2 and 51.1 percent of GDP—a level that is still manageable). Total debt service still accounts for 48 percent of total revenues—underscoring the need to increase revenue collection in the medium-term to ensure the sustainability of the fiscal stance.

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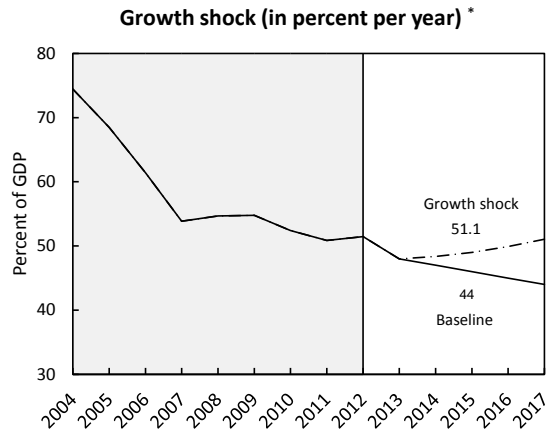
<sup>28</sup> The i-PCS is set to replace the bureau’s existing Electronic to Mobile (E2M) system, which was built to streamline shipment processing and improve trade facilitation.

<sup>29</sup> The ECTS uses global positioning system (GPS) technology to track containers in transit between ports.

<sup>30</sup> House Bill 4788 or “An Act to Prescribe the Customs Modernization and Tariff Act of 2011” has already been passed by the House of Representatives and is now with the Senate.

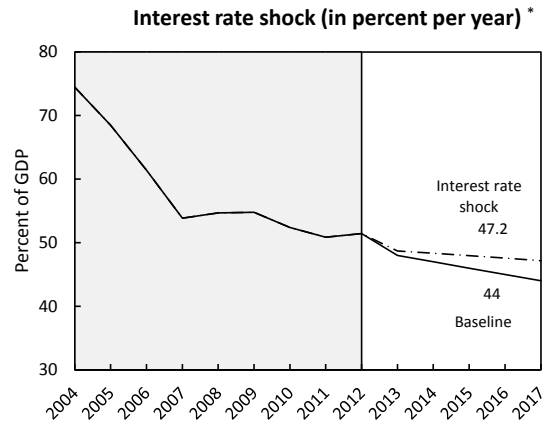
<sup>31</sup> The debt stock of the national government increased in 2012 by 0.3 ppt to 51.4 percent of GDP due to the PHP 55.6 billion on-lending to the Power Sector Assets and Liabilities Management (PSALM) Corporation.

**Figure 20. Debt sustainability analysis (DSA) – NG debt to GDP ratio projection with a growth shock.**



Source: World Bank staff calculations  
 Notes: \* Represents a 1 standard deviation shock to growth.  
 The shaded area represents actual data.

**Figure 21. DSA – NG debt to GDP ratio projection with an interest rate shock.**



Source: World Bank staff calculations  
 Notes: \* Represents a 1 standard deviation shock to interest rates.  
 The shaded area represents actual data.

## PROSPECTS AND POLICIES

### Output and demand

24. **The medium-term growth prospects for the Philippines are good.** The country has weathered the impact of the financial crisis and global slowdown quite well, and its macroeconomic fundamentals are improving —the result of past and on-going reforms in the financial and public sectors. With stronger reforms, the Philippines can see sustained growth of above 6 percent in the medium-term.

25. **In 2013, economic growth is projected at 6.2 percent and will be driven by domestic demand. As in previous years, private consumption will provide the primary basis for growth. It is expected to contribute around 4.5 ppt to GDP growth.** Remittance growth of at least 5 percent will sustain the growth of private consumption and to some extent household investment in housing and real estate. The current positive trend in the deployment of Filipino workers to overseas jobs should be able to provide support for remittance growth. Higher automobile sales growth of 29 percent in Q1 2013 and higher remittance growth of around 7 percent in the first two months of 2013 suggest a strong Q1 growth.

26. **Sustained increase in investments, in particular construction activities, and higher public spending, would contribute around 1.5 ppt to overall growth.** In 2012, approved investment pledges grew by 12 percent to PHP 289 billion (around 3 percent of GDP), the highest since 1996. More recently, the Philippine Economic Zone Authority (PEZA) reported that approved investment pledges in economic zones increased by 171 percent in Q1 2013. These statistics indicate stronger investment growth in the near-term. Exports, hinging on the recovery of electronics exports and higher exports of non-electronics, will provide the balance of about 0.2 ppt. Trade prospects for electronics should improve in 2013, but growth is not yet expected to recover to pre-crisis levels, given negative growth of electronic parts imports in recent months, and moderate improvements in the North American book-to-bill ratio—two important indicators of forthcoming electronic export growth. Stronger performance of non-electronics would provide support for the growth projection.

27. **For the Philippines to attain the level of investments seen in other East Asian countries, it would have to accelerate structural reforms to address key investment climate issues such as the lack of infrastructure, high cost of doing business, and corruption.** With these reforms in place, the country would be able to see a gradual increase in FDI inflows from less than USD 2 billion towards USD 5 billion or more in the medium-term. As in previous election years, the mid-term election in May 2013 is expected to contribute positively to GDP growth in the first half of 2013 (Box 3).

### Box 3. Elections and GDP growth

**The general elections in May 2013 may boost domestic demand growth in the first half by up to 2 ppt, if historical trends are repeated** (Box Table 3.1). In Q1 and Q2 of 2013, both public consumption and fixed capital formation are expected to see higher growth from increased campaign spending and the frontloading of infrastructure and other related spending to abide by the election rule banning the commencement of new projects 45 days before the election. The 2016 presidential and general election is estimated to contribute 2.7 ppt to the first half GDP growth.

**Box Table 3.1. Average incremental contribution to domestic demand in in the first half of the year (in ppt)**

TYPE OF EXPENDITURE	Senatorial election vs. non-election year			Presidential election vs. non-election year		
	Q1	Q2	H1	Q1	Q2	H1
<b>Domestic Demand</b>	<b>2.2</b>	<b>1.8</b>	<b>2.0</b>	<b>3.9</b>	<b>1.4</b>	<b>2.7</b>
Household consumption	0.3	-0.3	0.0	0.5	0.7	0.6
Government consumption	0.9	0.2	0.6	1.4	0.4	0.9
Fixed capital	0.9	2.0	1.4	2.0	0.3	1.2
Construction	0.1	1.2	0.7	0.4	0.1	0.3
Durable equipment	0.8	0.7	0.8	1.5	0.0	0.8

Source: World Bank staff calculations using NSCB data

Note: Elections in the Philippines are held every three years for all positions except the presidential and vice presidential posts, which are elected every six years. The incremental contribution to growth is computed as the difference between the average contribution to growth per expenditure type per quarter of an election year and of a non-election year. Estimates shown here are for the period 1999-2012.

28. **In 2014, projected economic growth of 6.4 percent will depend on the ability of the government to further increase infrastructure spending and the private sector to increase investment spending.** Higher public spending will require a significant increase in revenues (see the section on fiscal policy for a discussion on tax reforms). With sustained growth in revenues, the government would be able to raise infrastructure spending from the current 2.4 percent of GDP towards 5 percent of GDP by 2016, and spending in education, health, and other social services by an additional 5 percent of GDP. Higher government spending would, in turn, provide impetus to the private sector to increase investment spending. Finally, the projected recovery of the global economy in 2014 should be able to boost merchandise export growth towards its pre-crisis (2002 to 2007) rate of around 8 percent. Should merchandise exports fail to fully recover, economic growth of at least 6.4 percent can still be achieved by further increasing public spending, in particular infrastructure spending.

29. **Risks to the growth projections will primarily come from a slower global recovery, domestic reform lags caused by increased resistance from vested interests, and possible asset**

**bubbles in the real estate sector and the stock market.** Global uncertainties stemming from weak demand and financial market volatility in high-income countries pose substantial risks to Philippine growth. In 2013, global economic growth is expected to only marginally increase to 2.4 percent as growth in the US and Japan decelerates further (Table 1). The nascent economic recovery in the US is also at risk of being undermined by fiscally induced contractions to contain its large deficit. Europe is projected to remain in recession this year, and the G3 economies (i.e., US, EU, and Japan) are expected to recover only in 2014. The risk of a protracted recession and financial market tensions in these countries could still affect the Philippines through weaker external demand and sudden capital outflows. This low case scenario could drag down Philippine growth to below 3 percent. However, appropriate monetary and fiscal policies could push up growth to around 4 percent.

**Table 1. Global growth projections**

	2011	2012	Forecast	
			2013	2014
USA	1.8	2.2	1.9	2.8
EU	1.5	-0.4	-0.1	0.9
Japan	-0.7	1.9	0.8	1.2
China	9.3	8.0	8.3	8.0
ASEAN	4.5	5.6	5.8	5.9
World	2.8	2.2	2.4	3.0
High-income countries	1.7	1.3	1.3	2.0
Developing countries	5.9	4.9	5.4	5.7

Source: World Bank's Economic Prospects (January 2013) and EAP Economic Update (April 2013)

30. **On the domestic front, weaker reforms in tax collection and public financial management could slow progress in making public spending more timely and productive. This in turn can stall private investment.** In 2012, the reforms in tax administration and public financial management played important roles in pushing up growth to 6.6 percent. There is risk that the reform momentum starts to wane as attention is increasingly focused on the 2016 presidential election and vested interests strongly rally against leveling the playing field among economic actors, especially when it pertains to differential taxation. Some of these risks can be mitigated by ensuring that the tax and budget processes are insulated from political interference by promoting more transparency and accountability. For instance, this would include continuing improvements in participatory budgeting, complaints mechanisms, and strengthening citizens' voice and power with respect to public service providers.

31. **Finally, increased vulnerability in the real estate and stock markets could slow down growth further.** In recent years, both markets have grown significantly and there are concerns about asset price bubbles and sudden outflow of capital should financial market volatility return. Prudential measures and other reforms in place since the Asian financial crisis are expected to mitigate most risks, but a hard landing cannot be ruled out. Special Focus No. 2 discusses this issue further.

## Prices and monetary policy

32. **The inflation outlook is expected to be benign at around 4 percent.** As global commodity prices abate in response to weaker global growth prospects, prices of food as well as fuel, light, and water (FLW), which started to fall in Q4 2012, are expected to remain low and stable throughout 2013. However, with the output gap narrowing and with a possible supply side constraint to growth, such as the availability of power, CPI inflation is projected to accelerate to around 4 percent in 2013 and 2014. Near-term upside risks to inflation include the further influx of foreign capital, surprises in the global commodity markets, adverse local and international weather disturbances on food supply, tensions in the Middle East region affecting oil supply, and the looming power shortage in Mindanao.

33. **The current accommodative monetary policy stance is appropriate.** However, there is growing concern about the effects of the rapid capital inflow, which is fuelling the high growth of the asset and credit markets (Table 2). Prudential measures, such as closer monitoring of domestic credit markets, both household and corporate debts, and financial and real estate transactions are necessary to ensure healthy balance sheets and avoid any credit crunches, particularly in the real estate sector.

**Table 2. Growth of loans by universal and commercial banks**

	2010	2011	2012
Total loans			
Gross of reverse repurchase (RRPs) arrangement	8.9	16.4	15.4
Net of RRP's arrangement	8.9	19.3	16.2
Real estate loans*	12.2	25.2	29.7
Credit card loans	4.2	9.0	13.4

Source: BSP

Note: \* Includes loans in renting and other business activities sector.

34. **If growth prospect becomes negative, further monetary policy easing will be less potent going forward given very low interest rates while continuing to fuel asset-price increases.** To support growth, the government would need to rely more on fiscal policy. The following section discusses at length how fiscal policy can be strengthened to support growth.

## Fiscal policy to sustain growth

35. **Higher and more efficient public spending, underpinned by increased revenue mobilization, is needed to sustain growth.** A high case scenario calls for spending an additional 2.5 percent of GDP in infrastructure and an additional 5 percent of GDP in social services, for a total of 7.5 percent of GDP over the next decade. This will bring the national government spending level to around 25 percent of GDP and more in line with the spending patterns of its



neighbors, allowing the government to reduce poverty and help create jobs at a much faster pace. To meet this spending level, tax effort would need to be increased by about 7.5 percent of GDP. The current strong leadership in the government, strong initial gains in tax effort in 2012 largely on account of tax administration, and the country's past experience of successful tax administration suggest that attaining this feat is possible.

**36. The Philippines has significant opportunities to improve revenue generation to support its inclusive growth agenda.** Tax effort, in effect BIR and BOC revenue as a share of GDP, has been improving, but remains well below that of the country's peers, including notably middle-income countries that have achieved investment grade status. Indicative analysis set out in Table 3 suggests that the Philippines could improve tax effort to close to 20 percent of GDP from the current level of just under 13 percent through a range of policy and administration measures in the medium term. The Secretary of Finance has publicly stated his desire to see revenue effort at over 16 percent of GDP by the end of the Aquino Administration, and has put the spotlight on key sources of revenues to achieve this objective. The mix of administration and policy efforts to achieve this goal will be motivated by a number of considerations: what enhancements are doable both in terms of bureaucratic implementation capability and options for legislative reform on the policy side and which reforms promise to have the biggest pay-offs in terms of investment and jobs creation, especially when considering both tax expenditure<sup>32</sup> and spending channels.

**37. Effective prioritizing and sequencing revenue mobilization efforts will be critical for the second half of the Aquino Administration. While current improvements in tax administration can deliver significant revenue gains, policy reforms are also needed.** Following the passage of the excise tax law in December 2012, the law now needs to be effectively implemented. Next, rationalizing tax incentives is critical to plug systemic leakages in the tax system, level the playing field, and raise revenues. Mining tax reform is also needed, while significant gains can be made in revenue mobilization from the self-employed and estates. In addition, indexing petroleum excise taxes (frozen since 1996) is also needed to boost revenues and improve the overall progressivity of the tax system, as the top 10 percent of the population consumes 90 percent of total petroleum.<sup>33</sup> Finally, additional taxes can be sourced from fewer VAT exemptions and levying a national surtax on real properties to improve the equity of the tax system. These tax policy measures can increase the tax effort by up to 4 ppt of GDP. The political support for these reforms will, in part, depend on the public's perception of an improving tax administration and quality of public spending.

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<sup>32</sup> Tax expenditures are in effect foregone revenues because government offers particular exemptions to citizens or firms.

<sup>33</sup> Social protection is needed to protect disadvantaged groups should this reform be implemented. This could come in the form of limited and time-bound subsidies and discounts to public utility vehicles.

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

- Re-engineer and simplify procedures and processes required of small and micro businesses, followed by the full automation of all tax processes to facilitate taxpayer compliance and improve governance.
- Strengthen real-time monitoring of revenue performance at disaggregated levels to minimize tax leakages.
- Issue an executive order (EO) to mandate all government agencies and selected private sector groups (e.g., electric and phone companies, and professional associations) to provide third party data to BIR and BOC to improve tax audits.
- Further enhance the integrity of revenue officials by, for example, requiring the public posting of net worth of top revenue officials (as the Department of Labor and Employment, and the National Labor Relations Commission did in their websites<sup>34</sup>) to send a strong signal to the public that the revenue agencies are committed to good governance.
- Enhance internal and external audit (i.e., by the Commission on Audit [COA]) of BIR and BOC activities, in particular adherence of the BIR and BOC to their own audit rules, to improve transparency and accountability of tax administration.
- Institutionalize the recording and public reporting of key performance indicators to allow the public to track the performance of the BIR and BOC.

These reforms can significantly reduce the current tax gap (or the difference between potential and actual collection), which amounts to about 4 percent of GDP.

**39. Over the medium-term, a comprehensive tax reform is needed to simplify and improve the efficiency and equity of the tax system, and move towards a broad-based and low-rate tax regime.** Weaknesses in the tax system are currently resulting in major tax leakages. For example, the Philippines is one of the few countries that allow tax expenditure to take place outside the tax code. This needs to be corrected by consolidating the National Internal Revenue Code (i.e., the tax code) and related tax regulations, notably the various incentives laws. More importantly, certain tax policy regimes are both inefficient and detrimental to jobs creation. Enforcing a weak tax design may yield more revenue, but will have adverse impacts on jobs. In this regard, a simplified tax regime for micro and small firms is warranted to reduce the cost of doing business and spur job creation.

**40. Taken altogether, the above reform measures could raise revenues by up to 8 ppt of GDP (Table 3).** The government's medium-term target of an additional 3 ppt of GDP by 2016 is on the right track. While gains from a comprehensive tax reform will not be realized overnight in the Philippines, the administration can make significant progress towards realizing at least

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<sup>34</sup> See [http://www.dole.gov.ph/fndr/bong/files/2010%20SALN%20OF%20OFFICIALS%20\(WEBSISTE\)%207-15-11.pdf](http://www.dole.gov.ph/fndr/bong/files/2010%20SALN%20OF%20OFFICIALS%20(WEBSISTE)%207-15-11.pdf) and <http://nlrc.dole.gov.ph/?q=node/91>.

half of the needed tax improvement effort. The country’s experience between 1985 and 1997, which saw tax effort grow by 5.7 ppt of GDP on account of strong tax administration and policy reforms<sup>35</sup> clearly shows that a large increase in tax revenues is possible with strong political commitment and public support for the reform (Special Focus 3 discusses the Comprehensive Tax Reform Program of 1986 and related administrative reforms). This large incremental revenue would enable the government to significantly increase investments in human and physical capital to improve competitiveness, create more and better jobs, and allow more people to benefit from higher and sustained growth.

**Table 3. Potential revenue sources**

Revenue options	Percent of GDP
<b>Total</b>	<b>8.0</b>
<b>Tax policy</b>	<b>4.0</b>
Alcohol and tobacco excise taxes (enhanced version)	0.6
Petroleum excise taxes	1.0
Fiscal incentives rationalization	1.0
Removal of exemptions in VAT	0.5
National levy of the property tax	0.5
Other reforms (e.g., mining tax)	0.4
<b>Tax administration (plugging leakages in the following taxes)</b>	<b>4.0</b>
Corporate income tax	0.6
Value added tax	1.4
Personal income tax	2.0

Sources: World Bank (2011), World Bank (2012 forthcoming), and updated WB staff estimates.

41. **Successful public financial management (PFM) reforms would allow the public to see more tangible improvements in governance and convince them that their taxes are being spent wisely.** The following reforms, some of which have started, need to be institutionalized: i) strengthen the evaluation of key government programs, giving priority to the social contract flagship programs (e.g., conditional cash transfer) (Special Focus No. 4 discusses the findings from the recent impact evaluation of the conditional cash transfer program), ii) enhance transparency and accountability of the budget process by making budget data and reports more accessible to the public (e.g., public posting in agency websites), and iii) implement the roll-out of the Government Integrated Financial Management Information System (GIFMIS).

42. **Line agencies’ budget absorptive capacities can be improved** by ensuring the i) timely and consistent passage of the national budget, ii) timely release of budget allocations to line agencies, iii) more effective preparation of spending programs and projects, and iv) further improving the procurement process (Special Focus No. 5 discusses recent developments in procurement reform).

<sup>35</sup> Tax effort could have increased further after 1997 if not for the 1997 tax reform which eroded some 4 ppt of GDP in revenues, mostly due to the non-indexation of excise taxes and the granting of several fiscal incentives.

43. **Finally, the demand side for better PFM can be strengthened by promoting Open Data and Open Government,<sup>36</sup> and accelerating participatory budgeting such as bottom-up budgeting and community-driven development.** These crucial reforms would help make a better case for tax policy reforms. Successful implementation of these reforms would allow the government to increase public investment and pro-poor spending to create an environment conducive to attracting more investments and job creation.

### Medium-term reform agenda

44. **A window of opportunity exists today to accelerate reforms that will help create more and better jobs.** The country is currently benefiting from strong macroeconomic fundamentals, political stability, and a popular government that is committed to improving the lives of the people. It also stands to benefit from the global economic rebalancing (i.e., growth increasingly driven by developing countries instead of high income countries) and strong growth prospects of the East Asia region, China in particular. Several reforms have successfully started, notably in public financial management, anti-corruption, and social service delivery. With further structural reforms, especially in areas which will have more impact on the lives of the poor, the government can put the country on the irreversible path of inclusive growth and meet the jobs challenge.

45. **To create more and better jobs, the government will need to urgently accelerate comprehensive reforms across a range of sectors to create a business environment conducive to private sector job creation, in particular job creation by small and medium enterprises.** The following thematic reform areas deserve the highest priority: i) simplifying rules and regulations to encourage the growth of firms of all sizes, ii) enhancing competition in the economy, giving priority to sectors with the greatest potential in creating jobs, and iii) securing property rights on land for both rural and urban dwellers.

- **Simplifying rules and regulations** in business registration and licensing, entry and exit, paying taxes, access to finance, and labor relations and management are needed to encourage the rapid growth of firms of all sizes. The copious amounts of red tape are not just a break on investment (for firms of all sizes) but they also provide fertile grounds for rent-seeking and corruption, which are priority concerns for businesses.
- **Enhancing competition in the economy, giving priority to sectors with the greatest potential to creating jobs** – these sectors include agriculture, ports, shipping, water, and telecoms. Enhancing competition in ports and shipping are essential in bringing food and input prices down, and improving access to markets and raising the income of

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<sup>36</sup> See Special Focus III (*Open Governments/Open Data: How can 'Open Data' Provide the Government a Change Platform for Improved Transparency and Citizen Participation in the Philippines?*) of the Philippine Economic Update (December 2012).

farmers in less developed regions such as Mindanao. Enhancing competition in the water sector would help improve access to clean and affordable water, and improve health outcomes and worker productivity especially in rural areas. Continuing reforms in the telecoms sector is needed to support sustained accelerated growth in the business activities it supports.

- **Securing the property rights on land for rural and urban dwellers** – without secure property rights, investment will continue to suffer. In the rural areas, this means i) ensuring that farms of all sizes have clear property rights so that they have better incentives to invest, ii) reorganizing and unifying farmer support services, and iii) supporting linkages between smallholders and agribusinesses. In the urban areas, this means simplifying and decentralizing the lengthy and onerous procedures which continue to prevent the majority of the population from obtaining secure rights to their property.

To better sustain these reform efforts and to increase their chances of success, the government will need to invest more in health, education, and infrastructure. These investments can be sustained by institutionalizing reforms in public finance. These reforms are discussed in greater length in the forthcoming Philippine development report “Creating more and better jobs.”

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## SPECIAL FOCUS 1

### Measuring changes in inventory and statistical discrepancy in the national income accounts

*Good statistics—meaning accurate, timely, useful and accessible statistics—are crucial in helping the country achieve more inclusive growth. With good statistics, the country’s development targets, such as accelerating growth to 7 or 8 percent, creating one million jobs annually, and reducing poverty by half, would be easier to achieve, because government would be able to better formulate policies and allocate scarce resources in support of economic activities which yield the highest returns or offer the best prospects for reducing unemployment and poverty.*

*Good statistics are also crucial in supporting the government’s social protection program. With a limited budget and large number of poor and vulnerable people, good statistics will make sure that the budget is targeted to those people most deserving to be protected from hardship.*

*Finally, good statistics are needed for good governance. The Aquino Administration has put improving governance at the forefront of its reform agenda. It sees good statistics not only as important for the efficient functioning of the government, but also as a means for the Filipino people to hold its government accountable for its actions to the people and improve service delivery.*

*This Special Focus takes a closer look at two components of the national accounts: changes in inventory and statistical discrepancy.*

### Measuring changes in inventory

**The Philippine system of national accounts defines total capital formation to include fixed capital and changes in inventory.** Fixed capital includes construction, durable equipment, breeding stocks, orchard development, and intellectual property products. Inventories comprise finished goods, work in progress, material inputs, and goods for resale. The manufacturing, and wholesale and retail trade sectors account for the vast majority of inventories.

**Changes in inventory can be volatile, resulting in large differences between fixed capital formation and total capital formation.** For instance, in 2012, fixed capital formation grew by 8.7 percent but the 166 percent drop in changes in inventory led to a 4.4 percent contraction in total capital formation. As a share of GDP, fixed capital formation net of intellectual property products increased from 18.7 to 19.3 percent of GDP but total capital formation declined significantly from 21.7 to 19.4 percent of GDP. This section sheds some light on how changes in inventory are measured.

**In theory, the measurement of inventory is straightforward.** Inventory can be taken from balance sheets or business surveys, which ask establishments to report their opening and closing inventory levels for the various types of inventory. Businesses follow fairly straightforward procedures recommended in business accounting standards to value their inventories.

**In practice, compiling inventory for the national accounts can be difficult.** The 2008 SNA recommends that changes in inventories should be valued by summing the additions to inventories valued at market prices prevailing at their time of entry less the withdrawals from inventories valued at market prices prevailing at their time of withdrawal. This method can be difficult to implement if data support is weak.

**Good source data for accurately estimating inventories are limited in the Philippines.** National accountants in the National Statistical Coordination Board (NSCB) have to use any available information, such as relevant price indices and knowledge of how businesses value their inventories, to arrive at an estimate of changes in inventories that best approximates the conceptually correct measure. To estimate changes in inventory, NSCB uses several data sources: i) government administrative data for critical commodities such as rice, corn, sugar, crude oil, and petrol products, ii) financial statements of private establishments and their responses to business surveys conducted by the National Statistics Office (NSO),<sup>37</sup> and iii) reports from the Commission on Audit, Department of Finance, and Department of Budget and Management in the case of government agencies and government corporations. To improve the accuracy of the estimates, as quality of survey response can be weak, NSCB uses the commodity flow approach to validate these data before making any adjustment.

**The Philippine Statistical System continues to improve the measurement of investments in the national accounts.** These include efforts to systematically use financial statements from the Securities and Exchange Commission (SEC) to improve source data, and the regular conduct of an enterprise-level business survey to improve the collection of profit and investment data, which are better sourced at the enterprise level (e.g., head office) rather than at the establishment level (e.g., stores, factories).

### **Statistical discrepancy in the national income accounts**

**Statistical discrepancy (SD) is the difference between the level of GDP from the production and the expenditure accounts.** Theoretically, estimates of GDP should be the same whether one uses the production or the expenditure approach. In reality, both sets of estimates differ and a statistical discrepancy occurs as a result of the independent process of compiling the production and expenditure accounts, the use of different source data, and variations in the

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<sup>37</sup> These include the Monthly Integrated Survey of Selected Industries, Quarterly Survey of Philippine Business and Industry, Annual Survey of Philippine Business and Industry, and the Census of Philippine Business and Industry.

quality of data. Other measurement errors also contribute to the difference between the two estimates.

**In the Philippines, GDP levels and growth estimates have always been based on the production accounts given superior source data.** Data for the production accounts come from regular establishment surveys. The data support for the expenditure accounts is weaker as there is no regular retail sales survey, which can be used to improve the estimation of household final consumption expenditure (HFCE), which accounts for around 70 percent of GDP. There are also weaknesses in measuring changes in inventory as discussed above. To address these data gaps, commodity flow approaches and related indicators, including derived expenditure patterns from the Family Income and Expenditure Survey (FIES), are used.

**With the migration to the 2008 System of National Accounts, the country's national accounts estimates are subjected to a supply and use table (SUT) analysis.** This method checks the consistency of the production and expenditure sides of the accounts. On an annual basis, the SD is forced to zero, while on a quarterly basis, the SD is pegged at one percent of GDP or less due to limitations of the quarterly source data.

**Countries in the region have mixed experience in dealing with SD.** Some countries report a non-zero SD for the full year (e.g., Indonesia, Thailand, and Vietnam). Others have zero SD because they use the SUT approach to force SD to zero (e.g., Philippines since 2011 and Mongolia beginning 2014). Other countries incorporate the SD as part of changes in inventory (e.g., Malaysia).

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More information on the 2008 SNA can be accessed at <http://unstats.un.org/unsd/nationalaccount/SNA2008.pdf>.

Information on the PSNA can be accessed at [www.nscb.gov.ph/technotes/sna/default.asp](http://www.nscb.gov.ph/technotes/sna/default.asp).

Information on the recent revisions to the PSNA can be accessed at [www.nscb.gov.ph/announce/2012/0628\\_psnarevisions.asp](http://www.nscb.gov.ph/announce/2012/0628_psnarevisions.asp).



## SPECIAL FOCUS 2

### The Philippine real estate market: a cause for concern? An update

*The construction and real estate sectors contributed significantly to the faster-than-expected expansion of the Philippine economy in 2012. The central bank's accommodating monetary policy stance, which has resulted in the lowest interest rate regime, has encouraged lending to construction and real estate activities. Construction and real estate grew by 14.4 and 18.9 percent, respectively, in 2012. Their average growth rates of 12.4 and 8.2 percent, respectively, from 2010 to 2012 were the highest since 1995-1997. Bank lending to real estate grew by an average of 14 percent in the last three years. Since 2010, strong capital inflows and domestic demand have fueled the growth of the stock market. The main stock market index, along with the property index, doubled in value in the last three years. And, since 2004, while real estate selling prices grew by up to 90 percent, rental values on the average rose by around 60 percent. Some observers argue that the current economic landscape exhibits some similarities to the two years preceding the 1997 financial sector crisis.<sup>38</sup> In the light of these trends, a concern for the possible emergence of asset price bubbles is understandable.<sup>39</sup>*

**The surge in construction and real estate activities reflects higher demand for office spaces and residential condominiums, and house and lots** (Figure 2.1; refer to Box 2.1 for an overview of the Philippine real estate market). Moreover, 2012 growth benefited from low base effect, because between 2009 and 2011, real estate companies put on hold major development projects in light of the volatile growth outlook brought about by the European fiscal crisis and slowdown in other advanced economies.<sup>40</sup> By Q4 2011, many Philippine real estate companies, encouraged by the positive prospects for the Philippines, resumed construction of projects previously put on hold. The country's fast-growing business process outsourcing (BPO) industry

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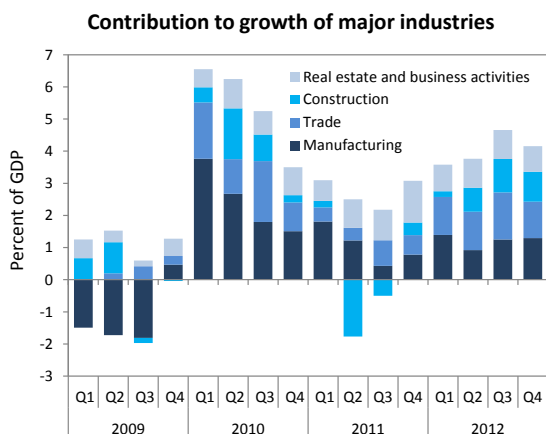
<sup>38</sup> According to Collyns and Senhadji (2002), the years leading to the 1997 Asian financial crisis followed a general pattern of "heady optimism" following years of rapid economic growth in the 1990s, capital account and financial market liberalization resulting in heavy capital inflows, high rates of investment, and rapid increases in asset prices.

<sup>39</sup> For instance, Fabella (2013) warns that while the country grew strongly in 2012, the economy nevertheless shows signs of weaknesses. Growth has largely been consumption-driven. Domestic investments, as well as foreign direct investments remain low at around 20 and 1 percent of GDP, respectively, and strong portfolio inflows pose significant risk to financial market and exchange rate stability. He recalled a similar event in the 1990s: "We have, in the past, witnessed episodes of great promise turned into muck by our visceral inability to handle favorable times. In the mid-1990s, the hopeful sapling nurtured with courageous policy reforms by the Ramos administration also attracted favorable global notice. But it was the carpetbaggers (nee portfolio investors) who flocked to make a killing on very high domestic interest rates and open capital account. Direct foreign investors were, contrariwise, held back by the regulatory maze, the high power cost and the appreciation of the peso. Like the Olsonian roving bandits, carpetbaggers thrive on such frailties. And the Central Bank (BSP) — playing the grateful host — rewarded carpetbaggers with peso appreciation and encouraging domestic private banks and corporations to join the feeding frenzy by borrowing dollars abroad. They borrowed and how and for two years we partied. They promptly created asset bubbles in the equity and real estate markets, birthing illusory prosperity before leaving the killing fields. This decision by the BSP to tango with portfolio reaped a firestorm in 1998. Thus was neutered Ramos's recovery."

<sup>40</sup> Sources include author's interview with Philippine real estate companies in December 2011 and February 2013.

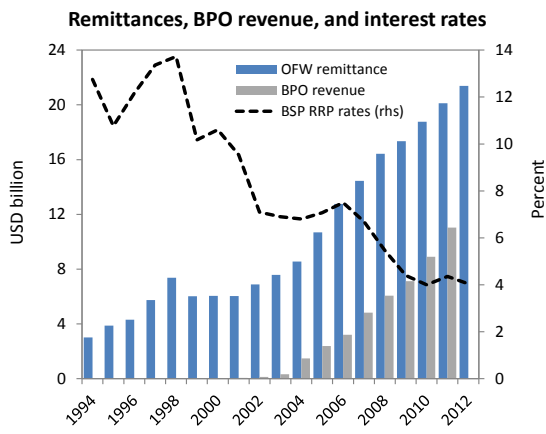
and robust overseas Filipino workers' (OFW) remittances are the main sources of demand for office and residential properties (Figure 2.2). For example, the luxury residential segment, which largely caters to the expatriate market (e.g., BPO expatriates), expects to see an additional 10,600 units in 2013 from an annual average of 3,500 units in the last 5 years,<sup>41</sup> while the Makati Central Business District (CBD) expects to see an additional 336,000 square meters (sqm) of office spaces in 2013 from an annual average of about 178,000 sqm in the last 5 years (Figures 2.3 and 2.4).

**Figure 2.1. Real estate and construction were key drivers of 2012 growth.**



Sources: National Statistical Coordination Board (NSCB)  
 Note: Real estate and business activities includes value-added from the BPO

**Figure 2.2. Robust OFW remittances, an expanding BPO industry, and low interest rates fueled domestic demand.**



Sources: Business Processing Association of the Philippines (BPAP) and Bangko Sentral ng Pilipinas (BSP)

**Real estate price inflation in recent years is much lower than in the pre-1997 period.** Though rising, capital and rental values are still below their 1997 peaks, as supply remains relatively strong. The average selling price for mid-range residential condominiums grew by up to 90 percent since 2004 to around PHP 100,000 per square meter (sqm). High-end units now sell at prices up to PHP 200,000 per sqm, an increase of 50 percent.<sup>42</sup> In contrast, rental values have not increased by as much since 2005. They are currently lower relative to 1992-97, which saw a tripling of rental rates. The rental price of Grade A office space in Metro Manila CBDs ranges from about PHP 800 to 1,000 per sqm, still below the 1997 peak of PHP 1,200. On housing rental, the official statistics show that housing rental inflation hovered at around 3 percent from 2007 through early 2013 from a high of 18 percent in 1996 (Figure 2.5). Since 2008, the divergence between rental and sale values is not growing as fast as one would expect if there

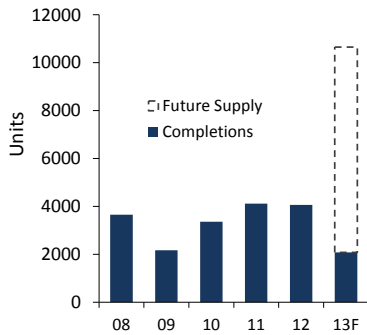
<sup>41</sup> According to leading real estate analysts, data for low-end to mid-range segments are only available to their subscribing clients.

<sup>42</sup> This refers to the average capital value for premium three-bedroom units in the Makati central business district. Source: Colliers International Philippines Research (2012)

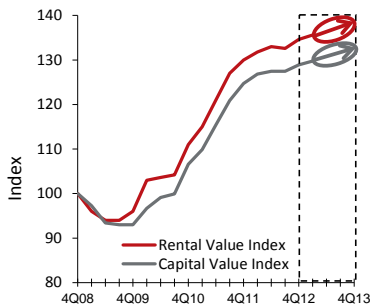
was a real estate bubble developing.<sup>43</sup> The inflation outlook for rental values is expected to moderate given the high supply of pipeline residential condominiums and office spaces.<sup>44</sup>

**Figure 2.3. The luxury residential segment expects to see 10,600 new units in 2013. Capital and rental values are rising at about the same rate.**

**Physical Indicators**



**Financial Indices**

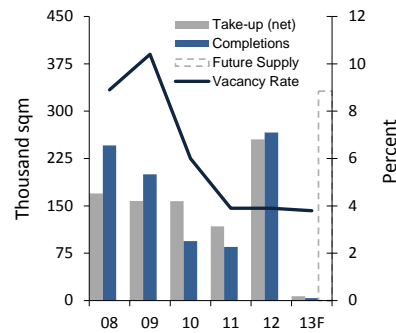


Arrows indicate 12-month outlook  
Index base: 4Q08 = 100

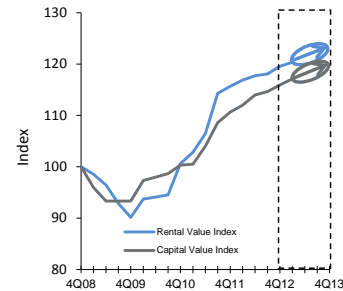
Reproduced from: Jones Lang LaSalle Asia  
Pacific Property Digest, Fourth Quarter 2012

**Figure 2.4. The Makati CBD expects to see an additional 336,000 sqm of office spaces in 2013. Capital and rental values are rising at about the same rate.**

**Physical Indicators**



**Financial Indices**



Arrows indicate 12-month outlook  
Index base: 4Q08 = 100

Reproduced from: Jones Lang LaSalle Asia  
Pacific Property Digest, Fourth Quarter 2012

**At the same time, most banking sector indicators show significant improvements from their levels in the 1990s,** thanks to the prudent banking policies put in place after the 1997 crisis. Lending to real estate is capped by prudential measures such as limits to bank exposure to real estate to at most 20 percent of total loan portfolio (TLP).<sup>45</sup> Bank asset indicators have also improved remarkably. Non-performing loans as a share of banks' TLP have gone down to 2 percent from 14 percent in 1996. Bank lending to real estate is still relatively modest

<sup>43</sup> Rental values typically respond closely to supply and demand fundamentals while sale values could also be driven by investor speculation and cheap credit (i.e., reflect an asset price bubble).

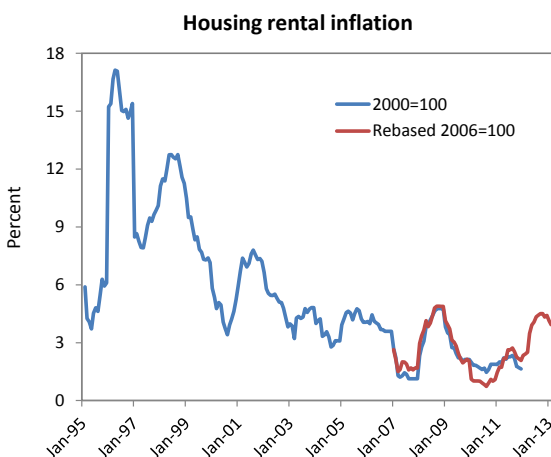
<sup>44</sup> Sources include author's interviews with Philippine property management and research firms, and real estate companies in December 2011 and February 2013.

<sup>45</sup> Source: BSP Circular No. 600 on regulatory framework governing bank real estate loans.

considering that interest rates are at historically low levels (e.g., bank lending rate of as low as 5 percent from over 15 percent in 1997).

**Low interest rates are driving real estate lending but leverage is still low relative to 1997.** In 2012, real estate loans (RELs) grew by around 30 percent and were equivalent to 4 percent of GDP, lower than 1997's 60 percent growth and RELs equivalent to 6 percent of GDP. Thus far, the balance sheets of top real estate companies remain healthy. The average debt-to-equity ratio of the top six Philippine real estate companies weighted by market capitalization was around 53 percent in 2012 (Table 2.1), lower than the debt-to-equity ratios seen at the height of the Asian financial crisis (i.e., 66 percent for the top real estate companies and 170 percent for the Philippines' top 1,000 non-financial corporations).<sup>46</sup>

**Figure 2.5. Rental inflation has been low and stable in recent years.**



Source: CEIC

**Table 2.1. Philippine real estate corporations have lower debt-to-equity ratios today.**

Corporation	Average debt-to-equity Ratio	
	1996-99	2011/12
Ayala Land, Inc.	60	69
Filinvest Land, Inc.	68	38
Megaworld Corporation	135	34
Robinsons Land Corporation	65	26
SM Development Corporation	NA	31
Vista Land and Lifescapes, Inc.	NA	66

Source: Le Borgne, et. al. (2009) for 1996-99 data, SEC 17-A forms for 2011-12 data

**Risks arising from bank lending to real estate firms are lower today.** This is because i) many weaker firms have been weeded out following the 1997 financial crisis, ii) the balance sheets of the remaining firms are stronger given lower leverage, iii) there has been a shift from lending against specific projects to lending against developers' balance sheets, and iv) developers are making more prudent decisions and are adapting better to difficult times by recalibrating the pace of real estate development and postponing new project launches when the outlook turns negative, among others.<sup>47</sup>

**Moreover, most real estate companies have adopted the practice of pre-selling properties and starting construction only after reaching 60 percent in pre-sales to further reduce risks.** Through pre-selling, firms are protected from overcommitting resources to a project without

<sup>46</sup> World Bank staff estimates. Source: SEC 17-A forms, Business World top 1,000 corporations.

<sup>47</sup> See Le Borgne, et. al. (2009) for more discussion.

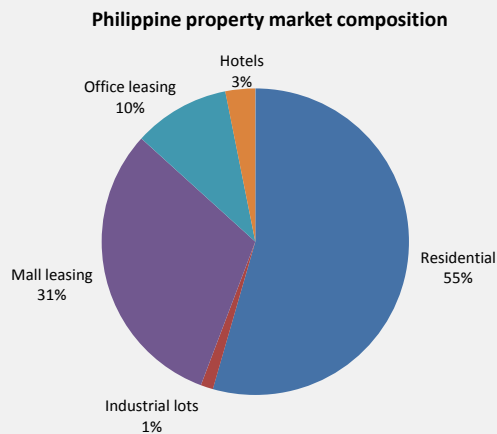
adequate revenue cover.<sup>48</sup> This practice, among others, is credited for having averted a hard landing in 2009.<sup>49</sup> In the case of office buildings, construction normally begins only after a portion of the leasable area has been pre-committed to tenants. While the pre-commitment requirement used to be 60 percent for office buildings, this has gone down to around 30 percent in recent years due to the high demand and faster turn-over time required by expanding BPO companies.

### Box 2.1. Overview of the Philippine real estate market

The Philippine real estate market comprises five main segments: i) residential (e.g., condominium units, and house and lots), ii) office spaces, iii) shopping malls, iv) hotels, and v) industrial lots. The residential segment accounts for the biggest share of total revenues at around 55 percent (equivalent to 6.4 percent of GDP).<sup>50</sup> Leasing of shopping malls and office spaces comprise another 40 percent of the property market (Box Figure 2.1).

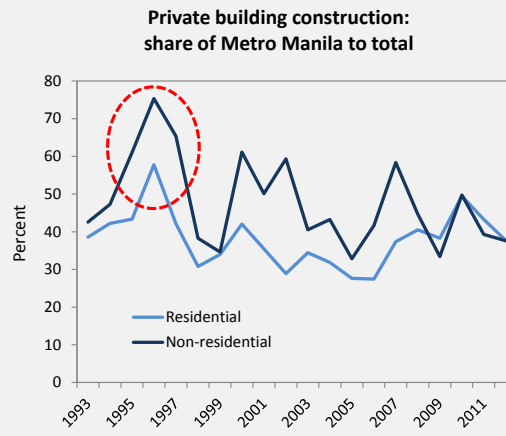
Real estate development has expanded geographically. Private building construction has become more dispersed with the development of new projects outside Metro Manila such as the Provinces of Cavite and Laguna, and Metro Cebu and Metro Davao. The concentration of construction activity in Metro Manila has gone down to 40 percent from almost 80 percent in pre-1997 and 60 percent prior to 2009 (Box Figure 2.2).

**Box Figure 2.1. The residential segment is the largest segment in the real estate industry.**



Source: Annual reports of Philippine real estate companies

**Box Figure 2.2. Construction activity has expanded outside of Metro Manila.**



Source: CEIC

<sup>48</sup> However, through pre-selling, a substantial portion of the risk is transferred from developers to buyers and not necessarily reduced.

<sup>49</sup> See Le Borgne, et. al. (2009) for more discussion.

<sup>50</sup> This is estimated as the weighted revenue shares per segment of the top five Philippine real estate companies according to market capitalization. Source: SEC 17-A reports of real estate companies.

The demand for mid-range residential properties mostly comes from residents and OFWs, and funded by savings, remittances, and stock market earnings. Buyers comprise both local end-users and investors. End-users include residents and OFWs who buy condominium units for use as “vacation houses” (i.e., the unit is used when OFWs return to the Philippines and are largely left vacant for the rest of the year). High-end/luxury properties are largely purchased for investment, with the purpose of renting out the unit to the expatriate market.

Sources: Real estate companies’ SEC 17-A reports and author’s interviews with Philippine property management and research firms, and real estate companies in December 2011, and February and April 2013.

**Notwithstanding the current strong underlying demand and improved fundamentals of Philippine real estate companies, vulnerabilities in the sector remain and may build up if key sources of risks are not managed.** First, as a substantial portion of residential buyers are OFWs, residential sales are exposed to adverse shocks to the global economy. Industry anecdotes suggest a significant number of defaults since 2009 by OFWs who are unable to pay their mortgages.<sup>51</sup>

**Second, the low interest rate environment may lead to moral hazards such as relaxing credit standards and documentary requirements for household real estate loans.** For instance, some banks have raised the loan-to-value ratio<sup>52</sup> from 70 to 80 percent (and as high as 90 percent according to industry analysts) and have waived several prudential requirements, such as proof of income, to generate more sales. This latter practice appears to be more prominent among OFWs who are unable to show proof of income, but are nevertheless granted loans if they are able to pay the 20 percent down payment. Moreover, anecdotal evidence suggests that some developers have increasingly used their balance sheets to offer in-house financing (i.e., a form of shadow banking), as opposed to bank financing.<sup>53</sup> This added exposure of developers’ balance sheets has yet to be properly recorded and monitored. Overall, the unknown magnitude of shadow banking by real estate developers with possibly weaker credit standards is not reassuring and can be a significant source of risk.

**Finally, the projected end-user demand for condominiums, especially at the mid-range to high-end, may be overstated,** especially since only about 10 percent of the total population (20

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<sup>51</sup> Balloon payments have been attributed to defaults as some buyers are unaware of large lump-sum payments required after several months of equal installment payment.

<sup>52</sup> The loan-to-value ratio refers to the portion of the total contract price of the property that can be financed by the bank. A very high loan-to-value ratio has the effect of reducing buffers against declines in property prices in the event of defaults.

<sup>53</sup> See the March 2012 issue of the Philippine Quarterly Update for more discussion on this topic.

percent in Metro Manila) is considered to be middle class and up.<sup>54</sup> According to industry observers, some firms are reported to continue building projects to preserve their market shares even if end-user demand is slowing down. If this is any indicator, some investor-buyers are having a hard time renting-out their units at prices commensurate to their investment. This is particularly true in areas with an oversupply of projects. Lower rental turnout may adversely affect investor-buyers who availed of bank or in-house financing.

**To mitigate risks, the BSP has tightened the coverage of bank exposure to real estate.** In August 2012, BSP lifted all exemptions in the computation of bank exposure to real estate and expanded them to cover funds channeled into securities of property firms.<sup>55</sup> The new BSP guidelines provide a more comprehensive measure of banks' 20 percent cap on real estate exposure. Previously excluded items which are now included in the computation are i) mortgage loans, ii) socialized and low cost housing loans, iii) loans guaranteed by the Home Guarantee Corporation (HGC),<sup>56</sup> and iv) investments in debt and equity securities issued by real estate companies. Moreover, banks are now also required to provide additional details on their exposure to the real estate sector such as i) investments in debt and equity securities that will be used to fund property developments, as well as, loans extended to property developers, and ii) ancillary services relating to the construction and development of real estate projects such as buying, selling, renting, and managing real estate properties.

**In conclusion, the Philippine real estate sector is currently enjoying high rates of growth, driven by low interest rates, robust OFW remittances, and the fast-growing BPO sector.** It also benefits from improved bank and real estate sector fundamentals as a result of past and ongoing reforms. The conservative and pre-emptive stance of the BSP and major market players, which continues today, have helped to put in place buffers against major shocks. Overall, the sector remains in good health, thanks to measures initiated by both the private sector and the government to address past issues.

**However, the sources of growth can also become the sources of risk.** A real estate sector driven by OFW sales and BPO leasing is vulnerable to shocks in the global economy. The low interest rate regime is also a source of risk. As lenders and developers compete for higher yields, lending requirements may be relaxed beyond prudent levels.

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<sup>54</sup> According to the 2009 Family Income and Expenditure Survey, only 10 percent of households have disposable active income of at least PHP 30,000. These households are considered middle class and up. In Metro Manila, around 20 percent of households are considered to be middle class. If 10 percent of them are prospective end-user buyers, this leads to a projected demand of around 50,000 units, which is much less than the pipeline supply.

<sup>55</sup> BSP's Memorandum No. M-2012-046 on "Expanded Report on Real Estate Exposures" issued on 21 September 2012 supplements the regulatory framework governing bank real estate loans under Circular No. 600 dated 4 February 2008. Source: <http://www.bsp.gov.ph/regulations/regulations.asp?id=3002>.

<sup>56</sup> HGC is a government owned and controlled corporation which supports homeownership among Filipinos by encouraging banks and financial institutions to lend to individual home buyers and housing developers. It assures lenders and investors in housing by issuing loan and security guarantees. (Source: [www.hgc.gov.ph](http://www.hgc.gov.ph))

**Going forward, vigilance is needed, especially in areas where risks are relatively high.** More transparency is needed in the disclosure of defaults and the reporting of in-house financing and other forms of shadow financing of real estate developers, especially smaller developers. This can be achieved by enhancing cooperation between the government and the real estate industry for more transparent, timely, and accurate market information on the health of the real estate sector.

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## SPECIAL FOCUS 3

### The Comprehensive Tax Reform Program of 1986 and related tax administrative reforms

**The Comprehensive Tax Reform Program (CTRP) of 1986 and related tax administrative reforms under the Administration of Corazon Aquino, and continued under the Ramos Administration, was a crucial reform** that was largely responsible for bringing back macroeconomic stability after the 1983-85 debt crisis.

**In 1986, after the fall of the Marcos dictatorship, the newly inaugurated Aquino Administration launched a comprehensive tax reform program to fix its fiscal house.** The reform was necessary given the fall in tax effort from 11.5 percent of GDP in 1979 to 9.7 percent of GDP in 1986 and the increase in the consolidated public sector deficit to above 4.5 percent of GDP.<sup>57</sup> More importantly, the debt crisis had shut out the Philippines from the international credit market and left the new government with no recourse but to embark on a full reform of its tax system to gain legitimacy and access to concessional finance.

**The reform covered a large area of the tax system.** Among the salient features of the reform were i) the shift from the dual tax schedule system (one for compensation earners and another for businesses and professionals) to a unified schedule for personal income taxation, ii) the introduction of ceilings on allowable deductions (which unfortunately was not implemented due to strong lobby from various professional groups), iii) a shift from the dual rate system of 25 and 35 percent applicable to corporations to a single rate of 35 percent, and iv) the introduction of the value-added tax (VAT).<sup>58</sup> These sweeping tax policy reforms were enacted through executive orders (EOs) thanks to the fact that during this “revolutionary” period, Congress had not been reconstituted and the President enjoyed the power to issue EOs with full force of legislation.

**Several administrative reforms followed to enable the Bureau of Internal Revenue (BIR) to implement the new policies and to prepare it for eventual modernization.** In 1987, the Department of Finance and its attached agencies including the BIR were reorganized under EO 127. The restructuring aimed to make the BIR organization more responsive to the new tax system, improve taxpayer service, and increase its efficiency. Tax collection was enhanced via a credible one-time amnesty covering the years 1981-85 (when compliance was the weakest), which resulted in PHP 1 billion (0.15 percent of GDP) in additional tax collection in 1986, and improvements in arrears management, which raised an additional PHP 4.2 billion (0.56 percent of GDP) in 1987. Lower perception of corruption (relative to the martial law years) helped

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<sup>57</sup> The ratios to GDP in this special focus use the revised and rebased (2000 base year) GDP series.

<sup>58</sup> The VAT replaced the previous sales tax system where differentiated rates were imposed on the original sale of goods and a turnover tax of 1.5 percent was imposed on subsequent sales. All in all, the VAT replaced 66 various types of sales taxes. The Philippines adopted a VAT based on the consumption and destination principle with three effective rates: 10 percent, exempt, and zero-rated (primarily for exporters) (Diokno 2005).

increase tax compliance and trust in the government. Moreover, in the succeeding years the bureau rationalized its audit process, significantly expanded the withholding tax system, and moved towards in-house computerization. Resistance was limited as the reforms did not directly curtail discretion and power of tax officials. Tax officials were also incentivized by higher salaries.<sup>59</sup>

**The revenue impact of the reform was significant.** These reforms, together with the improving economic environment and higher growth in the mid-1990s owing to structural reforms, resulted in an unprecedented growth in internal revenue tax effort from 6.9 percent of GDP in 1986 to 8.9 percent of GDP in 1992 and later to a historic high of 11.7 percent of GDP in 1997. And despite falling revenues from the Bureau of Customs due to trade liberalization, total tax effort reached 15.3 percent of GDP in 1997—the highest in history. This feat was accomplished through the concerted effort to improve both tax policy and tax administration in a coherent manner.

**General tax compliance also improved.** The number of tax filers doubled between 1986 and 1992 and continued to increase between 1992 and 1997 with the implementation of the new tax identification number (TIN). Public perception of corruption also improved, although there is little evidence to show that the severity of corruption declined, given the lack of efforts by the government to reduce corruption in the bureaucracy during this period.

**President Corazon Aquino fully supported the reform and a well-coordinated and competent economic team crafted the policies with little political and business interferences.** In tax administration, reform efforts, riding on the initial high credibility of the new government and public perception of improving governance, were successful due to a number of reasons such as continuity of leadership at the BIR and the appointment of competent outsiders to head the bureau.

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<sup>59</sup> To incentivize the BIR to collect during 1984-85 recession, President Marcos granted all BIR personnel a package of benefits and incentives and created a career system in the BIR (EO 1042). In particular, the BIR salary scale was upgraded to levels comparable to government financial institutions (this largely removed the inequity in the salary scale relative to other DOF agencies), resulting in an almost doubling of salaries. This salary advantage, however, was removed with the passage of the Salary Standardization Law in 1988.

## SPECIAL FOCUS 4

### Impact evaluation of the conditional cash transfer program

*This special focus section publishes the executive summary of the report “Philippines: conditional cash transfer program impact evaluation 2012.”<sup>60</sup>*

**The *Pantawid Pamilyang Pilipino Program (4Ps)* [henceforth called *Pantawid Pamilya*] provides cash transfers to poor households, conditional upon investments in child education and health, as well as use of maternal health services.** The objective of the program is to promote investments in the education and health of children to help break the intergenerational transmission of poverty, while providing immediate financial support to the household. Poor households are identified by the National Household Targeting System for Poverty Reduction (NHTS-PR) based on a transparent poverty targeting mechanism, using a statistical model known as the proxy means test to estimate income. Households with estimated income below the poverty line are classified as poor. From that database of poor households, *Pantawid Pamilya* identifies and selects eligible households who have children 0-14 years of age and/or a pregnant woman. These households then receive cash grants every two months ranging from PHP 500 to 1,400 per household per month, depending on the number of eligible children.

**Since its launch in 2008, *Pantawid Pamilya* has been scaled up rapidly and has become the cornerstone of the government’s social protection efforts.** This conditional cash transfer (CCT) program has been an important part of a renewed effort to address chronic poverty and meet the Millennium Development Goals (MDGs) to eradicate extreme poverty and hunger, achieve universal primary education, promote gender equality, reduce child mortality, and improve maternal health (DSWD 2009). By May 2012, the program covered approximately three million households. It accounted for about half of the national government’s expenditures on social protection programs in 2011.

**The specific objectives of the program are to:** i) keep children in school, ii) keep children healthy, and iii) invest in the future of children. It reflects the government’s commitment to promote inclusive growth by investing in human capital to improve education and health outcomes for poor children and pregnant women. The program is based on the premise that poverty is not about income alone but is multi-dimensional, and factors such as access to basic social services and social environments matter.

**A carefully designed, comprehensive, and rigorous impact evaluation was conducted, as the first of a three-wave evaluation study to assess the program’s initial effectiveness in**

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<sup>60</sup> The full report can be accessed at <http://documents.worldbank.org/curated/en/2013/01/17389714/philippines-conditional-cash-transfer-program-impact-evaluation-2012>.

**achieving its objectives.** As part of the government's commitment to evaluating its development programs, an impact evaluation for *Pantawid Pamilya* was designed and implemented during the very initial stages of program planning. The study was designed to represent the first implementation phase (known as Set 1 which took place between June 2008 and April 2009) of the program, since the program's scale-up plan was not yet in place at the time of study design.

**The report presents the findings from an analysis that assessed program impact by comparing outcomes in areas that received *Pantawid Pamilya* with outcomes in areas that did not receive the program.** The impact evaluation applied two analytical methods: i) randomized control trial (RCT), which compared randomly assigned program areas and non-program areas to assess program impact, and ii) regression discontinuity design, which compared the outcomes of poor households who received the program with similar poor households just above the poverty line. This report presents the findings from the RCT component only. It should be noted that although 2.5 years of program implementation is generally considered enough time to observe impacts on short-term outcomes, it is not long enough to assess impacts on long-term outcome measures.

**The findings of the impact evaluation support administrative and other assessments<sup>61</sup> that have found *Pantawid Pamilya* is reaching most of its key objectives.** The impacts found in the study are comparable to the levels of impact found in other CCT programs around the world at this stage of program maturity, particularly in terms of the program's achievements in improved health service use and school enrollment.

**Findings of the study indicate that, overall, the program is meeting its objective of helping to keep poor children in school,** by increasing enrollment among younger children (3-11 years old) and increasing attendance among 6-17 year olds. The study found higher rates of school enrollment among children 3-11 years old in the beneficiary households (by 10 ppt for 3-5 years old and by 4.5 ppt for 6-11 years old), compared to poor households who did not receive the program. In particular, the program has been successful in boosting the enrollment of primary-aged children (6-11 years old), helping to bring about near universal enrollment of 98 percent among this age group. Considering that this study group only includes poor children, this achievement is highly commendable. School attendance improved for all age groups across the beneficiary households, except for the youngest preschool/daycare age group.

**However, the findings suggest that the program has not had a significant impact on increasing enrollment among older children aged 12-17 years old.** The program was not explicitly designed to improve schooling of children above age 14, the age limit for education grants. However, the program was unable to even improve enrollment rate of children 12-14 years of age, who are currently covered under *Pantawid Pamilya*. Thus, the program as currently

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<sup>61</sup> Studies include those that looked at program impact on education by Chaudhury and Okamura (2012) and Manasan (2011).

designed is unable to keep older children in school. This implies that the program should consider expanding coverage to older children, and also reconsider the current five-year limit of program eligibility, if long term human capital investments are to be sustained.

**The program was found to be meeting its objective of helping to keep poor children healthy.**

The program has helped to improve the long-term nutritional status of younger children (6-36 months old), a positive impact not seen in other CCT impact evaluations at such an early stage of program implementation. The improvement was a 10 ppt reduction in severe stunting<sup>62</sup> compared to barangays that did not receive the program, where 24 percent of young children (6-36 months old) were severely stunted. This improved long-term nutritional status was achieved through the program, enabling parents to provide better care for their children in a consistent manner and feed their children more protein-rich food such as eggs and fish. Reduction in severe stunting among this young age group is expected to have strong long-term benefits, as stunting in the first two years of life is known to lead to irreversible damage including lower educational attainment, reduced adult income, and decreased offspring birth weight (Victora 2008). The program has also encouraged poor women to use maternal and child health services such as antenatal care, postnatal care, regular growth monitoring, and receipt of Vitamin A and deworming pills. In addition, it has helped increase healthcare-seeking behaviors among beneficiaries when their children become ill.

**The program is also achieving its objective of enabling poor households to increase their investments in meeting the health and education needs of their children.** *Pantawid Pamilya* is changing the spending patterns of poor households, with beneficiary households spending more on health and education than poor households who had not received the program. The study also found that beneficiary households spent less on adult goods such as alcoholic beverages and that the program may have contributed to increased savings among beneficiary households.

**Although the study found that the cash grants were reaching beneficiaries, the study did not find an overall increase in per capita consumption among the poor benefiting from the program,** although there was some evidence that poor households are saving more in certain provinces. The lack of impact on mean consumption is not unusual for CCT programs at a relatively early stage of implementation with programs finding impact on mean consumption as the program matures. The estimated per capita consumption per day reported by the sampled households was PHP 46 per day in both program and non-program barangays, while program beneficiaries in the study reported receiving PHP 5 per day (equivalent to USD 0.11 a day)<sup>63</sup>, representing approximately 11 percent of the households' per capita consumption. Internationally, the largest transfer amount was in Nicaragua with the transfer representing

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<sup>62</sup> Measured as height-for-age <-3SD applying the WHO Child Growth Standard

Source: <http://www.who.int/childgrowth/software/en/>, accessed March 9, 2012

<sup>63</sup> The reported amounts received from *Pantawid Pamilya* by beneficiary households are approximately the same as those reported by the program's operational process evaluation called Spot Checks (Social Weather Stations 2012).

about 30 percent of consumption, Mexico about 20 percent of consumption, and Brazil about 8 percent of consumption (Fiszbein et. al. 2009). Therefore, there is a wide gap between the benefit amounts beneficiaries are eligible for—an estimated 23 percent of income, which is relatively generous—and the amounts that beneficiary households actually receive, which are relatively small compared to those in most other CCT programs around the world. This gap could be minimized by working on three areas: i) improving beneficiaries' compliance rates to program conditionalities, ii) regularly updating the program database to better reflect beneficiaries' attendance in schools and health facilities to effectively link meeting of conditionalities to payments, and iii) ensuring that all schools and health facilities report on compliance verification to the program.

**The study also found that *Pantawid Pamilya* has had positive impacts beyond its originally targeted objectives.** For example, the program has contributed to increased coverage of the PhilHealth health insurance program. More poor households in areas that received *Pantawid Pamilya* reported that they were covered by PhilHealth, compared to their counterparts in non-*Pantawid* areas.

**The findings of the impact evaluation also indicate that the program has not affected fertility rates or decisions to work.** Despite the additional household income provided to poor families under *Pantawid Pamilya*, the impact evaluation did not find any evidence that beneficiary households worked less or made less effort to obtain more work. The study also found that women in the beneficiary households are not having any more children than women in non-beneficiary households.

**Although the sampling was not designed to be statistically representative at the provincial level, the findings suggest that program impacts differ by province.** The study found considerable differences in program impact on household socioeconomic, child health, and education outcomes across the four provinces. Across most outcomes, Negros Oriental consistently showed the most positive and strongest program impacts, while Lanao del Norte consistently showed weaker impacts than other provinces. Although there are several potential reasons for such differences, such as effectiveness in program implementation, supply-side differences, and other socio-environmental factors, further research is needed to better understand the reasons behind these differences.

**Although the impact evaluation found evidence of success on a broad range of outcomes, the results also revealed a number of challenges for *Pantawid Pamilya* going forward.** *Pantawid Pamilya* is designed primarily to increase demand among poor families for education and health services. To achieve overall improvements in education and health outcomes, however, the study findings highlight the need to intensify efforts to improve access to and quality of health and education services for CCT beneficiaries. For example, although more children are visiting health centers to meet the program conditionality of regular growth monitoring, the study did not find an increase in childhood immunization coverage—although not uncommon in impact evaluations around the world—which suggests that health providers are not yet able to fully capitalize on the opportunities to provide basic child health services to CCT families.

### **The study findings point to a number of policy implications:**

- To improve educational outcomes for older children, additional measures such as expanding the age of coverage of *Pantawid Pamilya*, increasing the grant amount for older children, and parallel supply-side interventions in the education sector are required.
- Currently, households can be enrolled in the program for a maximum of five years. Expanding the duration of coverage will not only help to keep children in school longer, it will also help to increase household consumption.
- Linkages and coordination with health service providers need to be strengthened to ensure that beneficiary mothers and children receive the services they require and to ensure a continuum of care.
- It is important to consider ways in which other social programs that may have a long-term impact on the welfare of the poor could take advantage of *Pantawid Pamilya's* strong and effective social mobilization structure.
- To ensure more efficient program implementation, the reasons for differences in program impact across geographical areas must be better identified and understood.

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## SPECIAL FOCUS 5

### Procurement modernization strategy: an update

**Since the enactment in 2003 of the Government Procurement Reform Act (GPRA), significant improvements have been recorded in the public procurement system** and the current administration is leveraging procurement policy strategically to support the quality of public expenditures and service delivery, while also enhancing transparency and accountability. This progress is discussed in the 2012 Country Procurement Assessment Report (CPAR), which includes an action plan to continue moving the reform agenda forward.<sup>64</sup> Implementation of this action plan is closely monitored and supported by the Philippine Development Forum's working group on procurement, a multi-stakeholder group chaired by the government Procurement Policy Board (GPPB) and co-chaired by the World Bank. Other members include the heads of key national government agencies, civil society organizations (CSOs), private sector, and other development partners. The Bank has been working closely with the government for the past several years, providing advisory and knowledge services as well as financial support to all key reform actions.

**Results to date include a sound regulatory framework and enhanced management capacity, including a compliance and performance measurement framework for the procuring entities, and a roadmap for professionalization of the procurement function.** Performance indicators in the last two years are positive in terms of use of open bidding by the agencies, coordination with the budget process, bidders' participation, and overall efficiency. In the area of transparency, CSOs were invited as observers in 93 percent of bidding events, although they chose to participate in only 35 percent of such events.

**A modern, fully transactional government e-procurement system (called Philippine Government Electronic Procurement System or PhilGEPS) is being implemented with five components already operational.** These are the e-bulletin board, e-catalogue of prices, subscribers' registry, virtual store, and e-payment. The last component, the electronic submission of bids, is currently being tested in two pilot agencies. Ninety three percent of all procuring entities use PhilGEPS, a 22 percent increase since 2008, with 94 percent of procurement opportunities being advertised. Registered prospective bidders numbered around 58,000, up from 33,000 in 2008, a 74 percent increase. PhilGEPS has made major contributions in improving the efficiency and transparency of the procurement system, resulting in major savings in terms of lower bid prices and reduced administrative costs.

**The Philippine Government has been engaging effectively with CSOs for several years and is currently looking at new ways to help further strengthen their monitoring and advocacy role.**

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<sup>64</sup> The 2012 CPAR, a joint document of the government, Asian Development Bank, Japan International Cooperation Agency, and the World Bank, will be published around July 2013.

Innovations are being introduced to facilitate this role, such as the use of modern technology in contract supervision. For example, geo-tagging allows citizens to provide quick feedback using emails, SMS, Facebook, or Twitter accounts. In addition, procurement audit by both internal and external auditors has been improved, and procurement is included as one of the areas of focus of the Integrity Development Programs, a joint undertaking of the Discipline Office of the Office of the President and the Corruption Prevention Unit of the Office of the Ombudsman.

**The World Bank continues to support the implementation of the government’s procurement reform program to help build trust in the government through strong and accountable stewardship of public resources.** It will also increase the use of country system in a variety of ways including, for example, relying more on oversight agencies for procurement supervision, increasing the threshold for national competitive bidding (NCB) using the agreed harmonized documents, and relying on PhilGEPS, including its “virtual store” (equivalent to a framework contracts<sup>65</sup>) in lieu of shopping and NCB. Thresholds for NCB have already been raised to USD 15 million for works (from USD 3 million) and USD 3 million for goods (from USD 1 million) with no prior review, except for the first contract in each project. The threshold for shortlists comprising only of national consulting firms was also raised from USD 200,000 to USD 500,000.

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<sup>65</sup> Framework contracts are long term agreements with suppliers, contractors, and providers of non-consulting services, which set out terms and conditions under which a specific procurement can be made.

## DATA APPENDIX

**Table A.1. Key economic indicators, 2010 to 2014**

	2010	2011	2012	2013	2014
	Actual	Actual	Actual	Projection	
<b>Growth and inflation</b>	(in percent of GDP, unless otherwise indicated)				
Gross domestic product (percent change)	7.6	3.9	6.6	6.2	6.4
Inflation (period average)	3.8	4.6	3.2	4.0	4.0
<b>Savings and investment</b>					
Gross national savings	24.8	24.9	22.3	23.5	25.0
Gross domestic investment	20.5	21.8	19.4	21.5	23.0
<b>Public sector</b>					
National government balance (GFS basis) <sup>1</sup>	-3.6	-2.1	-2.4	-2.3	-2.2
National government balance (Gov't definition)	-3.5	-2.0	-2.3	-2.2	-2.1
Total revenue (Gov't definition)	13.4	14.0	14.5	15.2	15.7
Tax revenue	12.1	12.3	12.9	13.5	14.0
Total spending (Gov't definition)	16.9	16.1	16.8	17.4	17.8
National government debt	52.4	50.9	51.4 <sup>2</sup>	50.0	48.0
<b>Balance of payments<sup>3</sup></b>					
Merchandise exports (percent change)	34.9	-6.3	8.5	7.0	9.0
Merchandise imports (percent change)	32.9	2.4	5.1	7.0	10.5
Remittances (percent change of USD remittance)	8.2	7.2	6.3	5.0	5.0
Current account balance	4.5	3.2	2.9	2.0	2.0
Foreign direct investment (billions of dollars)	1.3	1.9	2.0	3.5	5.0
Portfolio investment (billions of dollars)	7.2	4.1	4.7	4.0	3.0
<b>International reserves</b>					
Gross official reserves (billions of dollars) <sup>4</sup>	62.4	75.3	83.8	90.0	95.0
Gross official reserves (months of imports)	9.6	11.1	11.9	11.2	10.6
<b>External debt<sup>5</sup></b>	36.3	34.8	33.0 <sup>2</sup>	31.5	30.0

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

Notes:

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

2 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.

3 Using BPM5

4 Includes gold

5 Worldbank 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), 2008-12**

	2008	2009	2010	2011	2012	
					Actual <sup>1</sup>	Programmed
	(in percent of GDP, unless otherwise stated)					
Revenue and grant	15.2	14.0	13.4	14.0	14.5	14.2
Tax revenue	13.6	12.2	12.1	12.3	12.9	13.1
Net income and profits	6.2	5.2	5.4	5.9	NA	5.9
Excise tax	0.8	0.7	0.7	0.7	NA	0.6
Sales taxes and licenses	2.3	2.7	2.4	2.4	NA	2.7
Others	0.8	0.6	0.7	0.7	NA	0.6
Collection from Customs	3.4	3.1	2.9	2.7	2.3	3.3
Nontax revenue <sup>2</sup>	1.6	1.7	1.3	1.6	1.6	1.1
Grant	0.0	0.00	0.0	0.0	0.0	0.0
Total expenditure	16.7	17.9	17.0	16.1	16.9	16.9
Current expenditures	13.6	14.3	13.8	13.3	13.6	13.4
Personnel services	4.9	5.2	5.2	5.1	5.1	5.4
MOOE	1.8	2.1	2.0	2.1	2.4	2.4
Allotment to LGUs <sup>3</sup>	2.2	2.5	2.4	2.4	1.9	2.0
Subsidies	0.2	0.2	0.2	0.5	0.5	0.2
Tax expenditures	0.8	0.6	0.5	0.3	0.5	0.3
Interest payment	3.7	3.7	3.4	3.0	3.1	3.1
Capital outlays	2.9	3.4	3.1	2.6	3.2	3.3
Net lending	0.2	0.2	0.1	0.2	0.3	0.2
Balance (GFS definition)	-1.5	-3.9	-3.6	-2.1	-2.4	-2.8
Balance (GOP definition)	-0.9	-3.7	-3.5	-2.0	-2.3	-2.7
Primary Balance (GFS)	2.2	-0.3	-0.2	0.8	0.7	0.4
<i>Memorandum items</i>						
Privatization receipts (PHP billions)	31.3	1.4	0.9	0.9	0.0	2.0
CB-BOL interest payments (percent of GI)	0.2	0.2	0.1	0.1	0.1	0.1
Nominal GDP (PHP trillion)	7.7	8.0	9.0	9.7	10.6	11.0

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

1 Data for December 2012 is not yet available.

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.

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