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Philippines Economic Update
JUNE 2022 EDITION
**Strengthening the
Digital Economy to Boost
Domestic Recovery**

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Preface

The Philippines Economic Update (PEU) summarizes key economic and social developments, important policy changes, and the evolution of external conditions over the past six months. It also presents findings from recent World Bank analyses, situating them in the context of the country's long-term development trends and assessing their implications for the country's medium-term economic outlook. The update covers issues ranging from macroeconomic management and financial-market dynamics to the complex challenges of poverty reduction and social development. It is intended to serve the needs of a wide audience, including policymakers, business leaders, private firms and investors, and analysts and professionals engaged in the social and economic development of the Philippines.

The PEU is a biannual publication of the World Bank's Macroeconomics, Trade, and Investment (MTI) Global Practice (GP), prepared in partnership with the Finance, Competitiveness and Innovation (FCI); Poverty and Equity; Social Protection and Jobs (SPJ); and Governance Global Practices. Lars Christian Moller (Practice Manager for the MTI GP), Souleymane Coulibaly (Lead Economist and Program Leader), and Rong Qian (Senior Economist) guided the preparation of this edition. The team consisted of Kevin Chua (Senior Economist), Kevin Cruz (Economist), Karen Lazaro (Research Analyst), Eduard Santos and Ludigil Garces (Consultants) from the MTI GP; Isaku Endo (Senior Financial Sector Specialist), Uzma Khalil (Senior Financial Sector Specialist) and Ou Nie (Financial Sector Specialist) from the FCI GP; Nadia Belghith (Senior Economist) and Karl Jandoc (Consultant) from the Poverty & Equity GP; Yoonyoung Cho (Senior Economist), Ruth Rodriguez (Social Protection Specialist) and Ma. Laarni Revilla (Consultant) from the SPJ GP; Lesley Jeanne Cordero (Senior Disaster Risk Management Specialist) and Marilyn Martinez (Senior Disaster Risk Management Specialist) from the Urban, Resilience & Land GP; and Reem Hafez (Senior Economist), Melissa Ouellet (Consultant), Gandham Ramana (Consultant), and Vida Gomez (Consultant) from the Health, Nutrition & Population GP. A World Bank team from the MTI, FCI, SPJ, Digital Development, ID4D, and Education GPs, consisting of Jaime Frias, Kevin Chua, Roberto Galang, Uzma Khalil, Isaku Endo, Natasha Beschorner, Jonathan Marskell, Yoonyoung Cho, Sachiko Kataoka, Elena Gasol Ramos, Juni Zhu, Philip Grinsted, Kimberly Baltao-Chanda, Smita Kuriakose, Xavier Cirera and Alvaro Gonzalez prepared the Special Focus Note on Improving digital enablers in the Philippines: bridging the digital divide and accelerating recovery through reforms, under the guidance of Cecile Thioro Niang (Practice Manager) and Lars Moller. The report was edited by Oscar Parlbäck (Consultant), and the graphic designer was Pol Villanueva (Consultant). Peer reviewers were Dorsati Madani (Senior Economist), Ekaterina Vashakmadze (Senior Economist), Harish Natarajan (Lead Financial Sector Specialist), Sara Nyman (Consultant), Ana Cusolito (Senior Economist) and Massimiliano Cali (Senior Economist). Logistics and publication support were provided by Geraldine Asi and Kristiana Rosario (Team Assistant), and Hunter Tiro (Consultant). The External Communications Team, consisting of Clarissa David, David Llorito and Stephanie Margallo, and Moira Enerva (Consultant) prepared the media release, dissemination plan, and web-based multimedia presentation.

The team would like to thank Ndiame Diop (Country Director for Brunei, Malaysia, Philippines, and Thailand) for his advice and support. The report benefited from the recommendations and feedback of various stakeholders in the World Bank as well as from the government, the business community, labor associations, academic institutions, and civil society. The team is grateful for their contributions and perspectives. The findings, interpretations, and conclusions expressed in the PEU are those of the authors and do not necessarily reflect the views of the World Bank's executive board or any national government.

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

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Abbreviations and acronyms

4Ps	Pantawid Pamilyang Pilipino Program	FIES	Family Income and Expenditure Survey
AICS	Assistance to Individuals in Crisis Situations	G2P	Government-to-person
ASBP	Abuse of Superior Bargaining Position	GSMA	Global system for mobile communications association
ASEAN	Association of Southeast Asian Nations	GVCs	Global value chains
BARMM	Bangsamoro Autonomous Region in Muslim Mindanao	HEI	Higher educational institution
BIR	Bureau of Internal Revenue	ICT	Information, Communication, and Technology
BOP	Balance of payments	IT-BPM	Information technology - business process management
BPM	Business Process Management	KYC	Know Your Customer
BPO	Business process outsourcing	LFPR	Labor force participation rate
BPS	Basis points	LFS	Labor Force Survey
BSP	Bangko Sentral ng Pilipinas	LGUs	Local government units
BTr	Bureau of the Treasury	LICs	Low income countries
CAs	Certification authorities	MSMEs	Micro, small and medium enterprises
CHED	Commission on Higher Education	NCR	National Capital Region
COA	Commission on Audit	NICTHS	National ICT Household Survey
CPI	Consumer Price Index	NPL	Non-performing loans
CREATE	Corporate Recovery and Tax Incentives for Enterprises	NTC	National Telecommunications Commission
CRM	Customer Relationship Management	ODR	Online Dispute Resolution
DA	Department of Agriculture	PhilSys	Philippine Identification System
DFS	Digital financial services	PMI	Purchasing Managers' Index
DICT	Department of Information and Communications	PQF	Philippine Qualifications Framework
DOH	Department of Health	PSA	Philippine Statistics Authority
DOLE	Department of Labor and Employment	SAP	Social amelioration program
DPA	Data Privacy Act	SEC	Securities and Exchange Commission
DSWD	Department of Social Welfare and Development	SME	Small and Medium Enterprises
DTI	Department of Trade and Industry	TESDA	Technical Education and Skills Development Authority
EAP	East Asia and Pacific	TOP	TESDA Online Program
EMDEs	Emerging market and developing economies	TRAIN	Tax Reform for Acceleration and Inclusion
ERP	Enterprise Resource Planning	TVET	Technical and Vocational Education and Training
EU	European Union	VAT	Value-added tax
FCP	Financial Consumer Protection and Services Act		

Executive Summary

Recent Developments

The external environment has turned less favorable at a time when the Philippines has weathered the worst so far of the COVID-19 pandemic. Three international developments are placing significant pressure on the economy. First, the war in Ukraine is disrupting food and fuel supplies, raising market volatility, and undermining global confidence. While the Philippines has limited direct exposure through trade or financial flows, the conflict and sanctions affect it in terms of higher energy and food prices. Second, rising global inflation is inducing policy rate hikes in advanced economies and emerging market and developing economies (EMDEs). Tightening financing conditions are dampening global and domestic investment prospects. Finally, China's structural slowdown and regulatory response to COVID-19 are disrupting global trade and exacerbating the global growth deceleration. China's slowdown adversely impacts the Philippines, as its trade is increasingly oriented toward Chinese markets.

The Philippines demonstrated strong growth in the first quarter of 2022, but the recovery is uneven across sectors. The economy rebounded from a contraction of 3.8 percent in Q1 2021 to an expansion of 8.3 percent in Q1 2022. On a seasonally adjusted basis, first quarter output breached its pre-pandemic level, exceeding Q4 2019 output by 0.3 percent. Growth was driven by the expansion in services and industry and a recovery in private domestic demand, and partly lifted by base effects. The contact-intensive services sector benefitted from the relaxation of movement and capacity restrictions, while manufacturing activity was supported by still robust global demand. However, the agriculture sector performed tepidly as output was impacted by several typhoons. While most sectors have caught up to their pre-pandemic levels, some sectors such as accommodation and food services, real estate services, and transport and storage have yet to return to their pre-pandemic output levels in 2019. This is indicative that the recovery has been uneven across sectors. Meanwhile, domestic demand picked up along with people's mobility. Private consumption was buoyed by steady improvement in the labor market and the relaxation of movement restrictions beginning in February. Public consumption growth slowed as the government gradually withdrew its fiscal support. Meanwhile, higher investments in durable equipment and construction activities drove growth in capital formation. However, net exports weakened as import growth outpaced export growth.

Headline inflation jumped in March and April 2022 as the war in Ukraine pushed global energy and commodity prices to record highs. After steadily declining since August 2021, headline inflation rose to an average of 4.4 percent in March and April, up from 3.0 percent in January and February. The shock of the war in Ukraine pushed global energy and commodity prices to record highs, spilling over to domestic inflation. Inflation related to housing, water, and electricity prices increased from an average of 4.7 percent in January-February to 6.6 percent in March-April, while transportation inflation rose from 7.9 percent to 11.7 percent in the same period. In response, the government approved a total of 0.4 percent of GDP in fuel grants and cash transfers to cushion the impact of rising oil prices. Excluding volatile food and energy items, the core inflation rate is estimated to have risen from 2.1 percent in January to 2.8 percent in April 2022, indicating rising underlying price pressure. The Bangko Sentral ng Pilipinas (BSP) raised the policy rate by 25 basis points (bps) to 2.25 percent in May to prevent further second-round effects and buildup of inflation expectations.

The fiscal deficit narrowed in the first quarter of 2022. The unwinding of COVID-19-related fiscal support and the base effect from a one-time equity infusion to government financial institutions in the first quarter of 2021 resulted in slower growth of public expenditures in the first quarter of 2022. Public revenues were maintained at 15.9 percent of GDP, the same ratio as in the first quarter of last year. This reduced the fiscal deficit to 6.4 percent of GDP in the first quarter of 2022, down from 7.4 percent in the same period a year ago. Nevertheless, the deficit contributed to higher financing needs, which in turn increased central government debt from 60.4 percent at end-2021 to 63.5 percent in the first quarter of 2022.

The labor market continued to recover with increased labor force participation and accelerated job creation. The labor force participation rate rose to 65.4 percent in March 2022, surpassing the pre-pandemic level of 61.7 percent in January 2020. The increasing trend has occurred amid intermittent declines associated with the reimposition of community quarantines in July 2021 and emergency measures in response to the onslaught of Typhoon Odette and the emergence of the COVID-19 Omicron variant in January 2022. Notwithstanding the increasing number of workers in the labor force, the unemployment rate continues a decreasing trend, indicating that the labor market is creating jobs and absorbing more workers. The unemployment rate registered at 5.8 percent in March 2022,

down from 7.1 percent in the same month in 2021. Meanwhile, the underemployment rate, which has fluctuated widely during the pandemic, rose again to 15.8 percent in March 2022, reversing the downward trend since November 2021.

Outlook and Risks

The country's strong domestic conditions will help compensate for the weak external environment.

Growth is expected to benefit from an improving domestic environment, characterized by declining COVID-19 cases, more vigorous public mobility, and wider economic reopening. New daily COVID-19 cases dropped from a peak of nearly 40,000 in mid-January to less than 200 in mid-May, prompting the authorities to further ease mobility restrictions across the country. The easing of restrictions ensued amid increased vaccine coverage and a short-lived Omicron wave, which kept the country's hospital and critical care capacities below precarious levels. People's mobility has returned to pre-pandemic levels across different activities including for work and recreation. The return of robust domestic activity is expected to buoy growth at a time of weak external environment, reeling from a global growth deceleration, rising inflation, and geopolitical turmoil.

The growth outlook is positive but subject to downside risks. The Philippines is projected to grow at 5.7 percent in 2022 and 5.6 percent, on average, in 2023-24, in line with its lower, long-term potential rate. Growth will anchor on recovering domestic demand and sustained public investments amid an anticipated recovery among EMDEs next year. The reopening will benefit the services sector, especially transportation, restaurant and food services, and wholesale and retail trade. Tourism prospects have improved with the reopening of borders and attractions and relaxed travel requirements. Sustained public investments and reinvigorated domestic activities will likely raise the demand for construction and industry. Growth in the agriculture sector will remain tepid due to chronic underinvestment and vulnerability to weather-related shocks. The outlook faces downside risks from geopolitical uncertainty, abrupt tightening of global financing conditions, and growth deceleration of main trading partners like the United States and China. While the number of COVID-19 cases has been low for a long period, the threat of a new variant-driven surge hangs over the outlook.

The authorities must continue to use its available policy tools to tame inflation, some immediately and others later as needed. The source of inflationary pressure includes: (i) elevated global commodity and energy prices; (ii) global supply constraints driven by weak global agricultural output, exports ban by key commodity exporters, and the war in Ukraine; (iii) international supply chain and logistics

disruptions; (iv) currency depreciation; and (v) recovering local demand. High inflation will dampen household consumption, which is expected to rebound with the lifting of mobility restrictions. It can also induce rate tightening, which will increase the cost of borrowing. The authorities must use their available policy tools to tame inflation, some immediately and others later as needed. These tools include supply-side measures such as freer importation and lower tariffs and non-tariff barriers to help augment domestic supplies as needed; support to agricultural production through extension services, seeds, and fertilizers; and monetary tools to prevent a de-anchoring of inflation expectations.

Pursuing fiscal consolidation will help protect long-term fiscal sustainability. The authorities must, however, carefully manage the risks and trade-offs associated with consolidation. Increased taxation or a reduction of public spending will hold back economic activity in the short to medium term due to the reduction in aggregate demand. However, improved macro management will help safeguard long-term growth. To exercise fiscal discipline means that public revenue growth is higher than public expenditure growth in the coming years. This can be achieved through improved revenue collection, better spending efficiency and increased value for money in public procurements. Fast economic growth and fiscal consolidation will be needed to lower the debt ratio to near pre-pandemic levels. The country's debt profile remains favorable. Public debt is mostly domestic (69.9 percent as of March 2022), long-term (65.7 percent), and peso-denominated (69.8 percent). Financing risks are curtailed by the Philippines' comfortable access to capital markets, both domestic and international, and strong engagement with multilateral institutions.

The authorities could improve public investment management and leverage private sector participation to narrow the country's infrastructure gap. Limited fiscal space makes it necessary for the authorities to improve public investment management to increase spending efficiency and minimize cost overruns. There is significant room for improvement, as the country's spending efficiency is about 23.0 percent lower than what is considered best practices in efficiently translating public investment into infrastructure. The authorities can also leverage public-private partnerships to improve the country's infrastructure as long as financial risks to the government are managed and the quality of services for citizens is secured. The private sector is a source of not only finance but also expertise and innovation to improve the economy's infrastructure readiness. The passage of investment-friendly laws and amendments to restrictive laws signal the government's intent to intensify private sector involvement in key industries, including telecommunications, shipping, railways,

and subways.

Improved targeting of social assistance could ensure the protection of poor and vulnerable households. The implementation of social protection measures will help mitigate the adverse impact of shocks, including high inflation, on the vulnerable population. However, the narrow fiscal space means that assistance needs to be timely and targeted, only reaching those most in need. The challenge is to identify beneficiaries and swiftly deliver assistance in the most efficient way. There is no single targeting method that is universally preferred or equally effective across countries, as methods must be adjusted to the purpose of the program, availability of data, and institutional capacity. The digital transformation of the delivery system and the use of the Philippine National ID system for identifying recipients are steps towards building a more dynamic registry to better inform the needs of citizens.

With the threat of climate change, the authorities need to strengthen the use of public resources in disaster mitigation, response, rehabilitation, and recovery. Climate change and the COVID-19 pandemic have compounded the impacts of natural disasters, which has made it more difficult for the government to prepare for, respond to, and recover from disaster events. Over the past 10 years, strong typhoons have devastated 9 out of 17 regions and affected an average of 5 million people. Recently, the country was hit by Super Typhoon Odette that affected 11 million people and incurred total direct damages and indirect losses of around 1.45 percent of GDP. The increasing intensity and frequency of natural disasters will likely add pressure to the country's growth prospects and fiscal position. Hence, the government needs to strengthen the efficiency, transparency, and inclusive use of public resources in disaster mitigation, response, rehabilitation, and recovery. Given the country's vulnerability to disasters, deepening disaster risk financing will strengthen financial resilience.

Special Focus - Improving digital enablers in the Philippines: Bridging the digital divide and accelerating recovery through reforms

Digitalization represents a key driver for long-term economic growth. While the Philippines has grown remarkably in the past decades, only a transformative solution will catapult the economy into reaching its *AmBisyon Natin* aspiration of a prosperous middle-class society by 2040. Part of the solution lies in harnessing the digital economy. The benefits brought by the digital economy are extensive and can be shared by all sectors of society. Digitalization can enhance productivity by reducing firms' operational costs and delivering economies of scale. It

can empower firms of all sizes to access markets beyond traditional boundaries, with local micro, small, and medium enterprises (MSMEs) finding themselves competing in the global market on the back of digital technology. A 10 percent increase in Internet use in an exporting country is found to increase the number of products traded between two countries by 0.4 percent. Digitalization has also helped firms build resilience. Firms that have adopted digital platforms experience about 7.0 percent higher employment growth and are about 10 percent less likely to face bankruptcy than digitally constrained firms.¹

While the use of digital technology has accelerated during the pandemic, the Philippines has not fully leveraged its expected benefits. During the first year of the pandemic, the share of new users among online consumers was 20 percent in the Philippines, the highest among Southeast Asian countries. The average number of new digital services consumed by Filipinos climbed from 3.9 before the pandemic to 8.2 in 2021. By March 2022, approximately 71 percent of Philippine firms had either started or increased their use of digital platforms since the pandemic began. However, the density of digital solution providers in the country was only 0.5 digital businesses per US\$1 billion of economic output in 2020, much lower than Vietnam (9.2) and Malaysia (14.9). Moreover, digital adoption diverges significantly between small and large firms and across different sectors, especially on the use of advanced digital solutions, which has a high impact on firm productivity. There has also been an uneven adoption of digital technology in areas outside the National Capital Region (NCR) and key metropolitan cities.

There has been progress in expanding digital connectivity, but challenges remain. Digitalization faces a ceiling due to the low coverage of broadband service, despite the entrant of a third full-service operator in 2021. The country's fixed broadband, which is important for high-volume data transmission and typically required by large businesses and institutions, continues to lag that of regional comparators such as Vietnam, Malaysia, and Thailand. A key challenge is underinvestment owed to decades of insufficient competition and outdated legal, policy, and regulatory frameworks. Franchising requirements, complex permitting for network equipment, and lack of policy on infrastructure sharing are also slowing the network rollout. These challenges can be addressed by introducing pro-competition legislation for shared deployment of network infrastructure and by streamlining of permitting, efficiently allocating spectrum, and advancing public private partnership models for investment and management of infrastructure.

Digital financial services (DFS) remain in their infancy

¹ World Bank Group, COVID-19 firm surveys.

and take up has been bound by limited financial inclusion of consumers and businesses alike.

Enabled by fintech innovations, DFS have the potential to lower costs, increase the speed of transactions, and allow for more tailored financial services to serve the needs of underserved segments of the population at scale. However, the country has experienced a limited uptake of DFS (barely 10 percent of households), while fintech development remains nascent. While challenges to growing DFS are wide-ranging, two critical ones are: (i) limited coverage of payment infrastructure in the last mile; and (ii) low levels of consumer trust that impede wide-scale adoption. Addressing these challenges require promoting the adoption of Philippine Identification System (PhilSys) to underpin growth in DFS; easing regulations to promote the entry and innovation of fintech and non-banks in the provision of DFS; and establishing stronger coordination and better enforcement of the consumer protection framework.

Demand for digital skills is growing steadily, but the market does not seem ready to meet the rising demand.

Digital occupations have featured disproportionately on the list of most in-demand jobs in the country. However, workers' digital skills and literacy have not caught up. In the World Digital Competitiveness Ranking 2021, the Philippines ranked 54th on digital/technological skills, reflecting weak talent and training, and education. Results from the 2019 National ICT Household Survey reveal that over a quarter of Filipinos do not use the Internet because they do not know how to use it. While the government has started to address the skills gap, more can be done, including: (i) fostering digital competency through basic education to build the foundational skills for digital hardware and software

use; (ii) adopting more upskilling and reskilling policies for highly specialized Fourth Industrial Revolution skills (4IR); (iii) strengthening linkages with industry; (iv) improving digital skills training under Technical Education and Skills Development Authority (TESDA) programs; and (v) ensuring skills qualification and accreditation mechanisms reflect changes in skills demand and enhance the portability of skills.

The explosive digitalization during the pandemic requires policies to keep up with the pace of development of the digital economy.

Market access can be expanded by adopting an efficient regulatory framework that builds trust in the digital economy and facilitates electronic transactions and data flows. Digital consumers and operators need to feel confident in using digital services and safe from the undue risk of personal data breaches, unscrupulous vendors, and potential infringement on their privacy. While the government has passed laws and regulations to promote trustworthiness in the digital economy, some of these measures seem inadequate to protect consumers online. The legal basis of electronic transactions was cemented in 2000, and the authorities have recently issued guidelines on electronic documents, signatures, and digital signatures in government transactions. However, the absence of rules on electronic notarization, the persistent official requirements on paper documentation and manually signed forms, the limitations on the issuance of individual digital certificates, and the absence of accredited private *certification authorities* limit the widescale adoption of electronic contracts, receipts, invoices, and the use of supporting documents for government transactions.



Photo: Dragon Images

The following table summarizes key reforms that could improve the digital enablers in the Philippines over the next three years:

Enabler	Key Policy Recommendations
Digital infrastructure	<ul style="list-style-type: none"> • Expand pro-competition legislation for shared deployment of network infrastructure and streamlining of permitting. This will include the passage of the implementing rules and regulations of the Public Services Act amendment, and National Broadband Plan and Common tower and pole attachment policy. • Promote investment in connectivity through efficient allocation of spectrum and advancing public private partnerships models for infrastructure. This includes reviewing and revising regulations on spectrum allocation for mobile broadband and leveraging public private partnerships to draw private investments and manage government assets, including physical assets, and domestic backbone network especially in far-flung locations.
Digital financial services and national digital id	<ul style="list-style-type: none"> • Accelerate adoption of PhilSys to underpin growth in DFS. This involves promulgating use-cases for the greater use of the National ID and enabling the Know Your Customer (KYC) framework by issuing supplemental guidelines to allow underserved segments to access financial services. • Ease regulations to promote entry and innovation of fintech and non-banks in the provision of DFS. This includes establishing the Open Finance Oversight Committee, adopting industry-accepted standards, and promoting digitalization among rural financial institutions.
Digital skills	<ul style="list-style-type: none"> • Enhance the digital competency of the work force and meet the increasing demands of the changing work environment. This involves strengthening foundational skills through basic education under the Department of Education. • This involves strengthening foundational skills through basic education under the Department of Education. Higher education institutions, supported by the Commission on Higher Education, should update the higher education curricula and training opportunities to fit the needs of 4IR. • Strengthen digital skills training under Technical Education and Skills Development Authority.
Conducive regulations for digital market access	<ul style="list-style-type: none"> • Improve regulatory practice in the platform economy by improving guidelines on accreditation of private certification authorities and electronic notarization, which can stimulate the adoption of digital certificates. This includes advancing the transition to digital invoices, which is likely to simplify accounting systems for MSMEs. • Strengthen international cooperation on rules and certification for transmitting and processing personal data, which can accelerate data transfers.



Photo: wee dezin

Part I

Recent Economic and Policy Developments

Following a steady decline in COVID-19 cases in the Philippines, the authorities have loosened mobility restrictions, leading to more economic activity. The economy expanded by 8.3 percent, year-on-year, in the first quarter of 2022, fueled by the recovery of domestic demand and a still supportive external environment. The fiscal deficit narrowed as the government continued to wind down its COVID-19 fiscal support. Meanwhile, inflationary pressure has intensified, exacerbated by high global commodity and energy prices and the war in Ukraine. The authorities raised the key policy rate by 25 basis points in May to prevent further second-round effects and a buildup of inflation expectations. The growth recovery coincided with improvements in the labor market, with accelerated job creation and higher labor force participation.



Photo: MDV Edwards

1.1 Economic Growth: Sustaining the growth momentum

The economy expanded by 8.3 percent in the first quarter of 2022 despite the surge in COVID-19 cases in early-2022. Robust growth was driven in part by base effects and fueled by the recovery of the industry sector, a supportive external environment, and recovering private domestic demand.

Despite the Omicron wave, the pace of economic recovery accelerated in the first quarter of 2022. The high growth rate was driven by an increase in domestic activity despite the Omicron-induced wave of infections and the shift to stricter mobility restrictions early in the year.² Domestic activity remained robust as households and firms have learned to cope with new infections and mobility restrictions. Moreover, the quick containment of the Omicron wave resulted in the shift to the looser Alert Level 1 status in March. Domestic activity was also buoyed by an improving labor market, robust remittances, and a reopening of the country's borders to international tourism. On a seasonally adjusted basis, first quarter output breached its pre-pandemic level, exceeding Q4 2019 output by 0.3 percent, although the country's economic revival lags several countries in the region (Figure 1).

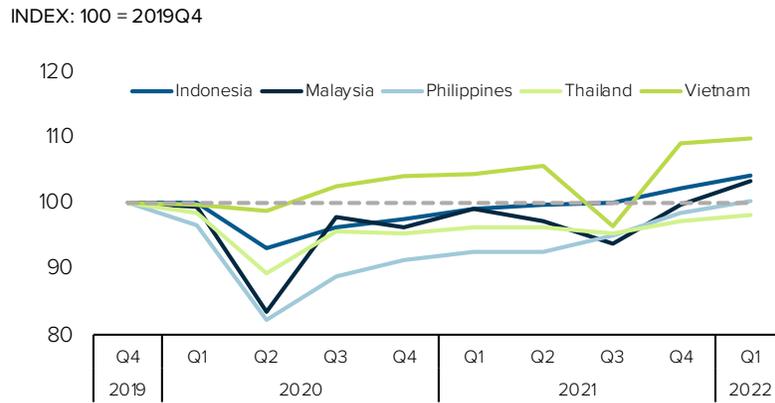
The economy rebounded from a contraction of 3.8 percent in Q1 2021 to an expansion of 8.3 percent in Q1 2022, driven by strong growth in industry and services (Figure 2). Strong industry growth was driven by the 10.1 percent expansion of manufacturing, as electronics manufactures, the country's main export commodities, benefitted from robust global demand. In addition, the construction sector sharply expanded by 13.5 percent in Q1 2022, from a 22.6 percent contraction in Q1 2021, fueled by strong public construction activity due to the government's recovery program. The services sector expanded by 8.6 percent, with transportation, accommodation, miscellaneous services, and wholesale and retail trade benefitting from the relaxation of capacity restrictions. Meanwhile, the agriculture sector's tepid performance continued into Q1 2022, as output marginally increased by 0.2 percent due to the adverse impact of several typhoons. While most sectors have caught up to their pre-pandemic levels, some sectors such as accommodation and food services, real estate services, and transport and storage have yet to return to their pre-pandemic output levels.

Domestic demand picked up in Q1 2022 despite the implementation of strict containment measures in January (Figure 3). Private consumption was buoyed by steady improvement in the labor market, moderate inflation, and the relaxation of movement restrictions beginning in February due to the swift containment of the Omicron induced wave of COVID-19 infections. As a result, private consumption grew by 10.1 percent in Q1 2022, from a 4.8 percent contraction over the same period in 2021. Private investment spending remained below pre-pandemic levels as robust growth was driven by base effects from the previous year amid lingering uncertainty and low business confidence in Q1 2022. Meanwhile, public consumption growth slowed as the government gradually withdrew its fiscal support, while public investment contracted amid a slowdown in public infrastructure delivery.

Buoyant global demand drove merchandise trade. Exports grew by 10.3 percent in Q1 2022, led by the 5.9 percent expansion in merchandise exports, as demand from the rest of the world remained strong (Box 5). Robust demand for electronics products lifted demand for electronics exports, the Philippines' main export commodities. However, services exports languished, as services exports remained well below pre-pandemic levels. Despite the strong rebound in business services and telecommunications, computer, and information services exports, the growth in services exports continued to be dampened by the international tourism, travel, and transport industries. Meanwhile, imports expanded by 15.6 percent in Q1 2022, driven by a broad-based recovery in the importation of consumption goods, raw materials, and capital goods. The recovery of imports reflected increased domestic activity and the robust performance of the manufacturing industry, leading to robust imports of raw materials and inputs.

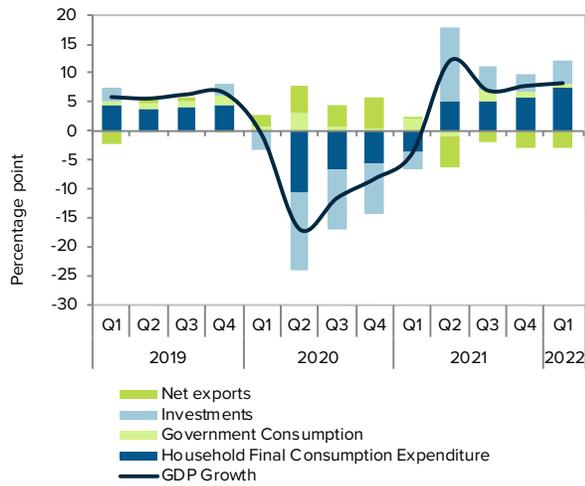
² Several regions in the Philippines were placed under Alert Level 3 Status from January 3 until January 31, 2022 as COVID-19 cases reached nearly 40,000 in mid-January. As cases declined, several regions were placed in Alert Level 2 status beginning in February, before shifting to Alert Level 1 Status in March as cases reached nearly 200 per day.

Figure 1. Output has surpassed its pre-pandemic level.



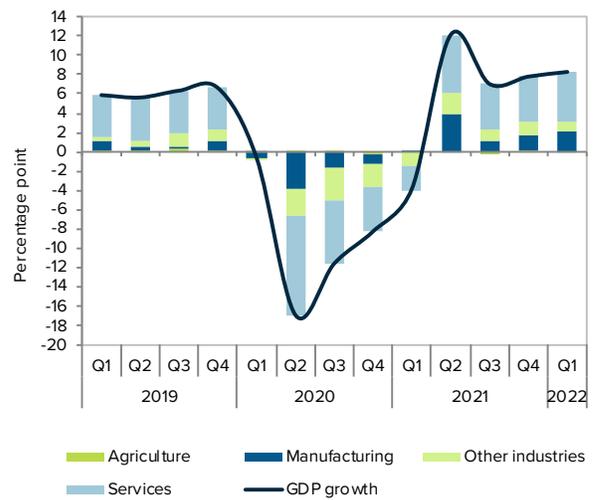
Source: Haver Analytics.

Figure 2. Growth was buoyed by robust private domestic demand in Q1 2022.



Source: Philippine Statistics Authority (PSA).

Figure 3. The industry and services sectors drove growth on the production side.



Source: PSA.



Photo: Antonio V. Oquias

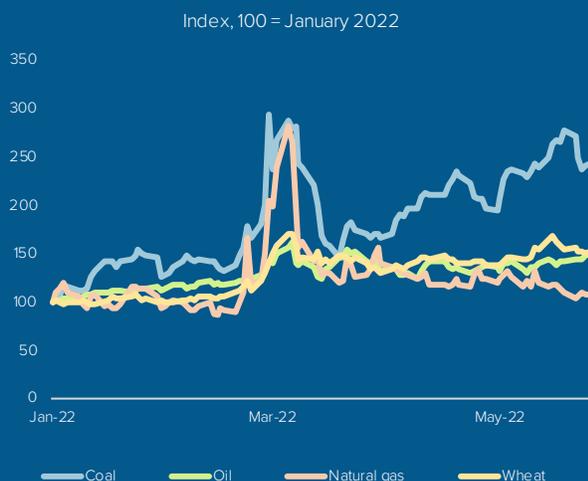
Box 1. Recent Global Developments

Global economic growth accelerated in 2021, but the recovery was uneven. Global growth surged to 5.5 percent in 2021, its strongest post-recession pace in 80 years. However, supply chain disruptions and high energy prices lowered growth from its earlier forecasts, and growth varied across regions. In advanced economies, economic growth averaged 5.0 percent, fueled by high vaccination rates and sizable fiscal support. The recovery in EMDEs was, however, slower than previous forecasts due to waning policy support and tightening financing conditions. While growth averaged 6.3 percent in EMDEs in 2021, it was 5.2 percent when excluding China. Moreover, low-income countries (LICs) grew by a mere 3.3 percent, as low vaccine coverage, high inflation, and limited policy space constrained the recovery.

The war in Ukraine and the COVID-19 surge in China are weighing on the global economic recovery. The global composite output purchasing managers' index (PMI) declined from 53.5 in February to 52.7 in March. Global activity slowed, as the war in Ukraine and the uptick in COVID-19 cases in China led to a surge in commodity prices and supply chain disruptions. Due to recent geopolitical risks, global financial conditions worsened as financial market volatility jumped. Aside from the war in Ukraine, COVID-19 continued to threaten growth. In China, the Omicron surge and the authorities' zero-COVID policy led to lockdowns in manufacturing hubs, Shanghai and Shenzhen, adversely affecting global value chains (GVCs).

Commodity prices rose due to the war in Ukraine, fueling global inflation. The price of Russian and Ukrainian commodity exports jumped in March (Figure 4). The price of oil, Russia's biggest export, reached a 10 year high of US\$130/bbl (Brent Crude oil), while the price of wheat, where both countries are top exporters, increased by

Figure 4. Commodity prices have jumped since the outbreak of the war in Ukraine.



Source: Bloomberg, UN Comtrade, World Bank.

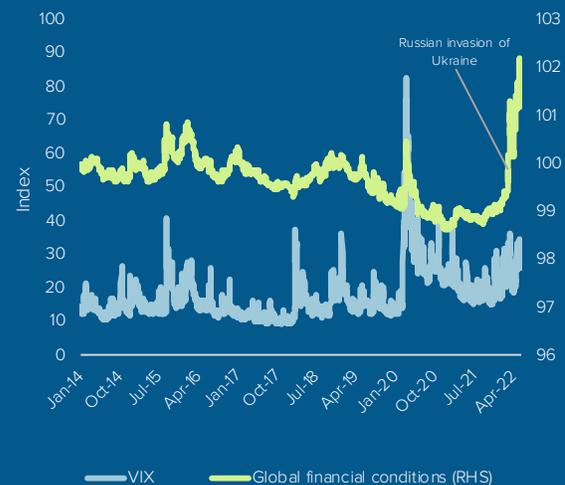
Source: Global Economic Prospects, January 2022; Global Monthly, March 2022; East Asia and Pacific (EAP) Economic Update, April 2022

40 percent to reach record highs. In addition, the prices of metals like aluminum, nickel, and palladium have also reached all-time highs. Elevated commodity prices have been fueling inflation, with the median global consumer price index (CPI) inflation reaching 4.6 percent in February, its highest level since 2008.

Global trade contracted in March due to supply chain disruptions. Global goods trade fell in March, as evidenced by the decline in Global PMI manufacturing new exports orders index from 50.8 to 48.2. The war in Ukraine, which has led to logistic disruptions and airspace bans, has exacerbated supply bottlenecks as commodity prices have increased and trade has been re-routed to longer and more expensive routes. Trade through the Black Sea has already been disrupted, with dry bulk vessels down more than 90 percent in Ukrainian ports, and calls to Russian ports are down by more than 20 percent over the same period. Meanwhile, the recent lockdowns in China due to the Omicron variant surge have disrupted global value chains, with more than 85 percent of Chinese manufacturers reporting disruptions in trucking and shipping in March.

Global financing conditions have tightened. The Russia-Ukraine war soured risk appetite, causing global financial conditions to worsen in March (Figure 5). In addition, the US Federal Reserve raised its policy rate by 25 bps in March, which adversely affected EMDEs and LICs where financial conditions are at their tightest since 2020. Due to elevated risk, global equities fell 5 percent between mid-February and mid-March. In a sign of heightened volatility, US long-term yields rose by 12 bps, and European equity volatility reached levels last seen during the initial spread of COVID-19. Meanwhile, sanctions targeting Russia led to the collapse of Russian financial asset prices.

Figure 5. The global financial market has been volatile.



Source: Chicago Board Options Exchange, Goldman Sachs.

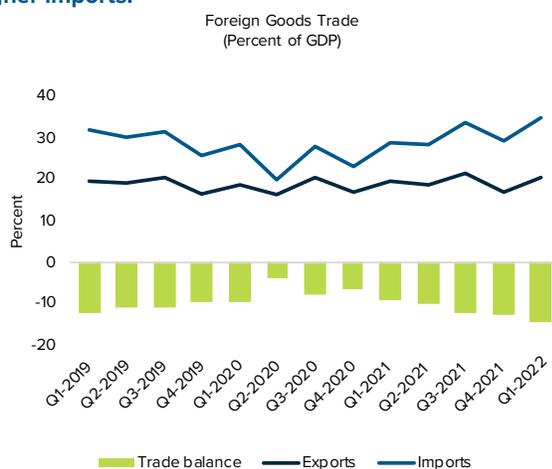
1.2 External Sector – Peso Depreciation amid Rising Imports

The Philippines’ balance-of-payments (BOP) surplus narrowed to 0.3 percent of GDP in 2021 as recovering imports widened the trade gap. The continued rise in import demand and soaring global commodity and oil prices weakened the peso against the US dollar in early 2022.

A wider trade gap reversed the current-account balance to a deficit in 2021. From a surplus of 3.2 percent of GDP in 2020, the current-account balance reversed to a deficit of 1.8 percent of GDP in 2021 as the trade deficit broadened. Recovering domestic activities, alongside rising global prices of commodities and oil, drove goods imports, which surged by 31.7 percent in 2021. It outpaced the 12.4 percent growth in goods exports, which gained momentum from improving external demand. Recent data point to a larger trade deficit in the first three months of 2022 relative to the same period in 2021, driven by 28 percent growth in goods imports and 9.8 percent growth in exports (Figure 6). Meanwhile, growth in the business process outsourcing (BPO) sector partly buoyed net services exports, which grew at a slower pace in 2021 due to a weak tourism sector. After contracting in 2020, remittances bounced back by 5.1 percent in 2021, supported by a sustained global economic recovery. Remittances continued to grow by 1.9 percent during the first two months of 2022.

Net capital inflows financed the current-account deficit and contributed to the BOP surplus in 2021 (Table 1). Capital and financial account net inflows rose to US\$7.0 billion (1.8 percent of GDP) in 2021, as higher inflows from foreign direct investment and other investment accounts outweighed portfolio investments net outflows. From a 21.3 percent slump in 2020, net foreign direct investment rose by 54.2 percent to US\$10.5 billion (2.7 percent of GDP) in 2021. Meanwhile, portfolio investments reversed to net outflows

Figure 6. The goods trade deficit widened in Q1 2022 amid higher imports.

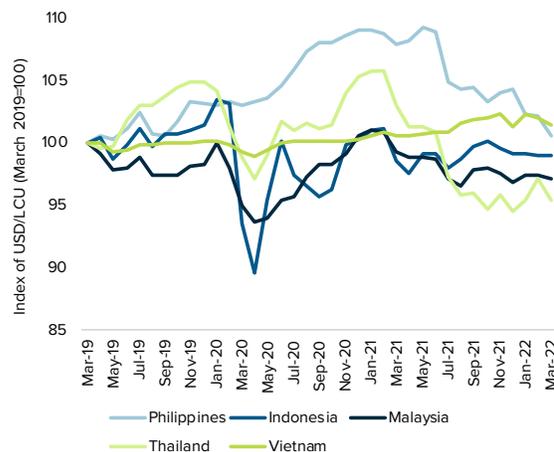


Source: PSA.

equivalent to 2.0 percent of GDP as foreign investors divested from domestic debt securities. The BOP surplus fell from 4.4 percent of GDP in 2020 to 0.3 percent of GDP in 2021. The BOP remained in surplus in Q1 2022 amid stronger remittances, government foreign borrowings, and foreign direct and portfolio investments. As of March 2022, the cumulative BOP surplus reached US\$495 million (0.5 percent of Q1 2022 GDP), a reversal from the US\$2.8 billion deficit (3.1 percent of Q1 2021 GDP) posted during the same period in 2021.

The Philippine peso depreciated against the US dollar in Q1 2022. After strengthening by 4.4 percent in nominal terms in 2020, the peso gained a mere 0.8 percent in 2021 as the trade deficit broadened. Higher imports driven by recovering domestic demand and rising global prices of oil and commodities, and the expected interest rate differential given the US Fed Rate hikes led to a 6.2 percent, year-on-year, nominal depreciation of the peso during Q1 2022 (Figure 7). Nevertheless, the Philippine peso continued to outperform most currencies in the region. In real effective terms, the peso appreciated marginally by 0.6 percent in 2021, before depreciating by 3.4 percent in Q1 2022. The real depreciation could help boost the country’s trade competitiveness, as exports become relatively cheaper. Gross international reserves dropped slightly by 1.2 percent to US\$108.8 billion by end-2021, before inching further down to US\$106.8 billion (9.4 months of import coverage) by April 2022.

Figure 7. The Philippine peso depreciated but continued to outperform most currencies in the region in early 2022.



Source: Haver Analytics.

Table 1. Balance of Payments, 2017–2021

	2017	2018	2019	2020	2021
In percent of GDP, unless otherwise indicated.					
Current account	-0.7	-2.6	-0.8	3.2	-1.8
Goods	-12.2	-14.7	-13.1	-9.3	-13.7
Exports	15.8	15.0	14.2	13.3	13.8
Imports	28.0	29.7	27.3	22.7	27.4
Services	2.6	3.3	3.5	3.8	3.6
Primary Income	1.0	1.1	1.4	1.1	0.8
Secondary Income	8.0	7.7	7.4	7.6	7.5
Capital and Financial accounts	0.9	2.7	2.2	1.9	1.8
Capital account	0.0	0.0	0.0	0.0	0.0
Financial account	-0.9	-2.7	-2.1	-1.9	-1.8
Direct investment	-2.1	-1.7	-1.4	-0.9	-2.1
Net acquisition of financial assets	1.0	1.2	0.9	1.0	0.6
Net incurrence of liabilities ^{1/}	3.1	2.9	2.3	1.9	2.7
Portfolio investment	0.7	0.4	-0.7	-0.5	2.0
Financial derivatives	0.0	0.0	0.0	-0.1	-0.2
Other investments	0.5	-1.4	0.0	-0.5	-1.6
Net unclassified items^{2/}	-0.5	-0.8	0.7	-0.7	0.3
Overall BOP position	-0.3	-0.7	2.1	4.4	0.3
<i>Memo:</i>					
Basic Balance	1.5	-0.9	0.6	4.1	0.3
Gross International Reserves (in billions US\$)	81.6	79.2	87.8	110.1	108.8
Import Coverage (in months)	7.8	6.9	7.6	12.3	9.6

^{1/} Net incurrence of liabilities refers to net foreign direct investment to the Philippines.

^{2/}The term “Net unclassified items” is a balancing figure. There are two methods of computing the BOP position: the first approach uses the change in net international reserves due to transactions, while the second approach computes the sum balances of the current account, capital account less financial account. The two measures do not necessarily tally. The BSP uses the first approach to determine the overall BOP position.

Note: Following the BSP presentation, the BOP balance = Current Account Balance + Capital Account Balance - Financial Account Balance + Net Unclassified Items.

Source: BSP

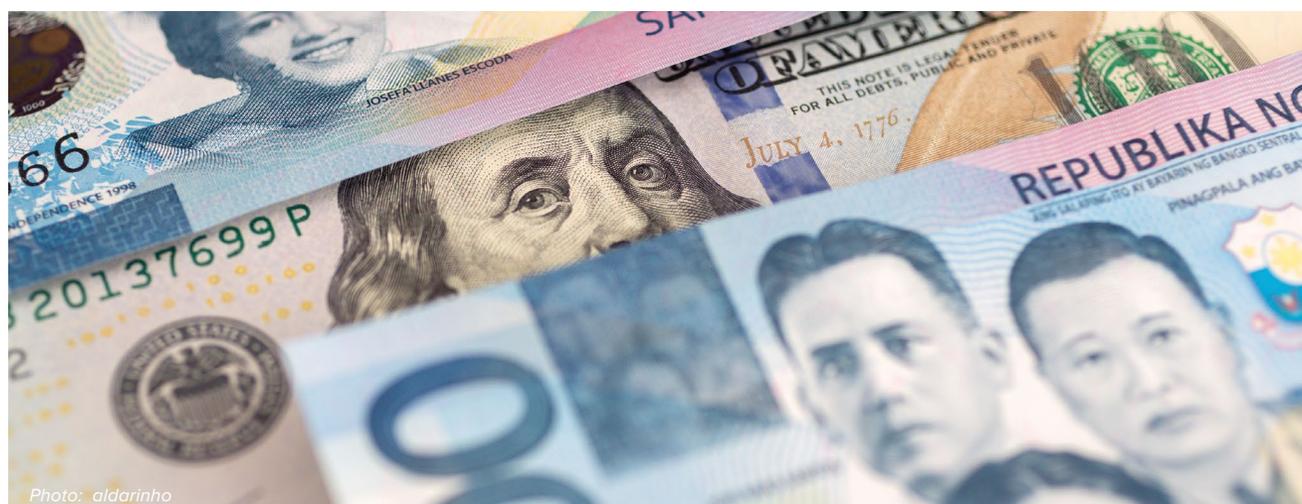


Photo: aldarinho

1.3 Inflation and Monetary Policy: Renewed Inflationary Pressures

After steadily declining since August 2021, inflation jumped in March and April 2022 as the war in Ukraine pushed global energy and commodity prices to record highs. In response, the Bangko Sentral ng Pilipinas (BSP) raised the policy rate by 25 bps to prevent further second-round effects and a buildup of inflation expectations.

Inflation jumped in March and April because of the war in Ukraine. Inflation fell between August 2021 and February 2022, settling within the BSP's 2–4 percent target range. However, the shock of the war in Ukraine pushed global energy and commodity prices to record highs, spilling over to domestic inflation as the country is a net importer of most staple foods, fertilizers, and fuels (Figure 8).³ As these commodities comprise around 36.3 percent of the CPI, headline inflation rose to an average of 4.4 percent in March and April, up from an average of 3.0 percent between January and February (Figure 9). Inflation related to housing, water, and electricity prices increased from an average of 4.7 percent in January-February to 6.6 percent in March-April, while transportation inflation rose from an average of 7.9 percent in January-February to 11.7 percent in March-April. In response, the government approved fuel grants and cash transfers to cushion the impact of rising oil prices (Box 2). Excluding volatile food and energy items, the core inflation rate is estimated to have risen from 2.1 percent in January to 2.8 percent in April 2022, indicating slowly rising underlying price pressure.⁴

The BSP kept the key policy rate at historic lows to support the economic recovery despite recent global uncertainties. The Monetary Board raised the key policy rate by 25 bps to 2.25 percent in May 2022, after maintaining the rate at 2.0 percent since December 2020. Inflationary pressures brought by high commodity prices coupled with terms of trade deterioration⁵ and peso depreciation, the emergence of second-round effects in wage hikes, and the buildup of inflation expectations drove its decision to tighten monetary policy stance. Moreover, the rebound in economic activity and improving labor market conditions in the first quarter of 2022 gave the BSP policy space to start rolling back pandemic-induced monetary accommodation. Aside

from the higher policy rate, the BSP has reconfigured its government securities purchasing window from a crisis intervention measure into a regular liquidity facility.

The Philippines' banking system appears resilient to a significant credit shock. The gross non-performing loan (NPL) ratio stood at 4.2 percent as of February 2022 (Figure 10), higher than its pre-pandemic level of 2.0 percent and higher than peer countries such as Indonesia, Malaysia, and Thailand. Other forward-looking indicators of asset quality have also deteriorated during the pandemic, pointing to some risks previously masked by regulatory forbearance: for instance, restructured loans to total loans increased from 0.41 percent in February 2020 to 3.09 percent in February 2022. Nonetheless, the banking sector appears to have sufficient financial buffers, as the NPL coverage ratio of 88.4 percent as of March 2022 is recovering and coming near to the 93.0 percent recorded in December 2020. Furthermore, banking sector profitability indicators shows that Return on Asset at 1.2 percent increased by 50 percent year-on-year and Return on Equity at 9.6 percent increased by 49 percent year-on-year in March 2022.

The support of the banking sector to the economic recovery increased but remains weak. Private credit grew by 5.6 percent in March 2022, still much lower than the pace recorded before and at the early stage of the pandemic (between 8 and 10 percent between January and May 2020). The possible causes of continued slow credit growth include economic conditions and policy support (demand side) as well as concerns over borrower risks and asset quality and profitability (supply side). Survey data⁶ point to stable household demand for credit. In the Philippines, change in credit growth stood at 1.4 percent compared to a year ago, suggesting an almost constant rate of credit expansion, similar to other regional peers.

³ The Brent crude oil prices reached a 10-year-high of US\$130/bbl in early March, and the price of other commodities like wheat and several metals also reached an all-time high.

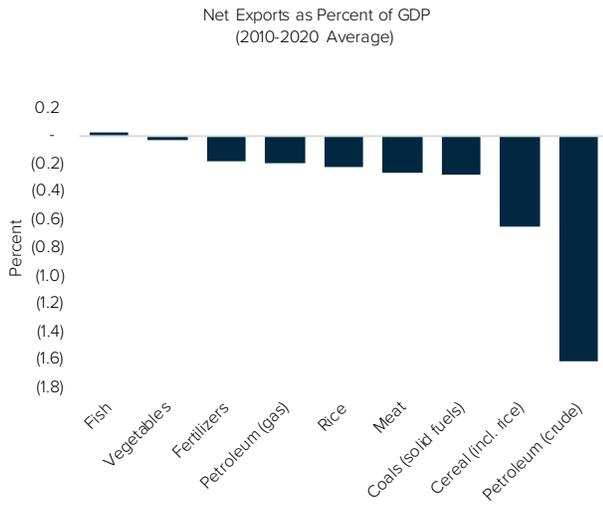
⁴ Official core inflation data based on 2018-based CPI series is not yet available. To estimate core inflation, the calculation followed the definition used for the 2012-based CPI series, which excludes the following commodities: rice, corn, meat (fresh, chilled, or frozen), fish (fresh, chilled, or frozen), vegetables (fresh, chilled, frozen, or dried cultivated for their fruit or roots), and fuels and lubricants used for personal transport equipment. These amount to 22.1 percent of the CPI using the 2018-based series.

Rising import prices have deteriorated the terms of trade (2018 base year) from 93.95 in Q4 2021 to 90.06 in Q1 2022.

⁵ Rising import prices have deteriorated the terms of trade (2018 base year) from 93.95 in Q4 2021 to 90.06 in Q1 2022.

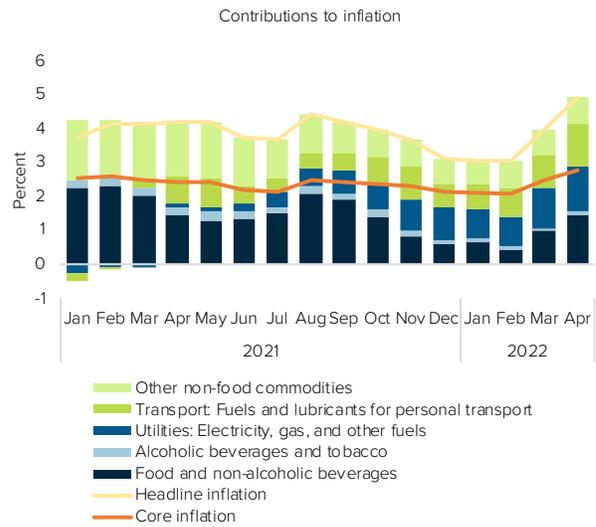
⁶ Department of Supervisory Analytics, Financial Supervision Sector, Bangko Sentral ng Pilipinas, January 2022.

Figure 8. The Philippines is a net importer of staple foods, fertilizers, and energy items.



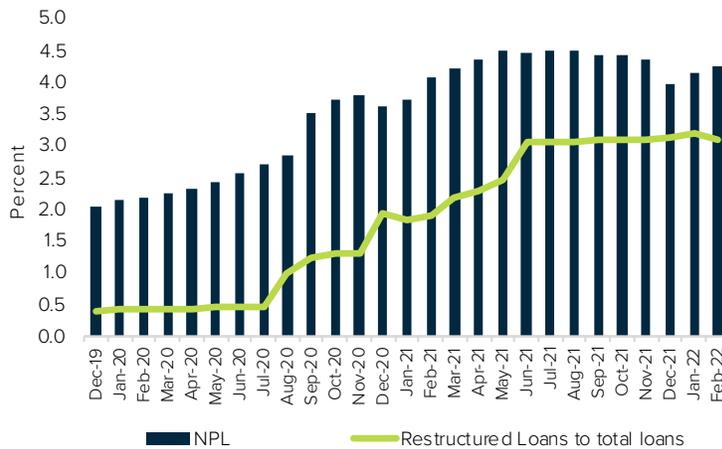
Source: PSA.

Figure 9. The war in Ukraine led to an uptick in inflation in March 2022.



Source: PSA

Figure 10. NPLs and restructured loans have risen.



Source: BSP.



Photo: MDV Edwards

Box 2. Fiscal Measures to address the Impact of Rising Inflation

The government has approved a total of 0.4 percent of GDP in fuel grants and transfers to help cushion the impact of the war in Ukraine on inflation. The package of interventions includes targeted transfers to the poorest households, fuel grants to the agriculture and transportation sector, and fertilizer grants for non-rice farmers. In particular, a Php500 (US\$10) monthly cash transfer will be provided to the bottom 50 percent of households for an initial six-month period, with a total fiscal cost of Php41.4 billion (0.2 percent of GDP). The proposal was approved by the president in lieu of a fuel excise tax suspension, which would have cost the Philippine government Php105.9 billion (0.5 percent of GDP) in foregone tax revenues. In addition, the government will provide a total of Php3.0 billion (0.02 percent of GDP) in additional fuel grants to the transportation (Php2.5 billion) and agriculture (Php0.5 billion) sectors, and Php20 billion in fertilizer grants, sourced from the Department of Agriculture's (DA) realigned 2022 budget.

While the fiscal cost of additional transfers and grants is relatively small, future increases in fiscal support

could further constrain the fiscal space. Financing new fiscal measures to provide support could prove more difficult in the future, given the country's narrower fiscal space. For example, while the government has committed to a monthly cash transfer of Php500 to the bottom 50 percent of households for 12 months, the Department of Finance has only allocated funding for the first six months of the program. Meanwhile, additional fiscal support amounting to 0.4 percent of GDP will be financed in part through a realignment of the 2022 national government budget and would partly rely on excess dividends from government-owned and controlled corporations and windfalls from higher value-added tax (VAT) collections on higher oil imports. Moving forward, the incoming administration must continue to review and rationalize existing grants and transfer programs beyond the core social protection programs in the context of an improving economy and its fiscal consolidation goals. Given the country's narrower fiscal space, measures need to be rationalized and targeted with efficient disbursement and distribution mechanisms.



Photo: VideoFlow

1.4 Fiscal Policy: Narrowed fiscal deficit

The fiscal deficit narrowed in the first quarter of 2022 relative to the same period last year as the government continued to unwind its COVID-19-related fiscal support.

The fiscal deficit narrowed in the first quarter of 2022 (Figure 11). The unwinding of fiscal support and the base effect from a one-time equity infusion to government financial institutions in the first quarter of 2021 resulted in the slower growth of public expenditures in the first quarter of 2022. This reduced the fiscal deficit to 6.4 percent of GDP in the first quarter of 2022, from 7.4 percent in the same period a year ago. The deficit contributed to an increase in financing needs, leading to the rise in central government debt from 60.4 percent in end-2021 to 63.5 percent in the first quarter of 2022 (Figure 12). Despite the increase in debt, the country's debt metrics remain favorable toward long-term fiscal sustainability, as 5.3 percent of total debt is short term, while 69.8 percent is peso denominated.

Public revenues-to-GDP remained steady in the first quarter of 2022. National government revenues expanded by 12.6 percent in the first quarter of 2022 (8.7 percent contraction over the same period in 2021) to reach 15.9 percent of GDP. This is the same as the revenue-to-GDP ratio in the first quarter of 2021. Tax collections by the Bureau of Customs rose from 3.4 percent of GDP in the first quarter of 2021 to 3.8 percent in the same period in 2022, supported by the growth of merchandise imports. By contrast, tax collections by the Bureau of Internal Revenue declined from 10.7 percent to 10.2 percent of GDP in the

same period, likely due to the impact of strict mobility restrictions that remained early in the year. Meanwhile, non-tax revenues increased due to higher incomes by the Bureau of the Treasury and remittances from government-owned and controlled corporations.

Public spending growth slowed as the government reduced pandemic-related fiscal support. National government spending expanded by 8.2 percent in the first quarter of 2022 (19.9 percent growth over the same period in 2021) to reach 22.3 percent of GDP, lower than the 23.3 percent of GDP in the first quarter of 2021. The decline was driven by a one-time Php45 billion equity infusion to government financial institutions in 2021, as mandated by the Bayanihan 2 law for pandemic response. Excluding the one-time equity infusion, government expenditure grew by 13.2 percent due to: (i) higher local government units (LGUs) allotments (29.2 percent growth) in compliance with the Mandanas Ruling;⁷ and (ii) increased interest payments (8.7 percent growth) because of higher public debt. Education and election-related spending, as well as the continued procurement of COVID-19 vaccines, also contributed to the growth in disbursements. The pandemic has highlighted the importance of investments in core public health functions, as the health sector received one of the largest budget increases across sectors in 2021 (Box 3).

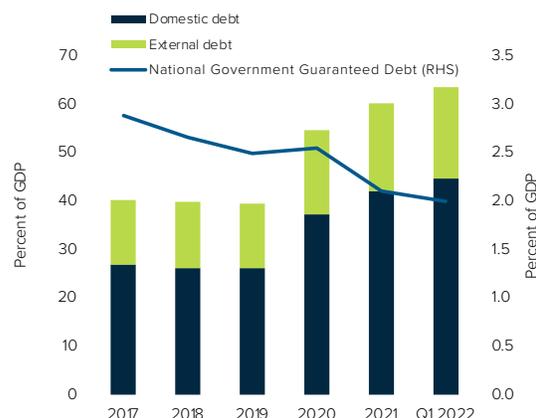
Figure 11. The deficit narrowed in Q1 2022 as the government reduced pandemic-related expenditures...



Source: Bureau of the Treasury (BTr), DBM.

⁷ The Mandanas Ruling increased the internal revenue allotment given to LGUs by requiring non-Bureau of Internal Revenue taxes to be included in the computation of the block grant.

Figure 12. ...although public debt inched upward.



Source: BTr, DBM.

Box 3. Lessons from COVID-19 to Strengthen the Health Sector's Pandemic Preparedness

The Philippines has been hit hard by the COVID-19 pandemic. To date, there has been over 3.7 million cases and close to 60 thousand deaths related to COVID-19. Reduced mobility, facility closures, and the fear of contracting COVID-19 have threatened to wipe out progress made in health outcomes. Overall, average monthly utilization of essential health services decreased by 25 percent in 2020 relative to 2019, with poorer households more likely to forgo care (Figure 13). There was also a reduction in the use of services related to nutrition, tuberculosis, and ischemic heart conditions at the primary care level. Moreover, estimates suggest that over 2 million Filipino children are expected to miss out on life-saving immunizations due to the pandemic (Figure 14).

The government's COVID-19 emergency response prioritized scaling up surveillance, testing and isolation capacity, and vaccine delivery. The Department of Health (DOH) included COVID-19 on the list of nationally notifiable diseases and set aside funds for the establishment of a virology institute. The number of testing centers increased from a single national reference laboratory to over 300 able to conduct more than 50,000 RT-PCR⁸ tests a day. The DOH and provincial hospitals were upgraded with additional isolation, intensive care unit, and ventilator-supported beds. Initial supply chain bottlenecks were addressed through tri-partite contracts with the private sector, LGUs, and multilateral partners. And, as of March 30, 2022, the Philippines had fully immunized approximately 66 million Filipinos, or 73 percent of the population.

However, the response has not been without its challenges. The lack of integrated information systems across (and within) levels of government and paper-based reporting at health facilities hampered the government's ability to do contact tracing and contain the pandemic early on. Tests per million population remains one of the lowest in the Association of Southeast Asian Nations (ASEAN), and bed occupancy in newly created isolation facilities is low. The vaccines procured through tri-partite agreements were delayed and arrived after some LGUs had already received a

stockpile from the national government. While the country's national vaccination coverage is high, only a quarter of people living in Bangsamoro Autonomous Region in Muslim Mindanao have been fully vaccinated.

The pandemic has highlighted the importance of investments in core public health functions—a lesson that the DOH has taken to heart. Health saw one of the largest budget increases (20 percent) across sectors in 2021, the bulk of which was allocated to system strengthening activities to ensure resilience to emerging infectious diseases. Along this vein, the Philippines should consider:

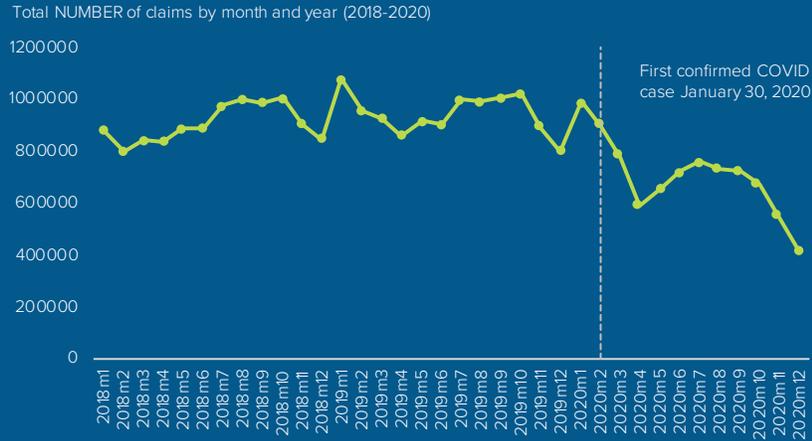
- 1. Strengthening health management and information systems.** Digitizing medical records and automating the reporting of notifiable diseases at the facility level would generate real-time data to promptly identify and respond to disease outbreaks. Accelerating the digital health transformation would also facilitate analytics to better target health interventions, monitor the quality of care, improve the efficiency of health spending, and support decision-making and policy formulation overall.
- 2. Increasing capacity of specialized laboratory services.** Developing a comprehensive national laboratory networking strategy would provide a benchmark for budget and planning decisions on meeting testing, staffing, quality, and reporting requirements for each level.
- 3. Safeguarding health promotion and hygiene.** Ensuring an adequate stockpile of personal protective equipment, cleaning and disinfection supplies, and water, sanitation, and hygiene facilities at healthcare facilities would temper global supply chain shortages and mitigate the spread of infection.
- 4. Enhancing the resilience of health facilities, including vaccine and cold chain storage.** As one of the most hazard-prone countries in the world, there is a need to adapt healthcare facilities to withstand the impacts of extreme climate-related events, including flooding and heat events.



Photo: MIA Studio

8 Reverse Transcriptase Polymerase Chain Reaction Test which is considered gold standard for SARS-CoV2.

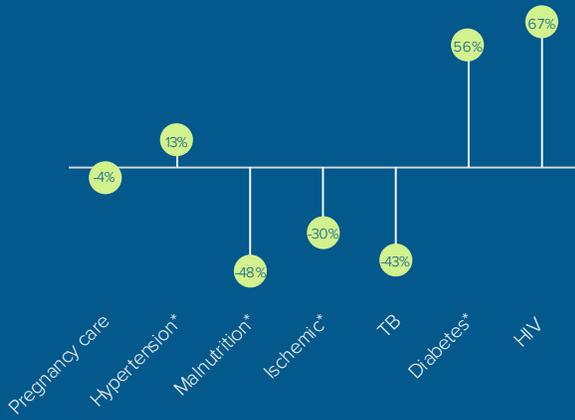
Figure 13. The drop in health claims coincides with the onset of COVID-19 and lockdown measures.



Source: PhilHealth Claims, 2021.

Figure 14. Reduction in malnutrition pregnancy care is especially worrisome for human capital, as the impact is compounded over Filipinos' lifecycle.

Percentage change between pre-COVID (2018-2019 average) and post-COVID (2020) visits at the primary care level.



* Does not include visits paid under the primary care benefit package.

Source: PhilHealth claims, 2021.

Percentage change between pre-COVID (2018-2019 average) and post-COVID (2020) hospital admissions.



Source: PhilHealth claims, 2021.



Photo: CaveDweller99

1.5 Employment and Poverty: Continued Recovery amid Economic Uncertainties

Increased labor force participation and accelerated job creation reflect signs of a continuous labor market recovery. However, uncertainties brought about by the pandemic, natural disasters, and rising fuel and commodity prices threaten household earnings and job security.

More individuals seek opportunities in the labor market as the economy gradually reopens. The labor force participation rate rose to 65.4 percent in March 2022, surpassing the pre-pandemic level of 61.7 percent in January 2020 (Figure 15). The increasing trend has occurred amid intermittent declines associated with the reimposition of community quarantines (July 2021) and the onslaught of Typhoon Odette and the Omicron variant related alert measures (January 2022). The typhoon directly impacted about 2.2 million workers, of whom nearly 839,000 (38 percent) were women.⁹ Notwithstanding the increasing number of workers in the labor force, the unemployment rate follows a decreasing trend, indicating that the labor market is creating jobs and absorbing more workers. The unemployment rate registered at 5.8 percent in March 2022, down from 7.1 percent in the same month in 2021. Meanwhile, the underemployment rate, which have fluctuated widely during the pandemic, rose again to 15.8 percent in March 2022, reversing the downward trend since November 2021 (Figure 16).

Net job creation continued to accelerate. From October 2021 to March 2022, there was a net increase of nearly 3.15 million jobs, despite the surge in COVID-19 cases, enhanced alert levels, and devastation from the typhoon especially in January. About a third of the net increase in jobs were from the agriculture sector, whereas manufacturing and construction have added only a small number of jobs. Meanwhile, some sectors such as fishing and aquaculture, water supply and sewerage, and waste management and remediation activities experienced a fall in employment. The decline in jobs in fishing

and aquaculture was likely associated with the heavy destruction from Typhoon Odette in December 2021.

Job quality remains a concern. The dominance of elementary occupations associated with lower pay remained high, registering at nearly one-third in March 2022. This is in line with the large number of jobs added in wholesale and retail trade as well as agriculture. The share of part-time workers—those working less than 40 hours a week—was 33.8 percent in March 2022, slightly higher than the pre-pandemic level of 31.6 percent in January 2020. Further, the share of wage and salary workers and employers in the total labor force was nearly 4 percentage points lower than before the pandemic at 63.8 percent in March 2022 (compared to 67.6 percent in January 2020).

The growth contraction in 2020 and the associated income loss among poor and vulnerable households led to an increase in poverty in 2021. Preliminary official poverty estimates using national poverty lines show that the poverty incidence increased by 2.6 percentage points between the first semester of 2018 and the first semester of 2021. The crisis hit Luzon and Visayas the heaviest, with poverty increasing by almost 5 percentage points—from 12.7 to 17.1 percent in Luzon and from 26 to 30.8 percent in Visayas. Inequality has also likely increased, with the Gini coefficient estimated to have inched up from 42.3 percent in 2018 to 45.0 percent in 2021. These poverty and inequality indicators would have been higher in 2021 without the social assistance (e.g., cash transfers and food aid) given to families during the height of the pandemic.¹⁰



Photo: Twinstephoto

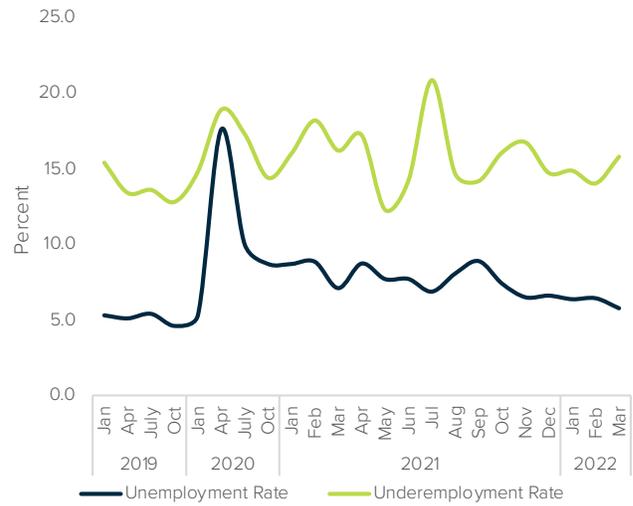
9 UNOCHA Reliefweb.

10 Results are based on a macro-microsimulation model that combines population and macroeconomic projections between 2020 and 2022 with pre-crisis data from the 2018 Family Income and Expenditure Survey (FIES) to predict income at the individual and household level. The model uses labor markets as the main transmission mechanism and allows for two types of shocks: (i) shocks to labor income, including employment shocks and earnings shocks from the pandemic, and (ii) shocks to non-labor income, including changes in private transfers and changes in social protection mechanisms (transfers from Bayanihan to Heal as One Act).

Figure 15. Labor Force Participation Rates, January 2019–March 2022 (normalized, Jan 2020=1) highlights greater volatility of female labor force participation



Figure 16. The underemployment rate fluctuated widely while the unemployment rate fell.



Source: PSA Labor Force Survey (LFS) (various rounds).
 Note: Starting February 2021, the LFS is conducted monthly to produce more timely data.



Photo: vichie81

Part II

Outlook and Risks

The economy is projected to grow at 5.7 percent in 2022 and 5.6 percent, on average, in 2023-24. Growth will draw strength from the domestic environment, with declining COVID-19 cases, looser restrictions, and wider reopening. The strong domestic condition will help compensate for the weak external environment, which is reeling from a global growth deceleration, rising global inflation, and geopolitical turmoil. The growth outlook, however, is subject to significant downside risks from external and domestic sources. The authorities are expected to tighten monetary policy and pursue fiscal consolidation in the medium term. The incoming administration needs to swiftly confirm its economic priorities to dispel policy uncertainty and preserve market confidence.



Photo: chanachai urchaitakul

2.1 Growth Outlook

The economy is projected to grow over the medium term, anchored in the recovery of domestic activities. Policy space is narrowing, with the authorities expected to raise the key policy rates and face the prospect of fiscal consolidation.

The external environment has turned less favorable at a time when the Philippines has weathered the worst so far of the COVID-19 pandemic. Three international developments are clouding the outlook. First, the war in Ukraine is disrupting food and fuel supplies, raising market volatility, and undermining global confidence. While the Philippines has limited direct exposure through trade or financial flows, the conflict and sanctions are affecting it in terms of higher energy and food prices. Second, rising global inflation is inducing policy rate hikes in advanced economies and EMDEs. Tightening global financing conditions are dampening global investment prospects. Finally, China's structural slowdown and regulatory response to COVID-19 are disrupting global trade and exacerbating the global growth deceleration. China's slowdown will adversely impact the Philippines, as its trade is increasingly oriented toward Chinese markets. About 4.1 percent of its value-added exports were destined for China in 2018, up from 3.0 percent in 2007.¹¹

The country's strong domestic conditions will help compensate for the weak external environment. Growth will draw strength from an improving domestic environment. Growth will draw strength from an improving domestic environment, characterized by declining COVID-19 cases, more vigorous public mobility, and wider economic reopening. New daily COVID-19 cases dropped from a peak of nearly 40,000 in mid-January to less than 200 in mid-May, prompting the authorities to further ease mobility restrictions across the country. The easing of restrictions ensued amid increased vaccine coverage and a short-lived Omicron wave, which kept the country's hospital and critical care capacities below precarious levels. People's mobility has returned to pre-pandemic levels across different activities including for work and recreation. The return of robust domestic activity is expected to buoy growth at a time when the external environment is weak.

The growth outlook is positive but subject to downside risks. The Philippines is expected to be one of the key growth performers in the region over the short- to medium-term (Figure 17). Its growth trajectory anchors on recovering domestic demand and sustained public infrastructure investments amid an anticipated recovery among EMDEs

next year. Growth is projected at 5.7 percent in 2022 and 5.6 percent, on average, in 2023-24, same as the projections made in the April East Asia and Pacific Economic Update (Figure 18). The projection incorporates the adverse impact of higher inflation on household consumption. The outlook faces downside risks from abrupt tightening of global financing conditions, geopolitical uncertainty, and growth deceleration in main trading partners like the United States and China. While the number of COVID-19 cases have been low for a long period now, the threat of a new variant-driven surge hangs over the outlook.

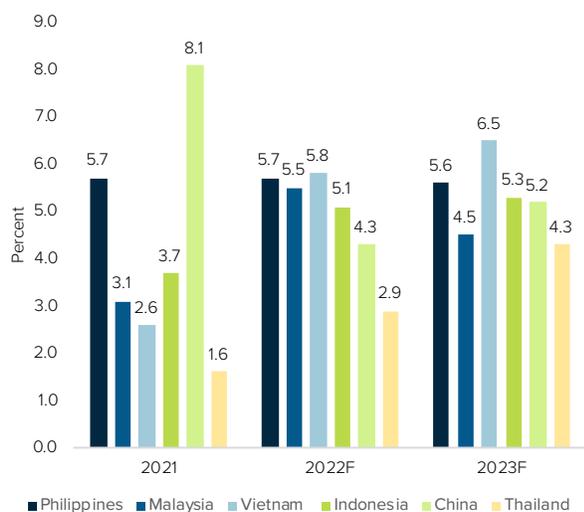
Without mitigation measures, the country faces weaker long-term growth potential due to economic scarring from the pandemic. Firm closures, due to the pandemic, have directly contributed to permanent jobs and income losses and the erosion of valuable intangible assets, such as management and technical know-how, employee competencies, and value network and relationships.¹² Some surviving firms face impaired balance sheets and are deferring productive investments. Higher incidence of malnutrition among the poor and disruption in education are eroding human capital and hurting peoples' future earning potential. The pandemic will have an adverse impact on the economy, lowering the long-term growth potential to a projected 5.7 percent, on average, in 2020–29, below the pre-pandemic estimate of more than 6.0 percent. The challenge is to limit the scarring by capitalizing on growth opportunities such as the acceleration of digitalization, and implementing a catch-up plan to mitigate the adverse socio-economic impacts of the pandemic.

Monetary policy is expected to tighten in the face of inflationary pressure and policy rate hikes in advanced economies. Headline inflation is expected to breach the central bank's target range of 2.0-4.0 percent in 2022, before declining in succeeding years. Rising oil and commodity prices, exacerbated by the war in Ukraine, firming local demand, and a weaker peso are stoking domestic inflationary pressure. Global energy prices are forecast to rise by more than 50 percent this year, with the Brent Crude Oil price averaging US\$100/bbl—an upward revision of US\$24/bbl.¹³ Meanwhile, agricultural prices are forecast to rise by about 18.0 percent this year, reflecting weaker grain production and high input costs for fuel,

¹¹ See World Bank, "East Asia and Pacific Economic Update: Braving the Storms," Washington, D.C.: World Bank, April 2022.

¹² The Philippines COVID-19 Firm Survey (March 2022) showed that 7 percent of firm respondents have closed and expected not to re-open, while another

Figure 17. The Philippines is expected to be among the top growth performers in the region.



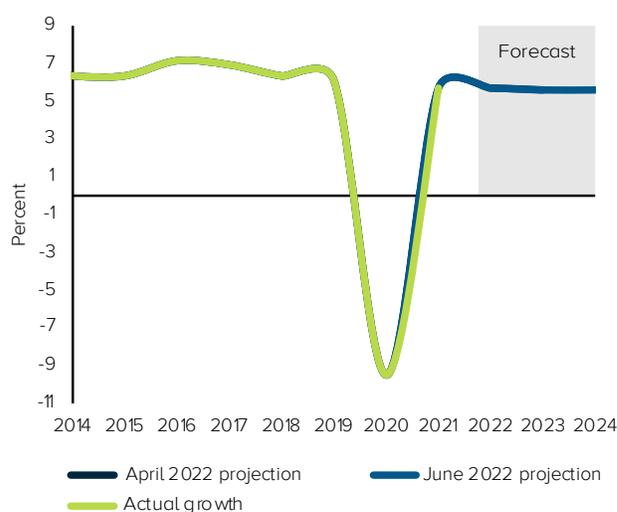
Source: World Bank staff estimates; various national statistics offices.

chemicals, and fertilizers. In May, the Department of Trade and Industry (DTI) approved raising the suggested retail prices of 82 basic necessities and prime commodities between 2 and 10 percent,¹⁴ while regional wage boards, including in Metro Manila, approved an increase in minimum wages for workers. The U.S. Federal Reserve started to hike key policy rates in March, and it has signaled its intent to raise rates further within the year. Monetary policy in the Philippines is thus expected to tighten in a bid to manage inflationary pressure and align with higher global interest rates.

The fiscal deficit is expected to remain elevated in the medium term but gradually decline with the economic recovery. The fiscal deficit is projected to reach 7.1 percent of GDP in 2022, before narrowing to 6.0 percent and 5.1 percent in 2023 and 2024, respectively (Table 2). The declining trajectory hinges on the economic recovery, which would be faster if the new administration pursues fiscal consolidation measures. The recovery will lead to higher tax collection from consumption taxes, while higher imports are contributing to increased customs collection. Corporate income tax revenue, however, is expected to be lower by an average of 0.5 percent of GDP per year in 2022-23 as the government implements the Corporate Recovery and Tax Incentives for Enterprises law. Meanwhile, public spending is expected to decelerate over the medium term as the government unwinds its pandemic response. Still, capital outlays will likely remain elevated as the government pursues infrastructure investments.

The economic reopening will benefit the services and industry sectors, while agriculture will grow modestly due to structural weaknesses and the impact of natural disasters. The reopening will benefit the contact-intensive

Figure 18. The medium-term growth prospect is positive.



Source: PSA; World Bank staff estimates..

services sector, especially transportation, restaurant and food services, and wholesale and retail trade. Moreover, prospects have improved for international and domestic tourism following the reopening of borders to vaccinated individuals, the reopening of tourist attractions, and relaxed travel requirements for travelers. Sustained public investments, along with reinvigorated domestic activities, will likely raise the demand in construction and industry. Weak external demand, however, may partly temper manufacturing growth. Growth in the agriculture sector remains tepid due to chronic underinvestment and vulnerability to weather-related shocks. Yet, supporting the sector is important to achieving inclusive growth, as it employs a disproportionate share of the labor force, while food comprises a large share of the household consumption basket.

Net exports are expected to be weaker amid a subdued external environment. After rebounding to 5.7 percent in 2021, global growth is expected to soften to 2.9 percent in 2022 and 3.0 percent in 2023 (Box 4). Growth in advanced economies is projected to decelerate by 1.2 percentage points in 2022 from earlier projection, and impact the country's goods exports, as nearly 70 percent are destined for high-income economies. Still, the prospect for services exports has improved from last year's as the BPO sector is expected to continue to capitalize on sustained global demand, and international tourism is set to recover with the reopening of borders and lifting of restrictions. Meanwhile, import growth will likely accelerate as the government implements infrastructure projects, leading to renewed demand for capital goods and construction materials. The current account deficit is projected to widen to 4.0 percent this year, and remain in deficits in 2023-24.

¹³ World Bank, Commodity Market Outlook: The Impact of the War in Ukraine on Commodity Markets," Washington, D.C.: World Bank, April 2022.

¹⁴ Department of Trade and Industry, "DTI releases new SRP bulleting for basic necessities and prime commodities," available online: <https://www.dti.gov.ph/news/dti-releases-new-srp-bulletin-for-basic-necessities-and-prime-commodities/>.



Photo: anek.soowannaphoom

Table 2. Economic Indicators for the Baseline Projections

	2019	2020	2021	2022F	2023F	2024F
Real GDP growth, at constant market prices	6.1	-9.5	5.7	5.7	5.6	5.6
Private Consumption	4.3	-5.8	3.1	4.0	4.1	4.1
Government Consumption	1.1	1.3	1.1	1.4	1.3	1.1
Capital Formation	0.9	-9.1	3.9	3.2	3.1	3.1
Exports, Goods and Services	0.8	-4.7	2.2	2.1	1.9	1.7
Imports, Goods and Services	1.0	-8.7	4.5	5.2	4.8	4.5
Real GDP growth, at constat factor prices	6.1	-9.5	5.7	5.7	5.6	5.6
Agriculture	0.1	0.0	0.0	0.1	0.1	0.1
Industry	1.7	-4.0	2.5	1.9	1.9	1.8
Services	4.3	-5.5	3.3	3.6	3.7	3.7
Inflation (period average)	2.4	2.4	3.9	4.6	3.9	3.5
National government balance (% of GDP)	-3.4	-7.6	-8.6	-7.1	-6.0	-5.1
National government debt (% of GDP)	39.6	54.6	60.5	61.9	62.7	62.7
Current account balance	-0.8	3.2	-1.8	-4.0	-3.5	-3.3

Source: PSA, BTr, and World Bank staff estimates.

Note: Growth subcomponents show contributions to growth.

Box 4. Global Economic Outlook

The global economic recovery is expected to slow due to the War in Ukraine, and as the effects of the pandemic reverberate across countries with limited fiscal space.

After rebounding to 5.7 percent in 2021, global growth is projected to decelerate to 2.9 percent in 2022 with growth in EMDEs projected to reach 3.4 percent (2.7 percent excluding China) (Table 3). The War in Ukraine resulted in drastically worse projections compared to the rosier forecasts earlier this year. Both Russia and Ukraine are major exporters of key commodities, such as wheat, natural gas, palladium, and seed oil. The conflict has contributed to heightened global inflation due to higher energy and food prices, which were already surging due to pandemic-related supply chain disruptions. Policymakers now face increasingly difficult tradeoffs as they attempt to support recovery while taming high prices. Conditions in EMDEs deteriorate as increasing risk aversion induce capital flight. The environment of EMDEs remains challenging because of limited policy response options to combat increasing debt and price levels, and lingering adverse effects of the pandemic on human and physical capital accumulation.

Global growth is projected to further moderate in 2023, keeping both EMDEs and LICs below pre-pandemic growth trends. Global growth is expected to moderate to 3.0 percent in 2023 as revenge spending is exhausted and fiscal support expires. The cumulative losses in output over its pre-pandemic trend is expected to mount until at least 2024, especially on EMDE commodity importers due to high prices and limited policy options (Figure 19). Globally, EMDEs and LICs whose food needs (e.g. wheat, corn, and seed oil) are dependent on Russia and Ukraine may become vulnerable to episodes of food insecurity. Energy prices are forecasted to rise by 52 percent in 2022, and Europe, which is critically dependent on Russian oil and gas, may also bear the brunt of this price spike in energy prices as a prolonged conflict looms. Limited policy space to rein in inflationary pressures and weak investment prospects are expected to particularly worry policymakers in EMDEs and LICs. Climate-related disasters may exacerbate the already fragile situation as EMDEs and LICs, which may

not be able to provide additional support when needed.

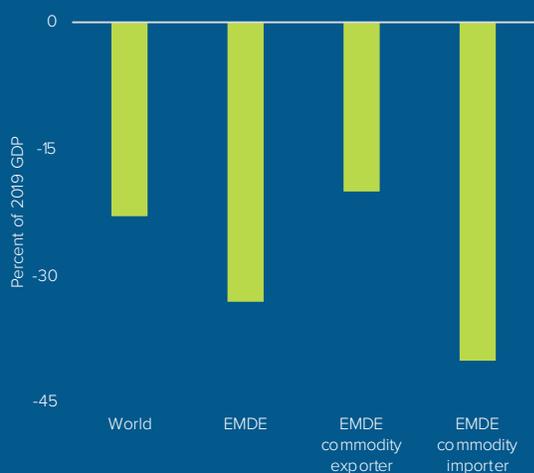
While global trade is expected to rebound in tandem with the economic recovery, it may be adversely affected by supply chain disruptions. The volume of goods traded globally is expected to increase by 4.0 percent in 2022 and 4.3 percent in 2023. Higher transport costs and persistent supply chain issues are making it challenging for GVCs contribute to the relatively meager growth. Nevertheless, these supply chain bottlenecks are expected to ease in the medium-term as pandemic-related shutdown of ports are lifted and the shortage of semiconductors and shipping containers ease. Still, key downside risks remain including potential new COVID-19 variants that could engender a fresh round of port-related restrictions, elevated oil prices could lead to persistently high shipping costs, and increased protectionism around the globe that could dampen trade in the long term horizon.

Global inflation remains persistently higher than expected, and high global debt levels contribute to increased financial stress. Inflation is above target in a vast majority of countries that employs an inflation targeting scheme (Figure 20). The War in Ukraine caused a surge in energy prices, worsening food inflation which was already reeling under the impact of supply chain bottlenecks. In the near term, this may accentuate food insecurity, particularly in EMDEs and LICs. Persistently high levels of inflation have led some monetary authorities to tighten monetary policy and raise long-term interest rates. This, in turn, has exacerbated the already-limited fiscal space of EMDEs as the prospect of further debt financing diminishes. If not reined in, worsening financial stress could reverberate across EMDEs as demand for traded goods and commodities decrease. Muted business and consumer confidence could dampen corporate profits, leading to bankruptcies that would dent bank balance sheets. Moreover, the war has triggered further risk aversion among investors, which could lead to capital outflows from EMDEs, resulting in currency depreciation, a fall in equity market valuations, and risk premium increases in bond markets.



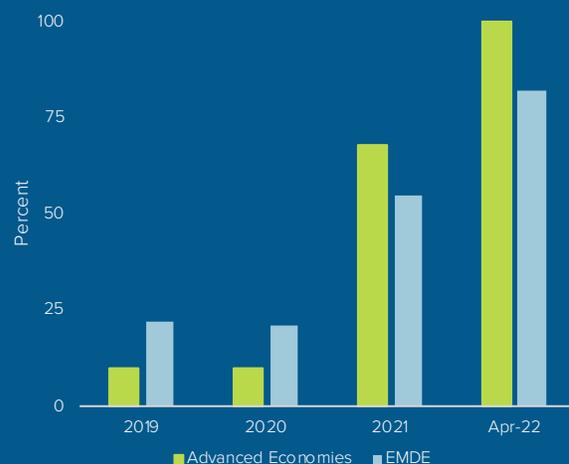
Photo: MDV Edwards

Figure 19. Cumulative output losses (2020-2024) versus the pre-pandemic trend are expected to mount.



Source: Consensus Economics, World Bank, International Monetary Fund

Figure 20. Inflation is above target in the vast majority of inflation-targeting countries.



Source: PSA; Consensus Economics, World Bank, International Monetary Fund

Table 3. Real Growth Projections.

	2019	2020	2021e	2022f	2023f
World	2.6	-3.4	5.7	2.9	3.0
Advanced economies	1.7	-4.6	5.1	2.6	4.2
Emerging market and developing economies	3.8	-1.7	6.6	3.4	4.2
East Asia and Pacific	5.8	1.2	7.2	4.4	5.2
Philippines	6.1	-9.5	5.7	5.7	5.6

Notes:

1. Developing East Asia & Pacific includes Cambodia, China, Fiji, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Solomon Islands, Thailand, Timor-Leste, and Vietnam.

2. Global growth projections may be updated in the upcoming Global Economic Prospects January 2022.

Source: Global Economic Prospects June 2022; East Asia and Pacific Economic Update April 2022.

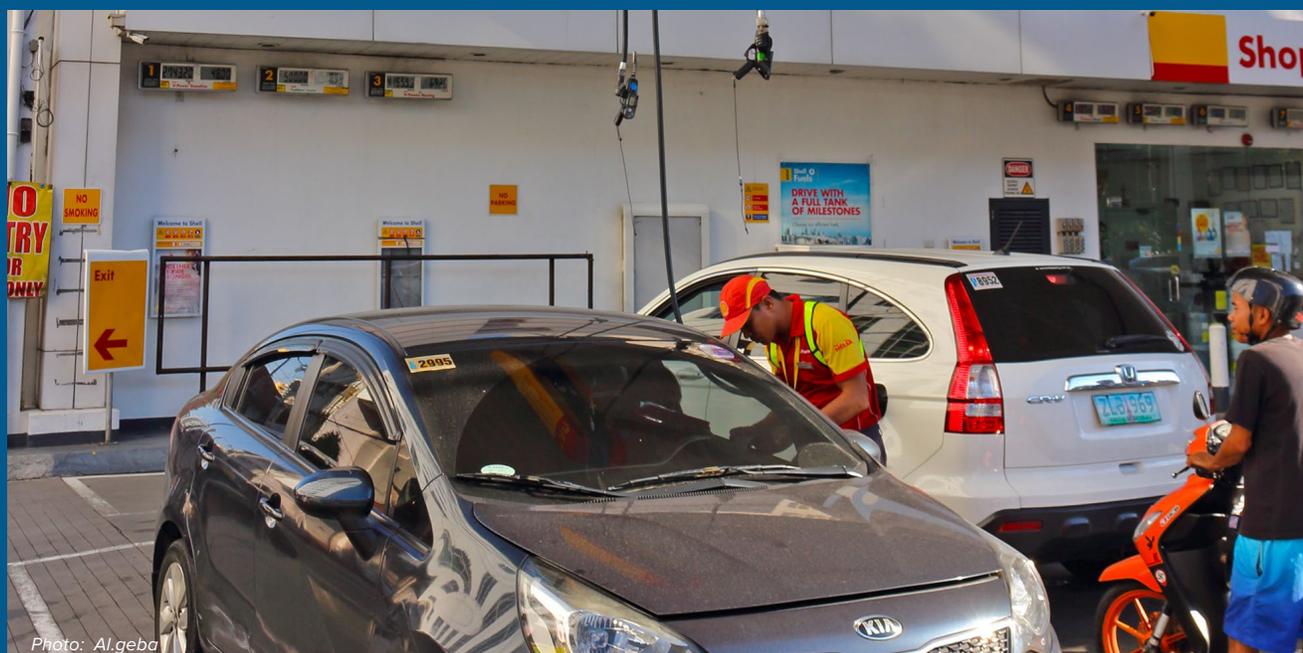


Photo: Al.geba

	ريال سعودي	Oman	62.55	95.82
	ريال قطري	Saudi Arabia	7.48	10.25
	Piso ng Pilipinas	Qatar	7.60	10.21
		Philippines	0.51	0.85
		Russia	0.35	0.88

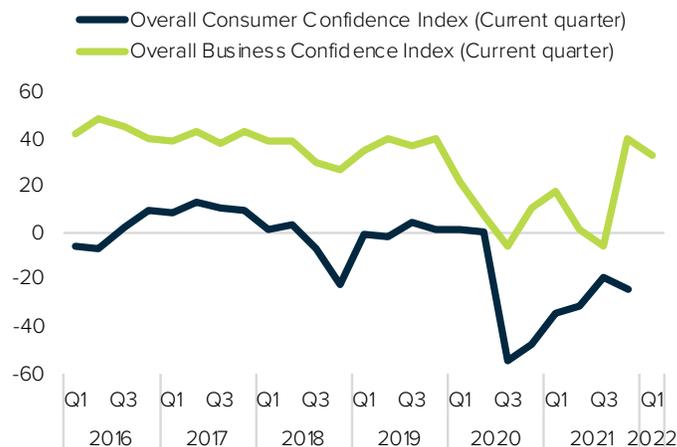
Photo: Bankoo

Private consumption is expected to expand with more robust economic activity, recovering employment, and sustained remittances. The economic reopening is expected to revitalize business activities, leading to job creation and improved household incomes. Together with sustained remittance inflows, recovering incomes will release pent-up demand and drive private consumption. Moreover, like in past election cycles, election-related activities are expected to have provided an added boost to the economy in the first half of the year. However, rising inflation is dampening consumer confidence, which has steadily improved since the trough during the pandemic (Figure 21). Moreover, it has partly compelled the authorities to raise the key policy rate. Absent the inflationary effect and the monetary tightening, private consumption recovery would have been higher in 2022.

Capital formation will drive growth in the medium term as the government attracts foreign investment and pursues

its public infrastructure agenda. Public infrastructure investment is expected to drive capital formation growth, with capital outlay disbursements programmed to rise from 5.1 percent of GDP in 2021 to 5.8 percent of GDP in 2022. The rollout of public infrastructure investments is expected to continue with the incoming administration, which has already signaled its intent to continue the flagship infrastructure program of the current administration. Private investment may be challenged by rising interest rates, a weak external environment, and domestic policy uncertainty. Nonetheless, in the medium term, broader private sector participation may drive capital formation growth.¹⁵ With the adoption of the amendment to the Public Service Act and the Foreign Investment Act, along with the passage of the Retail Trade Liberalization law and the Corporate Recovery and Tax Incentives for Enterprises (CREATE) law, the government has set the stage to attract foreign investments.¹⁶ This is timely, as the authorities face narrower fiscal space amid the continued delivery of infrastructure investments.

Figure 21. Consumer confidence has been steadily improving since mid-2020.



Source: BSP.

¹⁵ These laws allow more industries to full foreign ownership, lower the minimum paid-up capital requirement for foreign retail enterprises, and liberalize the practice of professions not governed by existing special laws.

¹⁶ These laws allow more industries to full foreign ownership, lower the minimum paid-up capital requirement for foreign retail enterprises, and liberalize the practice of professions not governed by existing special laws.

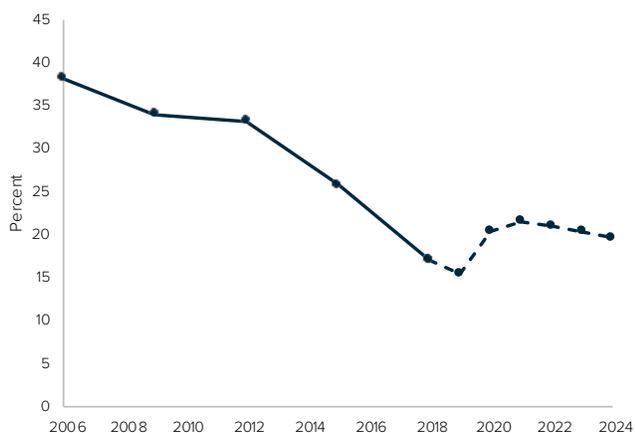
2.2 Poverty and Shared Prosperity

The gradual opening of the economy in March 2022 will likely have a positive effect on household incomes as conditions for workers and businesses improve. However, looming uncertainties on the ongoing war in Ukraine will likely slow down progress in poverty alleviation.

The gradual reopening of the economy, with most parts of the country placed under the lowest COVID Alert Level 1, will accelerate a recovery of labor markets, businesses, and household incomes in 2022. Following current growth projections, the poverty incidence is projected to decrease to 21.0 percent in 2022 and continue to decline through 2024 (Figure 22).¹⁷ Poverty will likely decline faster in major economic centers in Luzon (i.e., NCR, CALABARZON and Central Luzon) than in the rest of the country in 2022 because of faster employment growth in these areas. Recent official employment statistics also suggest that sectors associated with rural employment (e.g., agriculture and traditional services) is recovering slower than other sectors, indicating that poverty reduction will likely be slower in rural areas. The potential emergence of new COVID-19 variants and mobility restrictions during new rounds of lockdowns would impede the downward trend in poverty.

The looming uncertainties on the ongoing Russia-Ukraine

Figure 22. Actual and projected US\$3.20-a-day poverty rates



Source: World Bank staff estimates; various national statistics offices.

conflict will slow down the decline in poverty mainly due to direct effect of higher food prices and the knock-on effect of fuel price increases. Data from the 2018 Family Income and Expenditure Survey (FIES) reveal that food expenditures comprise over half of household consumption for 60 percent of households in the Philippines. For households in the poorest decile, food consumption accounts for 64 percent of total household consumption, with cereals alone comprising 44 percent of total consumption. With cereals comprising a considerable share of household expenditure, an increase in cereal prices will likely hurt the poorest households the most. Estimates of the direct effects of prices variations on poverty show that a 10 percent increase in the global price of cereals is expected to raise the poverty headcount by 1 percentage point, pushing an additional 1.1 million Filipinos into poverty (Figure 23). An increase of 10 percent in energy prices, on the other hand, is estimated to raise the poverty headcount by 0.3 percentage points, equivalent to an additional 329,000 poor Filipinos.

Figure 23. Simulated Changes in Poverty from Increases in Cereals and Energy Prices.



Source: FIES and World Bank staff estimates.

¹⁷ The macro-microsimulation model combines population and macroeconomic projections over 2020-2022 with pre-crisis data from the 2018 Family Income and Expenditure Survey (FIES) to predict income at the individual and household levels. The model uses labor markets as the main transmission mechanism and allows for two types of shocks: (1) shocks to labor income, including employment shocks and earnings shocks from the pandemic, and (2) shocks to non-labor income, including changes in private transfers and changes in social protection mechanisms (transfers from Bayanihan to Heal).

2.3 Risks and Policy Challenges

The growth outlook faces significant downside risks emanating from the external and domestic environments. The new administration will face the difficult challenges of taming inflation and supporting the economic recovery with narrowing fiscal space. It will need to swiftly confirm its economic priorities to dispel policy uncertainty.

Prolonged geopolitical tensions, coupled with intensified sanctions on Russia, could further disrupt global economic activity.

These geopolitical-related shocks would be wide-reaching, affecting global growth (e.g., growth deceleration in major economies), trade (e.g., adverse price and terms-of-trade shocks), and financial markets (e.g., muted capital flows). The Philippines would come under immense price pressure given its demand for imported crude oil, fertilizer, and food such as wheat and rice. Investment flows may be tempered as global investor sentiments retreat amid high uncertainty. As growth in advanced economies decelerate, with a fear of recession in Europe, demand for Philippine goods export would weaken, which in turn, would impair manufacturing activities. The adverse impact on growth would be severe and may have lingering effects in the medium term amid tempered investment and disrupted trade flows.

Faster-than-expected monetary tightening in advanced economies could induce financial market volatility and costlier financing.

Central banks in advanced economies may accelerate the pace of monetary policy tightening if the current period of elevated inflation persists and de-anchors inflation expectations. The U.S. Federal Reserve already started raising the Federal Funds Rate in March, and it signaled additional rate hikes within the year. A faster-than-expected tightening could induce capital outflows from EMDEs (including the Philippines), lead to currency depreciation, and raise financial market volatility. Private sector borrowing costs would rise, dampening investments, while the ensuing currency depreciation would be a burden on firms with large foreign currency-denominated loans. In April, EMDEs' financial conditions were already at their tightest levels since 2020,¹⁸ while in the Philippines, bond spreads increased from 83 bps at the start of the year to 143 bps on May 4.

The threat of natural disasters and climate change calls for strengthening the use of public resources in disaster mitigation, response, rehabilitation, and recovery. Climate change and the COVID-19 pandemic have compounded the impacts of natural disasters, which has made it more difficult

for the government to prepare for, respond to, and recover from disaster events. Over the past 10 years, strong typhoons have devastated nine out of 17 regions and affected an average of five million people. Recently, the country was hit by Super Typhoon Odette that affected 11 million people and incurred total direct damage and indirect losses of around 1.45 percent of GDP.¹⁹ The increasing intensity and frequency of natural disasters will likely add pressure to the country's fiscal position and growth prospect. Hence, the government needs to strengthen the efficiency, transparency, and inclusive use of public resources in disaster mitigation, response, rehabilitation, and recovery. Given the country's vulnerability to disasters, deepening disaster risk financing will strengthen financial resilience.²⁰

While the number of COVID-19 cases has been low for a long period, the threat of a new variant-driven surge hangs over the outlook.

The COVID-19 pandemic remains an ongoing threat more than two years after its initial emergence. Subvariants of the Omicron strain have already emerged and known to be spreading in a few countries. In April, the Philippines detected its first case of the Omicron subvariant. Nevertheless, the country is now better equipped to respond to the re-emerging threat. Vaccination coverage has reached 70 percent of the targeted population, and health protocol such as mask wearing continues. Moreover, the country has adopted systems that allow more public mobility and localized responses to outbreaks while households and businesses have learned to cope with the restricted mobility, effectively reducing the adverse economic impacts of the pandemic.

Taming the rise in domestic inflation is a key challenge this year.

The source of inflationary pressure includes: (i) elevated global commodity and energy prices; (ii) global supply constraints driven by weak global agricultural output, exports ban by key commodity exporters, and the war in Ukraine; (iii) international supply chain and logistics disruptions; (iv) currency depreciation; and (v) recovering local demand. High inflation will dampen household consumption which is expected to rebound with the lifting of mobility restrictions. It can also induce rate tightening, which

¹⁸ World Bank, Global Monthly April 2022.

¹⁹ This is higher than the damage and losses incurred during Typhoon Haiyan in 2013 at 1.10 percent of GDP.

²⁰ World Bank, Philippines Economic Update: Building a Resilient Recovery," Manila: World Bank, December 2020.

will increase the cost of borrowings. The authorities must use its available policy tools to tame inflation, some immediately and others later as needed. These tools include supply-side measures such as freer importation and lower tariffs and non-tariff barriers to help augment domestic supplies as needed, support to agriculture production through extension services, seeds, and fertilizers, and monetary tools to prevent a de-anchoring of inflation expectations.

In the short to medium term, pursuing fiscal consolidation will help protect long-term fiscal sustainability (Box 5).

The authorities has to carefully manage the risks and trade-offs associated with consolidation. Increased taxation or a reduction of public spending would hold back economic activity in the short to medium term due to the reduction in aggregate demand. Still, the improved macro management

will help safeguard growth in the long term. Exercising fiscal discipline means that the growth of public expenditure is slower than the growth of public revenues. This can be achieved through tax administration and policy measures, improved spending efficiency and increased value for money in public procurements. Besides fast economic growth, fiscal consolidation is needed to lower the debt ratio to near pre-pandemic levels. The country's debt profile remains favorable. Public debt is mostly domestic (69.9 percent as of March 2022), long-term (65.7 percent), and peso-denominated (69.8 percent). Moreover, contingent liabilities in the form of national government outstanding guaranteed debt have remained manageable and continued to decline to 2.1 percent of GDP as of March 2022. Financing risks are curtailed by the Philippines' comfortable access to capital markets, both domestic and international, and strong engagement with multilateral institutions.²¹



Photo: Pra Chid

21 In comparison with regional peers, the general government gross debt in the Philippines (59.1 percent of GDP in 2021) is lower than China's (68.9 percent) and Malaysia's (67.0 percent), but higher than Thailand's (58.0 percent), Vietnam's (47.9 percent) and Indonesia's (41.4 percent).

Box 5. Rebuilding Fiscal Buffers through Fiscal Consolidation

The COVID-19 pandemic has placed an undue burden on the Philippines' fiscal position. The combined effect of the global health crisis and the implementation of stringent containment measures led to a historic recession in 2020 and continued weakness in 2021. In 2020, revenue collection weakened while public expenditures were reallocated to prioritize social spending and immediate COVID-19 support. Despite the sharp erosion in tax revenues, the government continued to pursue expansionary fiscal policy in 2021 to provide relief, jumpstart the economic recovery, and support growth. This resulted in a sharp increase in national government debt from 39.6 percent of GDP in 2019 to 60.5 percent of GDP in 2021, the highest level since 2005. As a result, the Philippines now faces the challenge of protecting its fiscal health while attempting to navigate a challenging economic recovery in the medium-term.

Although debt sustainability risk remains manageable, pursuing fiscal consolidation in the medium-term is necessary to rebuild fiscal buffers, anchor the economic recovery, and undo the economic scarring effects of the COVID-19 pandemic. The current administration's medium-term fiscal program aims to gradually reduce the fiscal deficit, by initially unwinding fiscal support. Under current macro-fiscal assumptions, the debt-to-GDP ratio is projected to peak at 62.9 percent of GDP in 2024, before declining gradually to 60.6 percent of GDP by 2028. Although the

Philippines' ability to weather external shocks is aided by its prudent management of external debt and short-term risk, the country's fiscal buffers have narrowed over the medium term. As a result, the Philippines will have less policy space to remain flexible in an event of another exogenous shock, which could potentially derail the country's long-term inclusive growth agenda. Moreover, additional fiscal buffers are needed to help mitigate the damaging effects of the COVID-19 pandemic in terms of firm closures, jobs and income losses, and health insecurities and education disruptions.

A combination of revenue raising reforms, strategic expenditure cuts, and growth-enhancing structural reforms will be instrumental for the Philippines to pursue fiscal consolidation that does not disrupt its growth potential. The country has shown a willingness to pass difficult yet potentially game-changing reforms that could improve the country's long-term growth trajectory. For example, it has passed key reforms that have further liberalized the economy with amendments to the Public Services Act, Foreign Investment Act, and Retail Trade Liberalization Act. Ensuring that similar policies continue into the next administration will be crucial to help with economic recovery and reduce the strain on fiscal policy in order to safeguard the country's fiscal health and inclusive growth agenda.



Photo: KieferPix



Photo: LiteChoices

The authorities could improve public investment management and leverage private sector participation to narrow the country's infrastructure gap.

Limited fiscal space makes it necessary for the authorities to improve public investment management to increase spending efficiency and minimize cost overruns. There is significant room for improvement as the country's spending efficiency is about 23.0 percent lower than what is considered best practices in efficiently translating public investment into infrastructure.²² The authorities can also leverage public-private partnerships to improve the country's infrastructure as long as financial risks to the government are managed, and quality of services for the citizens are secured. The private sector is a source of not only finance but also expertise and innovation to improve the economy's infrastructure readiness. The passage of investment-friendly laws and amendments to restrictive laws signal the government's intent to intensify private sector involvement in key industries including telecommunications, shipping, railways, and subways.

Diversifying the sources of key food commodities through free trade would help ensure local produce, where inadequate, is augmented by foreign supplies.

In the context of recovering consumer demand following the loosening of mobility restrictions, high commodity prices, along with global food and fuel supply constraints, are partly driving inflationary pressure in the domestic economy.

Ensuring access to commodities from both domestic or foreign markets will help address inflationary pressure and mitigate food insecurity. The Rice Tariffication Law, in particular, has replaced quantitative restrictions on rice imports with tariffs, resulting in lower and more stable prices for unmilled and retail rice.²³ Recently, the temporary increase in the minimum access volume for pork and lower tariffs raised pork import and added to supplies amid the outbreak of African Swine Fever which decimated local hog population. Food security is tied to the ability to draw from diversified sources both local and international.

Improved targeting of social assistance could ensure the protection of poor and vulnerable households.

The implementation of social protection measures will help mitigate the adverse impact of shocks, including high inflation, on the vulnerable population. However, the narrow fiscal space means that assistance needs to be timely and targeted, only reaching those most in need. The challenge is to identify beneficiaries and swiftly deliver assistance in the most efficient way. There is no single targeting method that is universally preferred or equally effective across countries, as methods must be adjusted to the purpose of the program, availability of data, and institutional capacity.²⁴ The digital transformation of delivery systems and the use of the PhilSys for the identification of recipients are steps towards building a more dynamic registry to better inform the needs of citizens (Box 6).

22 International Monetary Fund, "Public Investment Management Assessment," IMF Country Report No. 19/137, Washington, D.C.: IMF, May 2019.

23 R. Briones, "Does rice tariffication in the Philippines worsen income poverty and inequality?" PIDS Policy Notes no. 2021-02, February 2021.

24 M. Rutkoski and M. Grosh, "Is there a best way to target social assistance?" World Bank Blogs, March 2022, available online: <https://blogs.worldbank.org/voices/there-best-way-target-social-assistance>.

Box 6. Spotlights on PhilSys for Social Protection Delivery

The Philippines has made steady progress towards a comprehensive social protection framework. The flagship conditional cash transfer, Pantawid Pamilyang Pilipino Program (4Ps), has contributed to reducing poverty, improving human capital, and women's empowerment, among other positive outcomes for the poorest families. In addition to the regular program for poverty reduction and human capital investment, adaptive social protection programs to mitigate the negative consequences of shocks have been implemented. The unconditional cash transfer in response to the Tax Reform for Acceleration and Inclusion (TRAIN) in 2018 and social amelioration program (SAP) in response to the COVID-19 pandemic for instance demonstrate at a large scale how the country has been using social assistance to mitigate the socio-economic impacts of shocks for the poor and vulnerable population.

These policies and best of intentions, though, have been undermined by relatively weak delivery systems. Processes for enrollment, eligibility determination, and payments – with some exceptions related to 4Ps – are paper-based and manual, and thus inefficient, costly, and time-consuming. This was on display during the SAP when the use of paper forms, manual data entry, and physical cash delivery increased processing times, and led to crowds that increased public health risks.²⁵ Listahanan, the current targeting system that depends on surveys every few years, does not cover all households, does not link information between surveys, and is out of date for Filipinos whose socio-economic situation may have changed since the enumeration or was not captured accurately. Furthermore, agencies face difficulties matching

information, such as to identify gaps or duplications in assistance. And documentation-related barriers for beneficiaries to access financial services means that government-to-person payments cannot be digital.

The authorities have shown commitment to use PhilSys to tackle these challenges as part of a broader agenda for digital transformation to increase impact and resilience.

The Department of Social Welfare and Development (DSWD) was the first to sign a memorandum of agreement with PSA on PhilSys adoption, and has begun preparation for piloting PhilSys seeding, online identity authentication and e-KYC into 4Ps and the Assistance to Individuals in Crisis Situations (AICS) program. These pilots will pave the way for the DSWD to launch several important and interconnected initiatives:

- **Cleaning databases:** Using PSN token seeding to identify ghost, deceased, and duplicated beneficiaries.
- **Establishing a Unified Beneficiary Database:** Integrating beneficiary and household information across programs to make monitoring and decision-making easier.
- **Dynamic targeting:** Shifting from intermittent surveys towards a real-time system of targeting by cross-checking administrative data in real-time in sources such as PhilHealth, Social Security System, DA, and the community-based monitoring system.
- **On-demand enrollment:** Using e-KYC to shift to online and paperless applications for assistance, which will be especially important during responses to disasters and other shocks.
- **Digital government-to-person payments:** Incorporating bank and e-money account information into DSWD's delivery systems will enable programs to transfer payments digitally.



Photo: Venus78

25

Y. Cho and D. Johnson, "COVID-19 and Social Assistance in the Philippines: Lessons for future resilience," Manila: World Bank, March 2022.

Promoting digital transformation brings an opportunity to boost economic recovery and position the country for long term growth. This will require leveraging digital technologies to (i) create new markets and business models, (ii) enable economies of scale and better organization, and (iii) improve operational efficiency and service delivery. While the pace of digitalization has accelerated, evidenced by the higher volume of digital transactions, increased

use of online platforms, and expansion of e-commerce, the use of digital technologies has been uneven, creating a digital divide between demographics (young and old), socioeconomic groups (rich and poor), regions (urban and rural), and firms (large and small firms). Chapter 3 of this report investigates the state of digitalization of the private sector in the Philippines, identifies the challenges to digital adoption, and provide policy recommendations.



Photo: Chaay_Tee

Part III

Improving digital enablers in the Philippines: bridging the digital divide and accelerating recovery through reforms

Digitalization encompasses innovative technologies that have the potential to radically change the way firms operate, create new markets and business models, and make goods and services accessible to more consumers. This special chapter focuses on reforms aimed at accelerating the growth of digital markets and services as well as digital technology adoption by firms. It shows that digitalization in the Philippines has expanded over the past years and accelerated during the pandemic. The use of digital technology is reshaping service delivery and improving the competitiveness of the economy. However, the depth of digitalization falls behind regional peers, and its benefits have not been shared equally across firms. This chapter examines specific barriers that explain these gaps in the Philippines. It performs a deep dive into the building blocks of the digital economy and provides reform recommendations to bridge the digital divide. Policy reforms need to build on the reform impetus of the past two years to ensure the digital dividend is broad-based.



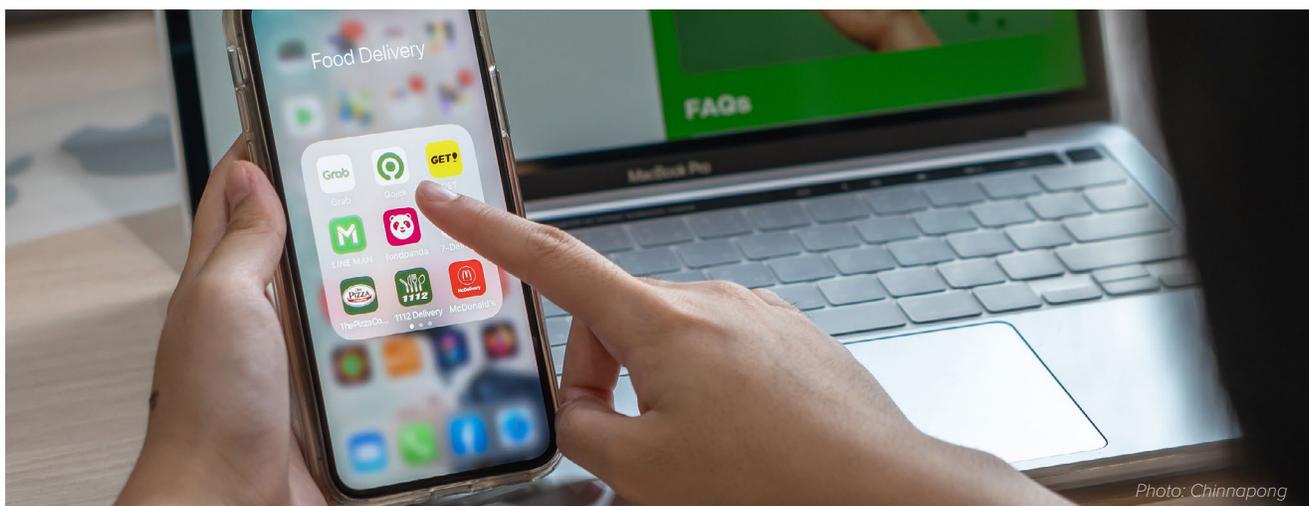
3.1 Introduction

While the Philippines has grown remarkably in the past decades, only a transformative growth solution will catapult the economy into reaching its long-term aspirations laid out in the *Ambisyon Natin 2040*. Prior to the COVID-19 pandemic, the Philippines enjoyed about two decades of uninterrupted economic growth. Growth accelerated from an annual average of 2.8 percent in 1990–99 to 4.5 percent in 2000–09, before averaging an impressive 6.4 percent in 2010–19. However, the pandemic slowed this momentum, with an economic contraction of 9.5 percent recorded in 2020. It had an adverse effect on the economy, hurting both physical and human capital accumulation, and lowered the country’s growth potential below the pre-pandemic projection of more than 6.0 percent. Furthermore, recent global technology trends are disrupting the way countries participate in the market economy. The growth of digital services as a complement to manufacturing, and the emergence of artificial intelligence, the Internet of Things, and Big Data, as complements to services, are being embraced by regional competitors of the Philippines, such as Vietnam, Malaysia and Indonesia. Therefore, a business-as-usual approach will not deliver the sustained growth necessary to reach the *Ambisyon Natin 2040* aspirations of attaining a prosperous, middle-class society by 2040; rather, a transformative solution is needed to increase the economy’s productivity and competitiveness. That transformative growth solution lies in harnessing the potential of the digital economy.

The digital economy offers an opportunity to boost the economic recovery and position the Philippines on a

long-term growth trajectory. Stringent lockdowns imposed during the pandemic drove a new wave of digitalization in the Philippines. The average number of new digital services used by Filipinos climbed from 3.9 before the pandemic to 8.2 in 2021. The country is shifting to a new phase of managing the post-pandemic recovery, where policymakers will refocus from pandemic relief to economic growth. Harnessing the power of the digital economy will be central to accelerate growth. One important benefit of digitalization is that it drives productivity by enhancing coordination, reducing operational costs, delivering economies of scale, and increasing firm efficiency. Its benefits have been well documented. The most digital-intensive industries have driven labor productivity growth in European countries and have contributed to as much as 86 percent of labor productivity growth in the United States. Moreover, digital adoption is associated with productivity gains, having a deep impact on productivity in industries such as manufacturing and those with routine-intensive activities.²⁶

Digitalization has the power to expand market access for businesses and consumers. Digital solutions can reduce the need for face-to-face interaction, allowing for remote delivery of services. It can easily connect firms, workers, suppliers, and customers and create opportunities to expand tele-health, financial technology (fintech), and travel technology business models. Digitalization has led to greater trade in more markets, often by newer and younger firms. For instance, a 10 percent increase in internet use in an exporting country is found to increase the number of products traded between two countries by 0.4 percent; while



26 Van Ark et al. (2019) and Gal et al. (2019).

a similar increase in internet use of a country pair increases the average bilateral trade value of products by 0.6 percent.²⁷

Furthermore, digitalization can build resilience against economic shocks. The presence of technology sophistication before the COVID-19 pandemic resulted in higher sales during the initial stages of the crisis.²⁸ In the Philippines, the pandemic has encouraged firms to digitalize and consumers to increase the use of digital services in response to the economic shock. By March 2022, approximately 71 percent of Philippine firms had either started or increased their use of digital platforms since the pandemic began. Moreover, firms that adopted digital platforms have experienced about 7.0 percent higher employment growth and are about 10 percent less probable to go bankrupt than digitally constrained firms.²⁹ During the pandemic, 39.0 percent of digital merchants believed that their business would not have survived the pandemic if not for digital platforms.³⁰

This focus note investigates the digitalization of firms and

proposes reforms to improve the enabling environment and advance the digital transformation of businesses. It builds on previous reports,³¹ expands the discussion by examining the barriers to digital adoption in the private sector and provides recommendations to accelerate the pace of reforms. The study presents four main findings. First, underinvestment in digital infrastructure, owed to decades of insufficient competition and outdated legal, policy, and regulatory frameworks, has hampered the rollout of more affordable, faster, and reliable internet services, especially broadband. Second, DFS face two critical challenges: (i) limited coverage of payment infrastructure in the last mile; and (ii) low levels of consumer trust. Third, the labor market does not seem ready to meet the rising demand for digital skills. While the government has begun to address the skills gap, more can be done to foster digital competency through basic education, deliver upskilling and reskilling for highly specialized skills, and strengthen skills qualification and accreditation. Finally, regulations must keep up with the development of the digital economy in areas of trust, electronic transactions, and data flows.

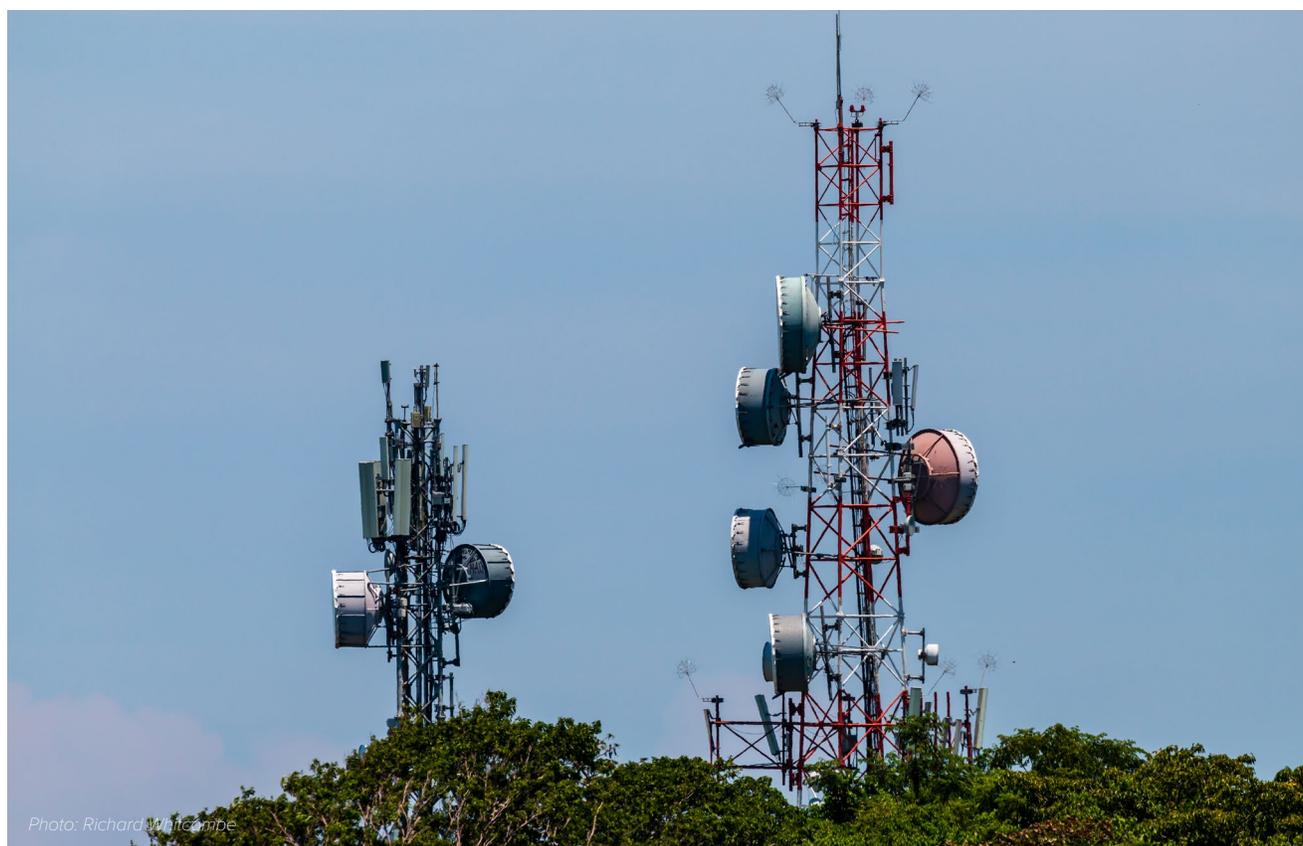


Photo: Richard Whitcombe

27 World Bank (2016).

28 The paper is based on the firm technology adoption surveys done in Vietnam, Senegal and Brazil. It proposes that a one standard deviation on technology sophistication before the onset of the pandemic leads to 3.8 pp of higher sales during the early stages of the pandemic (Cirera et al, forthcoming).

29 World Bank Group, COVID-19 firm surveys.

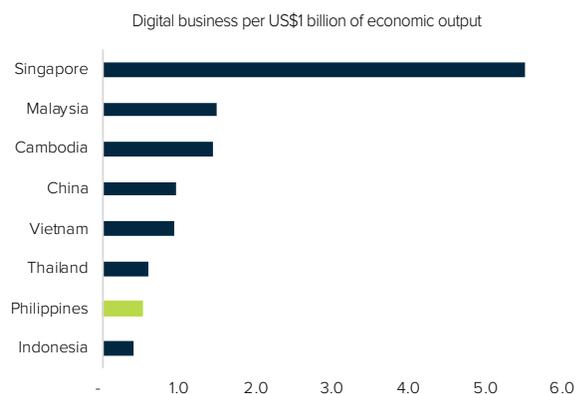
30 Google, Temasek, and Bain (2021).

31 The World Bank Philippines Digital Economy Report 2020 systematically analyzed the operating environment for households, businesses, and government in the digital economy.

(14.3). Similarly, median investments per digital firm (e.g., through venture capital and private equity) are below that of peers, with a median ticket size of US\$0.5 million (Figure 26 and Figure 27).

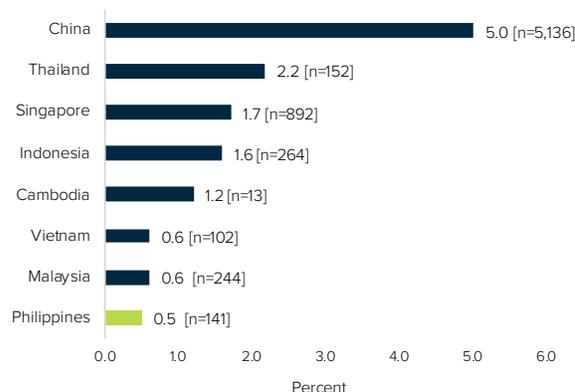
In addition, the level of digital adoption is uneven across firms. In several East Asian countries,³⁴ firms have increasingly used front-end (consumer facing) digital technologies to reach customers and fulfill sales online. But larger firms in these countries, as in the Philippines, have also increased the use of advanced digital solutions that have a greater impact on firm productivity performance.³⁵

Figure 26. Number of Digital Business relative to GDP, 2020



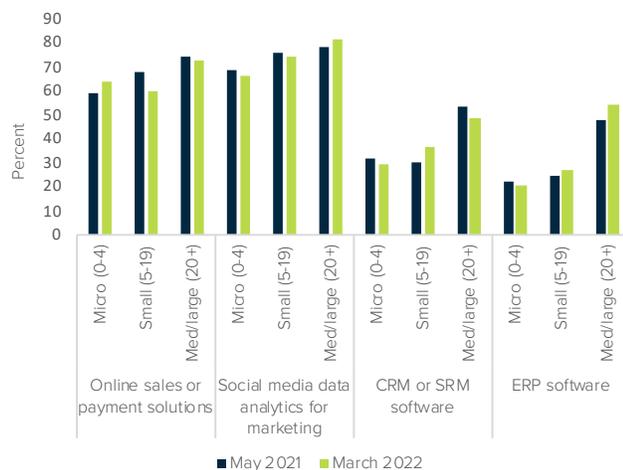
While there is convergence across firms in the use of front-end technologies, including online sales³⁶ and social media,³⁷ a large gap exists between small and large firms in the use of sophisticated, back-end technologies, such as enterprise resource planning (ERP) and customer relationship management (CRM) applications, internal process technologies, and data storage and management technologies. Furthermore, the adoption of digital technologies is slower in areas outside the NCR and key metropolitan cities, and digital adoption is higher in services sectors than in manufacturing and extractives (Figure 28 and Figure 29).

Figure 27. Median Investment Received Per Firm, 2020 (US\$ million)



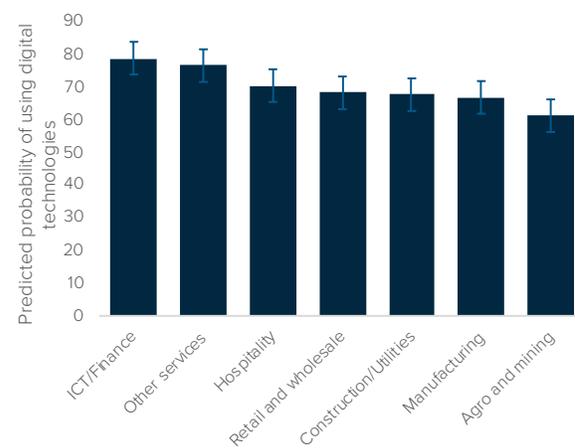
Source: World Bank FCI Digital Business Database based on CB Insights, Pitchbook and Briterbridges
Note: These charts use CB Insights to enhance cross-country comparability. 2020 represents the latest round of investment.

Figure 28. Adoption of digital technologies since COVID-19 onset by type of Technology and Firm Size



Source: World Bank COVID-19 firm survey, March 2022.

Figure 29. Adoption of digital technologies since COVID Onset by sector



Source: World Bank COVID-19 firm survey, March 2022.

34 Adoption between baseline and wave 1 or wave 2 for EAP countries comprising Indonesia, Mongolia, the Philippines, and Vietnam, Business Pulse Surveys, and COVID-19 firm surveys of the World Bank.

35 Marked differences in the adoption of more complex technologies by large firms. Large firms that use digital platforms were 35 percent more likely to use them for supply chain management, and 38 percent more likely to use for internal business processes than smaller firms (World Bank, EAP Economic Update).

36 Reported use for small firms at 27 percent versus large firms at 35 percent.

37 By 31 percent for small versus 38 percent for large firms.

3.3 Enablers of Digitalization

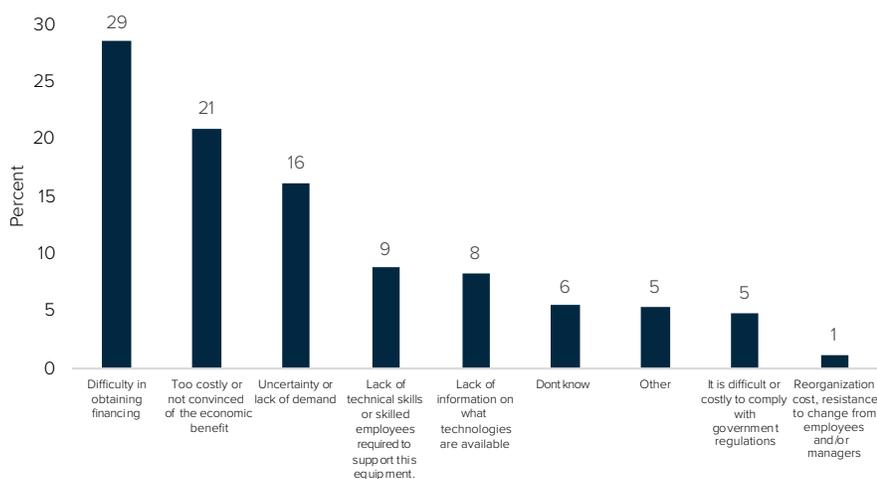
The business environment and firm capabilities represent complementary conditions for the adoption of digital technologies. Several factors affect the speed of digitalization among firms. Key drivers such as digital infrastructure, a conducive regulatory environment, DFS, and digital skills, to name a few, need to be in place. These are external to the firm and remain under the scope of policy reforms. But complementary factors that are internal to the firm, such as the business capacity to use digital infrastructure effectively or the ability to manage externally financed investments in digitalization, can drive the speed of digitalization. The importance of these factors depends on the context, the type of digital technology, and the type of firm susceptible to digitalization.³⁸

Limited access to finance ranks high among perceived constraints to technology adoption in the private sector (Figure 30). The difficulty in obtaining financing affect digitalized and digital firms alike. Digitalized firms are traditional (analog) firms that seek to apply digital technologies to their business functions. Examples include travel tech, fintech, digital media and entertainment, health tech and educational tech. Digital firms include data-driven firms and online platforms that provide digital solution services to traditional firms. These services include software solutions, cloud services, and big data and analytics. In the Philippines, SMEs are more likely to be financially constrained to invest in acquiring digital technology, which is contributing to the divergent trend in digitalization between small and large firms. Weaknesses

in credit information disproportionately affect SMEs since they typically lack financial records. Furthermore, the pandemic has heightened risk aversion to SME lending. Sources of financing for early-stage firms are also limited, hampering business opportunities to access mentoring, smart capital, and financial resources to innovate in digital services. Digital businesses tend to be disproportionately affected by lack of innovation finance, particularly as their intangible assets are not recognized as collateral for traditional loan-type financing. Young firms cite access to innovation finance as a major constraint in establishing a new business and innovating.³⁹

Demand constraints that prevent investment in digitalization such as lack of perceived benefits from technologies, and uncertainty, rank high as well, and need to be addressed with priority. Issues that affect the demand from digitalized and digital firms for investments in digital technology, such as the perception of value from digitalization, and awareness of the potential benefits behind adoption represent necessary pre-conditions for deciding whether to acquire digital solutions. Smoothing the digital transition through access to finance should become a priority once the demand for investment has been established. Despite the importance of finance for the expansion of digitalized and digital firms, this note will not address it in detail. The scope of SME and innovation finance is part of broad agenda whose scope extends beyond the topic of digitalization in this focus note.

Figure 30. Main reported barriers to adopt digital technology, 2022.



Source: World Bank COVID-19 firm survey, March 2022.

38 Cirera et al., forthcoming.

39 In 2020, Philippines' start-up ecosystem was ranked 53rd in the world (up from 70th in 2017), being home to 400+ startups, 50+ angel investors, 40+ venture capitalists, and 35+ incubators and accelerators and having seen an estimated 47 known deals in 2019.

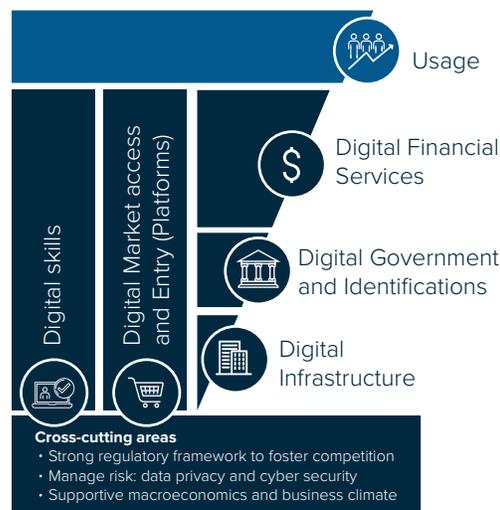
Promoting digital adoption requires creating strong foundational enablers of digitalization These enablers include affordable and reliable digital connectivity, which is a basic prerequisite to participate in the digital economy, as well as DFS and digital identification, which can sustain electronic transactions and allow for increased financial inclusion. The depth of digital skills in the labor pool can also expand the use of technology and increase the economic participation of workers in digital technology. Finally, a strong regulatory framework that builds consumer trust and manages risks for participants of e-commerce will help to allay potential concerns about privacy and support safe engagement in digital markets. The continued implementation of reforms aimed at creating these digital enablers of digitalization is needed because: (i) these foundational enablers are necessary to foster digital technology adoption at scale; (ii) prioritizing legal, regulatory, and institutional reforms will put less stress on fiscal resources, especially if they can unlock private investment; and (iii) improving the operating environment for firms can boost the economic recovery by easing business entry and promoting the efficient reallocation of investment and human resources. Figure 31 borrowed from the Digital Economy for All framework to introduce the foundational enablers.

Biases in management may prevent firms from making the necessary growth-enhancing investments. Cognitive bias plays a role in inhibiting the adoption of e-commerce, especially for smaller firms in the Philippines, and favoring technological path-dependence is one of the most critical impediments to adopting e-commerce.⁴⁰ Firms tend to not be aware of their own limitations and the potential value from adopting new technologies. Preference to preserve the status quo ranks at the top of the reasons for not investing in new technology, with 18.6 percent of respondents reporting this to be a bottleneck. For example, firms continue to be largely unaware of the potential economic benefits from acquiring digital solutions for business management.⁴¹ As a result, firms do not spontaneously replace their existing analog methods with digital ones, and many would rather continue to employ technologies in areas where they have a comparative advantage.

Besides digital skills, managerial and organizational skills support investments in digital ‘upgrading.’ The skills needed to operate in the digital economy go beyond skills related to ICT. Not only do employers and workers need to know how to use digital technology, but they also need to gain soft leadership, managerial, and organizational skills to help navigate the complexities of the work environment. Before the pandemic hit, the prevalence of skills and favorable attitudes toward entrepreneurship among small and medium-sized enterprises (SMEs) represented key determinants of innovation among these same firms.⁴² However, 62.5 percent of firms report that managerial talent is difficult to find. Supporting underlying managerial competencies and providing the right information about the availability and potential value of digital technology investments will be important to support digitalization.

There are gaps in business digitalization that deserve government attention. The ensuing sections identify these digitalization gaps and provide the general policy direction to bridge the digital divide.

Figure 31. Foundational Enablers for Business Digitalization



Source: Adapted from the World Bank Digital Economy for All (DE4A) framework.

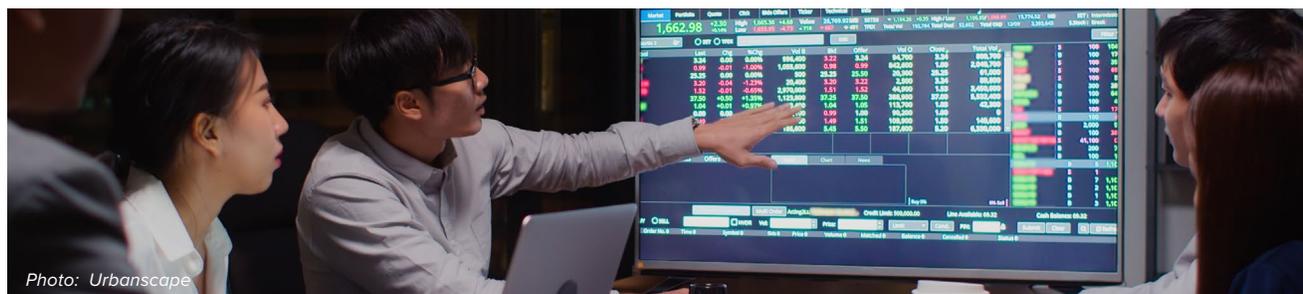


Photo: Urbanscape

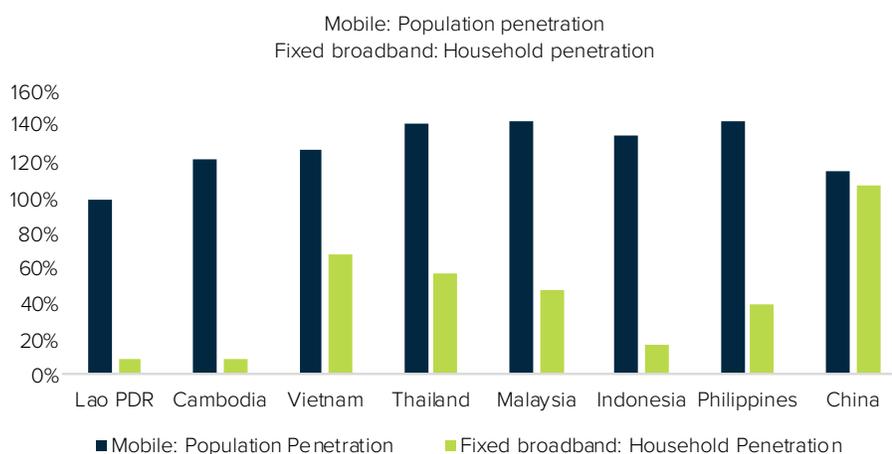
40 Quimbo and Cateo (2019)
 41 World Bank COVID-19 firm survey.
 42 Asian Institute of Management, 2018

3.4 Digital infrastructure

Digital connectivity is critical to bridge the digital divide and enable deep digitalization. Affordable, reliable, and widely available high-speed internet is a prerequisite for the Philippines to accelerate the nation's digital transformation. Acceleration requires a combination of increased investment, particularly in unserved and underserved parts of the country, and regulatory reforms that crowd in private investment. In many parts of the country with limited or no internet access, MSMEs have yet to benefit from online transactions and e-commerce opportunities. Telemedicine is out of reach for many urban and most rural communities, limiting its growth prospect. Access to fast internet stands as a prerequisite for deepening of digitalisation, as the operability of cloud computing, internet of things, and large data management depends on reliable service, capable of sustaining high volume of information.

While there has been progress in enhancing digital connectivity, challenges remain. Private investment in broadband infrastructure and services increased in 2020-21 in response to growing pandemic-related demand for internet-based services. While mobile penetration in the Philippines is among the highest in the region, its broadband penetration is still lower than that of neighboring economies, despite the entrant of a third full-service operator in 2021 (Figure 32, Figure 33, and Figure 34). The Philippines' fixed broadband (e.g., fiber to premises), which is important for high-volume data transmission for large businesses and institutions, continues to lag regional comparators. The quality of internet service (indicated by average download speeds) improved in 2020 and 2021 due to network upgrades and increased infrastructure deployment. However, there is scope for further improvement, particularly in smaller urban centers, rural areas, and islands planned for accelerated tourism development.

Figure 32. Mobile and Fixed Broadband Internet Penetration, 2022

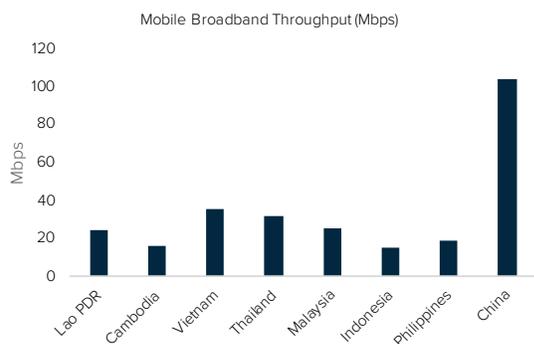


Source: Global System for Mobile Communications Association.



Photo: kittirat roekburi

Figure 33. Mobile broadband speeds: Philippines & selected economies



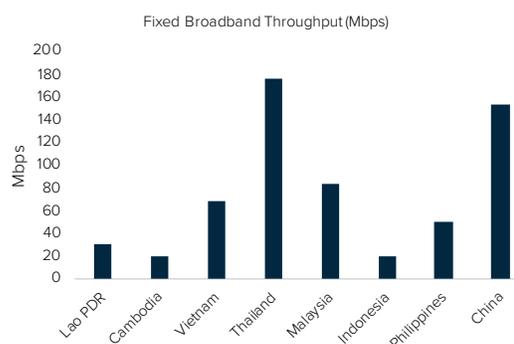
Source: <http://www.speedtest.net/global-index> on 5 February 2022 (Dec 2021 data)

Key challenges to faster rollout of digital infrastructure

Underinvestment in broadband infrastructure stems from decades of insufficient competition and outdated legal, policy, and regulatory frameworks. The rugged topography and archipelagic nature of the Philippines increases the costs of extending connectivity to underserved populations. However, the slow rate of rollout of telecommunications infrastructure has been in part due to barriers to competition and restrictions on foreign direct investments. The development of the Philippines' digital infrastructure has always been private-sector-led. From the monopoly and fixed line era, the country shifted to mobile services following the liberalization of the telecommunications sector in 1993, which resulted in new market entrants and increased competition. However, unchecked mergers and acquisitions over the years have resulted in a highly concentrated market, with two dominant players, each controlling and operating their own single, vertically integrated network. A third player entered the market in 2020 but has not yet proven disruptive. Several reforms in the sector have recently been passed, but there are a few remaining challenges.

Lack of efficient digital spectrum management results in an uneven playing field for new prospective entrants. Current laws that regulate spectrum use and allocation are designed for legacy (analog) technology and merely provide a general framework for the regulator to interpret into regulation. The current allocation is fragmented based on the original distribution of the spectrum to legacy telcos and would benefit from a restacking program. An administrative approach, instead of auctions, to allocate spectrum favors incumbents and large telcos and diminishes the chance for spectrum to be awarded to a new entrant. The scarcity of the remaining unassigned spectrum bands limits the competitiveness of any new incoming player.

Figure 34. Fixed broadband speeds: Philippines & selected economies



Source: <http://www.speedtest.net/global-index> on 5 February 2022 (Dec 2021 data)

Restrictions on investment and competition are deterring further expansion of digital infrastructure. The requirement for congressional franchise limits the ability of new telcos and independent internet service providers to deploy infrastructure, access spectrum, and use distinct types of Internet technologies. Similarly, the franchise requirement and licensing framework on cable TV operators make it costly and cumbersome to compete in providing broadband services. Furthermore, the absence of access to parts of the broadband infrastructure increases the provision costs of mobile broadband services and restricts competition to non-incumbents. This is exacerbated by the lack of regulation to unbundle the local loop, which has enabled incumbent telcos that control the control loop to impose discretionary access prices for wholesale and retail broadband service provision at levels that limit the ability of rival providers from competing efficiently, increasing the cost of broadband services and reducing the penetration of digital services in harder to reach areas.

Complex permitting for network equipment and lack of policy on infrastructure sharing are slowing the network rollout. While local clearances for the construction of towers and poles have improved, the remaining clearances for the installation of network equipment and its electrification are administratively awarded, and the process can take time and, without guidance for an expeditious awarding process, cause delay or even halt the network rollout. In addition, the regulator, the National Telecommunications Commission, still imposes significant requirements for the importation, distribution, and installation of equipment. Furthermore, the government has no guidelines on how the private sector can use government assets, such as landing stations (e.g., Pacific Light Cable Network) and the National Grid Corporation of the Philippines' fiber optic network. The hurdles on permitting and lack of infrastructure sharing represents a missed opportunity to attract investment in network and connectivity infrastructure.

3.5 Digital financial services and digital ID

While the growth of DFS can benefit the economy, risks need to be managed. DFS encompass a range of transaction accounts, digital payments, and digital insurance and credit. Enabled by fintech innovations, they have the potential to lower costs, increase the speed of transactions, and allow for more tailored financial services to serve the needs of underserved segments of the population at scale. Where available, DFS have been found to allow faster disbursement of relief payments to both households and firms, and they can reduce information asymmetries, support sound risk management, and allow lenders to support the recovery through the uninterrupted provision of credit to households and businesses. However, the adoption of digital technologies, including the provision of finance, also poses various risks and challenges such as data protection and privacy, cyber security, and operational risks. These risks and challenges need to be well understood and mitigated.

Account ownership has significantly increased but financial inclusion remains uneven. The financial inclusion landscape of the Philippines, measured by the account ownership, has drastically changed due to heightened needs for use of accounts for payments. BSP estimates 53 percent of adults now have accounts, jumping from 37 percent in 2017.⁴³ For a long period of time, only a third of adults had accounts in the Philippines. The country has had a limited uptake (10 percent of households) of DFS, while fintech development is rapidly developing and increasingly diverse, but remains nascent. Encouragingly, fintech players in services beyond payments have notably grown since 2018.

The adoption of a series of reforms during the COVID-19 pandemic has laid a solid foundation for the rapid growth of digital finance. Building on the NRPS, the BSP has formulated the Digital Payment Transformation Roadmap, which aims to increase the share of digital transactions in retail to 50 percent and provide 70 percent of Filipinos with payment accounts by 2023. Moreover, the Government of the Philippines (GOP) has renewed its commitment under the new National Strategy for Financial Inclusion 2022–2028 and identified reform areas to reach its goals. Finally, financial sector regulators have been promoting responsible DFS through the Financial Sector Forum, and DFS has played a key role during the pandemic by facilitating the use of digital payments by consumers.

During the pandemic, digital payment transactions increased rapidly. Between 2013 and 2020, the share

of monthly payments as of total payments went from 1 percent to 20.1 percent. DFS played a key role during the pandemic by facilitating the use of digital payments by consumers. Digital transactions, measured by account-to-account transfers through a fast payment infrastructure, increased by 600 percent from February 2020 to April 2022 by both value and volume. These include payment transactions initiated by mobile phones using the QR Ph which is a standardized Quick Response code.

Innovation finance and embedded e-commerce financing represent key DFS that can help extend firms' access to finance. The expansion of fintech and other innovative nonbank financing is an alternative to the limited access to bank finance to unleash private-sector-led growth and can help close some of the \$221.8 billion of the country's MSME financing gap. Similarly, DFS presents important opportunities for the development of e-commerce. DFS can augment the impact of e-commerce through embedded services, including payments, consumer credit, authentication, and verification. The expansion of interbank transfers and digital payment acceptance have enabled the Philippine private sector and individuals to use fast payments (InstaPay) and batch payments (PESONet).

Several initiatives have been launched by the GOP, BSP and financial sector regulators to address the above constraints including digital banks, open finance, credit risk database and approval of Financial Consumer Protection and Services Act (FCPSA). In 2020, BSP introduced the regulatory framework on digital banks to create an enabling environment for providing a cost-effective banking experience for retail clients and MSMEs. This reform attracted strong interest from the financial sector and to date five digital banking licenses have been approved. The open finance regulatory framework has been introduced in 2021 laying down the technical, security, and governance standards for data sharing. This aims to empower customers by giving them better control over their personal and financial data and developing products and services responsive to their needs. The credit risk database launched by the BSP has been operationalized and is expected to expand access to finance for MSMEs by strengthening credit information that will allow better assessment of risks by financial institutions. The recently enacted FCPSA Act aims to strengthen the mandate and powers of financial sector regulators to implement market conduct supervision and regulation effectively

43 World Bank Global Findex 2017.

and thus build consumer trust in the financial sector.

PhilSys can play a role in facilitating electronic transactions through secure authentication. It has the power to expand the value of a digital ID by enabling digital onboarding through websites and smartphone applications. This will open new channels for products and services and increase access for Filipinos living in rural and remote areas. Identity verification services can allow businesses to reduce costs through automation. This will also improve the overall customer experience, through paperless documents. Authentication and e-KYC services can help with accuracy of demographic information held by the private sector and facilitate data sharing, when legally authorized.⁴⁴ Solving the identity problem can become the basis for open APIs and protocols to link digital financial services and payments, data sharing platforms, e-signature providers, e-commerce, and other platforms to create a set of rails for digital economy transactions. This would create a more open digital ecosystem that would unlock innovation and entrepreneurship.

PhilSys is also a strong enabler of financial inclusion. Agents equipped with a smart device will allow for services such as account opening, deposits, and withdrawals in areas where there is no access to branches and ATMs. PhilSys authentication will reduce fraud in the financial sector, including with respect to loans and insurance, as biometric verification will provide more integrity to application processes. It will also improve the quality of credit information and unlock data portability, which is crucial for the country's open banking framework initiative. It is for these reasons that the BSP has been one of the strongest drivers in creating an enabling regulatory environment for its supervised entities to leverage PhilSys. Other sectors that will benefit from PhilSys include e-commerce and transportation. For example, securely verifying the identity of buyers and sellers on platforms will increase trust in transactions, and remote onboarding will allow for online

companies to more easily onboard gig workers, such as for ride hailing and deliveries. For the air industry and other transportation sectors, digital onboarding of customers will allow them to improve the customer experience, including by automating their processes at air and seaports.

Fast-tracking e-governance can increase efficiency and transparency in the provision of government to business (G2B) and government to citizen (G2C) services. The government's essential backbone processes such as budget and treasury management are still largely paper based and fragmented, which is a source of inefficiency, constraining the development of e-gov services. The integrated budget and treasury management system (BTMS) is aimed to address these constraints. It offers an end-to-end solution to execute financial transactions, generate electronic purchase orders and process payment orders to vendors and citizen alike. As public expenditures make about 25 percent of GDP, the BTMS represents a potential driver for digital transformation. The BTMS has been acquired and customized. However, its roll out has been suspended. Resuming the roll out of this essential backbone system to foster digital transformation is thus a priority. It will further help anchor agency specific digitization and streamlining efforts, such as customs processes to increase transparency and mitigate corruption. The Document Tracking System, for example, enables the public to view and monitor online the status of documents received by the Bureau of Customs (BOC 2019). Moreover, providing citizens and firms with the option to pay taxes and process salaries through digital means can reduce processing times and costs. Mobile-intermediated government-to-citizen payments also offer the opportunity to encourage uptake of mobile services and widen the public's participation in the digital economy. But this would require the government to digitize its own core financial management systems on which most of these e-government services to citizens and firms are built upon (Box 7).



Photo: Ezra Acayan

⁴⁴ An example is the India Stack, which offers an interface that integrates authentication, payment, and data sharing on top of the digital 'rails' of Aadhaar (India's digital ID system), the Unified Payments Interface (UPI), e-Sign (for electronic signatures), and the Data Empowerment and Protection Architecture (for consented data sharing). Today, India is developing a Health Stack that would follow a similar approach, enabling healthcare providers to build systems on top of the same 'rails'

Box 7. Digital Government: Public Services Access made easy

Digitalization of government is more than digitalizing government systems and transactions. It is also about capitalizing on opportunities to make systems more efficient and effective and transactions simpler, enabling government services to be smarter and more proactive. For example, the objective could be to enable the authorities to: (i) provide pre-filled taxation declarations (to improve compliance and increase revenue); (ii) make more evidence-based fiscal policy decisions; (iii) check the eligibility of welfare beneficiaries (to ensure the right assistance is going to the right people); and (iv) allow businesses to use and re-use public sector databases (to unlock data-driven innovation to boost the digital economy).

The Philippines has made steady progress in establishing laws and policies for digital government. The Department of Information and Communication Technologies (DICT) was established in 2016 as the Philippines' first cabinet-level agency dedicated to promoting digitalization. For instance, the DICT updated the Cloud First Policy in 2020, which was very forward-looking and a good example of creating a policy framework for digital government. However, this also requires the re-engineering and simplification of core government policies and business processes, such as the budget and treasury management system, which impacts all public services aimed at firms and citizen alike.

The experience of effectively leveraging policies, laws, and institutions in implementation efforts has, however, been mixed, and the Philippines risks falling behind comparable countries. In the 2020 UN E-Government Development Index, the country ranked a respectable 77th globally and 5th among ASEAN countries, although this represented an increase of only one place since 2010. In the same period, Indonesia and Thailand jumped from 109th to 88th and 76th to 57th, respectively. While most, if not all, national government agencies are adopting digital technologies, the process has been very fragmented in the Philippines, characterized by digitizing what exists rather than digitalization for optimization and integration. For instance, forms have been made available to download only to be required to be printed and submitted at an office, rather than enabling citizens and businesses to submit forms and complete transactions online. There is a lack of integrated backbone information systems to manage financial and human resources and administrative processes. Many LGUs also face significant challenges digitalizing their processes. Nevertheless, there have been some successful initiatives, such as the Philippine Identification System (PhilSys), the VaxCertPH digital COVID-19 vaccination certificate, and the digital transformation of the Bureau of Internal Revenue.

The root causes and challenges are structural and multi-faceted. Fundamentally, past efforts have focused more on technology rather than on the people and processes required to digitally transform the government, and the digital skills of government officials, including in LGUs, remain limited and have not been systematically developed nor fostered. Low civil service salaries and limited career growth opportunities also make it difficult to attract and retain ICT professionals and graduates (compared to the private sector). Initiatives are often ad hoc and focused on front-end applications and services, rather than addressing essential back-office systems and processes upon which these services rely. Moreover, rigid and paper-based budget and public procurement practices are not conducive nor adaptable to digital technology adoption, especially larger projects that span across multiple years and agencies. Finally, coordination between agencies remains a key challenge to realize horizontal integration and whole-of-government systems, data, and shared infrastructure. While the DICT has stepped up, especially as part of the COVID-19 response, it is acutely under-staffed and under-resourced to carry out its mandate effectively.

There are four clear measures that can be taken to begin fast-tracking the digitalization of government:

1. Equipping the DICT with the human and financial resources necessary to coordinate efforts, develop whole-of-government frameworks that will end the fragmentation of government systems and data, and develop digital skills across the public sector.
2. Prioritizing and expediting the digital transformation (and integration) of core cross-cutting government budget, financial management, and human resources processes and systems upon which all public services depend (e.g., Budget Treasury and Management System (BTMS) to improve payments to citizens and firms).
3. Re-engineering and simplifying (not just digitizing) essential government business processes to enable meaningful digital transformation and services (both backbone and e-gov services).
4. Modernizing procurement policies and processes to be conducive for digital technology projects, including to maximize the use of digital public goods such as open-source software. Prioritizing LGU digitalization by, for example, adapting national frameworks and systems (e.g., BTMS, e-procurement, etc.), re-usable software, cloud computing, and infrastructure tools that reduce the need for LGUs to 're-invent the wheel' for common use cases, such as public financial management and e-procurement, license and permit applications, and social protection and healthcare delivery. Accelerating the adoption of cloud services will be particularly important to enable the sharing of technology resources and services.



Key constraints that limit the uptake of digital finance in the Philippines

Underlying collateral requirements, along with difficulties in evaluating borrowers' creditworthiness, reduce the demand for DFS. The Philippine credit reporting system remains underdeveloped, which results in limited information available to banks to assess credit risks when lending to MSMEs. The COVID-19 pandemic has further exacerbated SMEs' access to much-needed liquidity, due to heightened risk aversion by financial institutions and risks of rising firm insolvencies. While some fintech companies are entering the space of SME finance, low digital adoption by SMEs and limited data in digital format pose challenges. As mentioned earlier in this note, the limitations to access finance remains a top impediment for SMEs to further invest in digital upgrading.

Digital finance and fintech services are still at nascent stage, although the landscape is rapidly changing. Non-digital payment instruments such as cash and checks have long been widely used in the Philippines. Both firms and individuals are accustomed to payment transactions that are convenient for face-to-face transactions. Checks, including postdated checks, have often been used due to a lack of appropriate payment instruments such as interoperable

direct debit. In addition, the high cost of fees charged by banks for interbank transactions, caused by low competition, has created incentives for consumers to choose non-digital payments. However, a series of reforms before and during the pandemic have created a strong momentum to digitize financial services by enabling new services and allowing new players to enter the market. Most recently, the BSP announced the introduction of new payment streams such as bill pay, direct debit, and 'request to pay.' These will address obstacles to using digital payments to make recurring payments (e.g., for utilities), collect payments, and pay bills.

Low levels of consumer trust and awareness of electronic payments impede wide scale adoption of DFS. Fraud (actual or the perception of risk) and breaches in consumer data have led to low levels of online consumer trust. Moreover, according to World Bank Findex, 40 percent of banked Filipinos were not aware of electronic payments in 2017, showing the limitations of the country's current level of digital financial literacy. Without awareness of the benefits of electronic payments and trust in electronic payment systems, additional uptake of electronic transactions may stall.

3.6 Digital skills

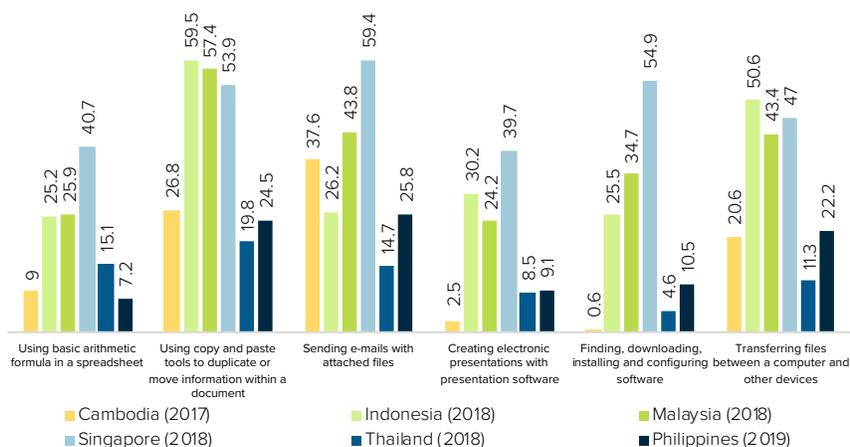
Demand for digital skills is growing steadily.⁴⁵ Digital occupations figure heavily on the list of the country's most in-demand jobs, with applications and game developers, cyber security experts, data development engineers, and database managers highly sought after in the information technology and services, computer software, financial services, and business outsourcing industries (DOLE 2020). In terms of freelance work, COVID-19 labor market information survey conducted by the Department of Labor and Employment (DOLE) revealed IT-related jobs on top of the list for 2020-2022 such as IT specialist, online seller, graphics designer, IT developer, IT programmer, data analyst, digital marketer, and encoder.⁴⁶ Most of these professions did not exist even a decade ago, and it is likely that the advent of the technologies of the Fourth Industrial Revolution (4IR)⁴⁷ will spawn new industries. This will require the training and education sectors to continue adjusting their programs to respond to future skills needs. Data from LinkedIn (2020) identify the top 10 emerging professions and job titles that require high-level 4IR digital skills. In the order of industry demand are robotics engineers, cybersecurity specialists, customer success specialists, data scientists, sales development representatives, full stack engineers, DevOps engineers, data engineers, JavaScript developers, and cloud engineers.

However, the market does not seem ready to meet this rapidly rising demand. In the World Digital Competitiveness Ranking 2021, the Philippines ranked 54th on the digital/technological skills indicator and 58th on the overall index for digital competitiveness, dropping from the 46th in 2017. The decline in the country's performance is reflected in the weakening of the talent, training, and education, suggesting a need to improve training in digital literacy and competency.

Key Challenges to Deepening Skills for the Future

There are considerable gaps in digital skills and other skills among students, although they vary by field of study. An analysis using an algorithm that matches the forecasted demand for skills, along with predictive analytics using demand data from job sites, reveals a worrying reality (World Bank & HeadAi, 2022). The analysis identified a large number of unique missing skills (skills gaps). Missing digital skills include knowledge of Windows, search engine optimization, social media marketing, blogging, and data analysis. Other missing skills include soft skills such as team leadership, problem solving, coaching, and public speaking, in addition to hard and technical skills such as data analysis, strategic planning, and business strategy.

Figure 35. Regional Comparisons of Proportions of Youths and Adults with ICT Skills



Source: Data for the Philippines are from 2019 National ICT Household Survey (NICTHS), DICT, and PSRTI, <https://dict.gov.ph/ictstatistics/nichs2019/>. Data for all other countries are taken from UN Global SDG Database, <https://unstats.un.org/sdgs/indicators/database/>.

⁴⁵ Digital skills include proficiency in using basic, standard, and advanced ICT skills. Basic skills, for example, comprise using copy and paste tools to duplicate or move information within a document, managing email, and navigating the internet. Standard ICT skills include using basic arithmetic formulae in a spreadsheet. Advanced ICT skills include programming, use of artificial intelligence (AI), Augmented reality/Virtual reality/Mixed reality technologies (AR/VR/MR), big data analytics, Internet of Things (IoT), among others. IT, engineering and other STEM related disciplines are also critically needed in the digital economy. In addition, digital occupations require not only digital skills, but also cognitive and socioemotional skills (Cunningham et al. 2021). Digital skills can be more effective when coupled with good cognitive and socioemotional skills

⁴⁶ JobsFit Labor Market Information Report: Road to Recovery, DOLE, 2022.

⁴⁷ The 4th Industrial Revolution (4IR) is a fusion of advances in artificial intelligence (AI), robotics, the Internet of Things (IoT), genetic engineering, quantum computing, and more.

DOLE (2022) corroborates this finding and shows that skills shortages are prevalent with unmet demand for high-level and middle-level skills, especially in digital skills. The report also shows that highly demanded jobs require advanced and specialized digital skills such as computer network operations, information technology and support, and software development, in addition to hard skills like financial analysis and business services.)

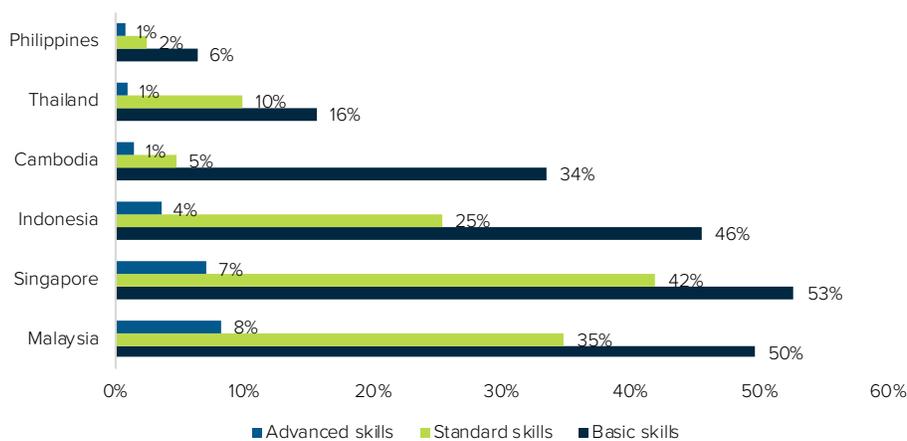
Limited digital skills and low level of digital literacy in the Philippines are obstacles to digital transformation.

The country performs below its peers on Sustainable Development Goal Indicator 4.4.1 on Skills for a Digital World, which identifies a set of needed ICT skills in youth and adults. An analysis from the 2019 NICTHS reveal that over a quarter of individuals in the Philippines do not use the Internet because they do not know how to use it. It further finds that only 25.8 percent of both youth and adults have the basic ICT skills to send e-mails with attached files, while less than one in 10 can use basic arithmetic formulae in a spreadsheet or create electronic presentations with presentation software (Figure 35). Across these ICT skills,

the Philippines lags other neighboring countries. Similarly, in a study on digital trends in the Asia and Pacific region, a significantly lower share of individuals in the Philippines possess basic, standard, and advanced ICT skills (e.g., writing a computer program using specialized programming language) than in regional peers (ITU 2021) (Figure 36).

Despite the Government’s recent efforts to bridge the gap, qualification and accreditation of new skills remain imperatives to expand their availability. The Philippines government has introduced several reforms and increased allocation of resources to modernize education and build the skills of the future.⁴⁸ Given the evolving complexities accompanying increased digitalization, these initiatives seek to close gaps in digital literacy and skills across Filipino workers, provide trainings on how to navigate online spaces effectively, improve employment prospects, and to equip micro, small, and medium-sized enterprises with the needed capacity to bring their businesses online. However, strengthening schemes for skills qualification and accreditation is necessary to reflect the rapidly changing skills demand and to enhance portability of skills.

Figure 36. Basic, Standard, and Advanced ICT Skills by Country, 2017–2019



Source: ITU (2021).

48 The Public Schools of the Future in Technology (PSOFT) Act was unanimously passed in December 2021 to ensure adequate investment in digital technology and innovation in the country’s public schools. The CHED has allocated additional funding to support the digital transformation and modernization of higher education and launched an open educational resources platform to provide free access to learning, teaching, and research materials for students, teachers and researchers. CHED is also currently developing the Digital Transformation Strategy of Philippines Higher Education 2022-2025 to enhance digital skills—from basic to high-level—of Filipino workers and citizens. The Department of Education has launched the Digital Rise Program to enhance digital literacy, basic programming skills, and ICT-assisted learning for K-12 basic education. In light of the COVID-19 pandemic and the unprecedented disruption to employment stability, the TESDA has renewed its focus on strengthening the digital skills of the Filipino workforce, including through the Go Digital ASEAN program.

3.7 Conducive regulations for digital markets

Digital technology has opened market access opportunities for more Filipinos. E-commerce platforms, for example, allow firms to access domestic and foreign markets and expand their market reach.⁴⁹ It can also boost trade by reducing the costs of operations and sales. Together with other digital technologies, the use of digital platforms, has been shown to lower SME export costs by as much as 82 percent and foreign market operating costs by up to 59 percent.⁵⁰ Digital markets can also expand market access by enabling services from home, adding flexibility in working hours and location. Finally, technology-driven integration into global data value chains (e.g., by enabling cross-border data flows) expands market access for firms and stimulates innovation by exposing firms to international competition and promoting technology transfer.

Market access can be expanded by adopting an efficient regulatory framework that builds trust in the digital economy and facilitates electronic transactions and data flows. Well-designed regulations are needed to achieve inclusive market participation and promote deeper digitalization. Trust is a prerequisite for engaging in digital commerce. Digital consumers and operators need to feel confident that participating in digital markets will not expose them to undue risk of personal data breaches, unscrupulous vendors, and infringement on their privacy. The willingness to surrender personal and financial information depends on it. Without trust, scaled adoption of digital technology and engagement in digital services will not be possible. A good regulatory framework for electronic transactions can enable remote contractual arrangements between buyers and sellers and clarify the rights, responsibilities, and obligations of market operators engaged in digital commerce, which can increase trust in the digital economy. Contractability is essential for deepening digitalization. Last year, a spate of fraudulent orders and unjust cancellations victimized food and grocery delivery riders in the Philippines, prompting the authorities to start exploring legal means to protect the community of users and operators in the industry.

Rapid digitalization during the COVID-19 pandemic has made it clear that policies need to keep up with changes in the digital economy. The stringent requirements for registration, operation, and closure of brick-and-mortar companies equally apply to online sellers and gig economy workers, discouraging entry and formalization in the sector. Adapting these procedures to online business models and simplifying them will be critical to facilitate the formalization

of online sellers and gig economy workers/service providers. Exempting certain digital businesses from permits required for 'offline' businesses (e.g., sanitary permits or fire safety inspection permits) could incentivize them to register. This formalization would enable digital businesses to issue receipts and pay taxes, which in turn would promote consumer trust in digital businesses.

A regulatory framework that fosters competition is critical to a dynamic digital market. Digital services can be dominated by networks of connected firms that create barriers to entry for new and independent firms. Promoting market contestability provides a level playing field for new entrants to introduce innovations that would create value for the digital economy. While applicable to digital markets, the Philippines Competition Law does not respond to the challenges of data-driven business models, multi-sided digital platforms, and digital mergers. For example, in merger control and notification mechanisms, the law has not been adapted to the nature of small but competition-distorting digital mergers and acquisitions in which big digital technology firms acquire smaller firms before they can become a competitive threat ('killer acquisitions'). Meanwhile, efforts to update merger control and acquisitions provisions to address digital markets must also balance pro-competitive integration of complementary assets (through mergers and acquisitions) into larger organizations and incentivize funding to and innovation by smaller firms.

Incorporating a digital angle into existing competition policy can promote market contestability and dynamism. Digital competition policy comprises contestability, firm entry, and rivalry that are often embedded in ex ante market policies and enforcement of antitrust laws 'ex post' if violations are detected. Contestability in digital markets is affected by a range of issues that Philippine regulators need to account for. These issues include: (i) the relationship between online platforms and firms that are dependent on them to conduct business (i.e., online supplier protection); (ii) market concentration due to economies of scale and scope in data-driven business models (e.g., dominance of 'gatekeeping' platforms); and (iii) opportunities to enhance contestability by making data more widely available. Traditional antitrust laws are challenged because digital business models blur the lines between markets and complicate the use of established antitrust tools and thresholds (e.g., competition analyses focused on prices may not work in the case of nominally free online services).

49 World Bank, 2016; World Bank and World Trade Organization, 2019
50 Ganne and Lundquist, 2019; AMTC, 2018.

Key Challenges to Building Trust

The Government of the Philippines passed laws and regulations to promote trustworthiness in the digital economy, but these need updating and enforcing to protect consumers online.⁵¹ The 2000 Electronic Commerce Act established the DTI's authority over e-commerce. The DTI has taken steps to join international enforcement efforts to address complaints about online cross-border transactions. However, mandatory mediation mechanisms for consumer complaints remain limited for cross-border transactions. The launch of a pilot phase of the Philippine Online Dispute Resolution System by the DTI's Consumer Policy and Advocacy Bureau in 2021 was a crucial step toward supporting the enforcement of consumer rights in e-commerce.

Enforcement of consumer protection falls short on sanctioning transgressors. As a guardian of consumer rights, DTI has instituted a 'No-Wrong Door' policy to address consumer complaints received, typically related to delays, online fraud, copyright infringement, prevalence of defective products and reneged warranty agreements, among others. However, information on responses, such as seizure of goods and collection of fines, is not available to consumers. In addition, DTI has infrequently exercised its authority to impose sanctions, which is a critical tool to increase trust in the system. Instead, it has issued voluntary guidelines for e-commerce.⁵² While the current legal framework for online consumer protection fosters mediation, there is also room to increase the imposing of sanctions when appropriate, and to increase consumer awareness of existing remedies, and encourage them to file complaints when appropriate, overcoming a mindset less familiar with complaint processes.

Enforcement of privacy and consumer protection rules should be strengthened and widely announced for participants in digital markets. Remedies and enforcement need to be shared among consumers and suppliers alike. This can build credibility that remedies are effective when online transaction go awry. In a non-litigious culture, education campaigns that familiarize consumers and suppliers of their rights, and the actions they can take if violations arise, can build trust in the digital economy, and increase confidence in the system. Close alignment and integration with partner countries' ODR (Online Dispute Resolution) systems is critical to ensure the resolution of cross-border disputes – as agreed upon, for example, in the ASEAN Strategic Action Plan on Consumer Protection).

Box 8. A prevalent threat in East Asia: how to avoid winner-take-all dynamics in the digital economy?

Large conglomerates have a diversified offering of products and services that reach several different sectors. Paired with high market shares and vertical integration, this creates a market structure that could be prone to market dominance, barriers to entry, and abusive anticompetitive practices in Southeast Asia. Commercial strategies from these firms are frequently focused on ensuring customers use the adjacent products/services provided by the conglomerate. To do this, they commonly offer benefits for the use of the platform's digital wallet to make purchases in its digital commerce marketplaces or even offline retail store. The kind of benefits offered range from point collection and redemption, rebates and cashback when using digital payments within the conglomerate's environment. The user of each digital commerce platform then tends to use the respective digital wallet since it offers better promotion and services.

While the Data Privacy Act (DPA) addresses many relevant issues, its enforcement lags in effectiveness and transparency. The National Privacy Commission (NPC) has shown its commitment to address cases and privacy complaints, but it seems less effective in imposing fines to deter violations. Information on complaint resolution is not easy to find.⁵³ Close to 10 years after the enactment of the DPA, the NPC is still working toward making administrative fines effective. The current policy draft incorporates a penalty ceiling of PHP 5 million, with potential penalties based on annual gross income,⁵⁴ ranging from 0.25 to 3 percent for grave violations and 0.25 to 2 percent for major violations. Furthermore, the DPA lacks standards for data anonymization, limiting the potential use and transfer of anonymized data. Proper anonymization would allow the government and private firms to leverage anonymized data for research, product development, performance optimization, productivity improvements, and better services. Therefore, the issuance of guidelines on appropriate safeguards for anonymization by data controllers could help unleash the value potential of data. The NPC could communicate to stakeholders the specific modalities of data

51 The law on digital transactions – the Electronic Commerce Act – was passed over 20 years ago. Its implementation has been further supported by legislation that applies to both online and offline transactions. This includes the Data Privacy Act, the Philippine Competition Act, the Consumer Act of the Philippines, and the National Payment Systems Act, amongst others.

52 DTI Bureau of Product Standards, referencing a recent Singapore's standard (TR 76), issued Philippine National Standard (PNS) 2155:2020: Guidelines for e-commerce transactions

53 The annual report provides no details about how the cases are resolved or what the resolution consists of.

54 of personal information controllers or processors.

Box 9. A private coalition in Sri Lanka to advance digital cross-border transactions

Despite Sri Lankan authorities enacting the Electronic Transactions Act. No. 19 (ETA) in 2006, bureaucratic red tape, and administrative resistance to modernization stalled the implementation of this act. The ETA authorized the use of digital signatures and digital documents in export import processes, which would have streamlined exports. Sri Lankan exporters continued to face costly requirements to submit hard copies of trade paperwork for customs clearances.

The Import Section of the Ceylon Chamber of Commerce (CCC), along with the legislature and the civil service, tried to understand why the implementation of the ETA had not taken hold. They realized that only a very small proportion of business leaders were aware of the ETA's provisions, and the system relied on outdated clearance protocols and administrative procedures.

The coalition of stakeholders, led by the CCC, put together a reform proposal to automate and reengineer clearance processes, paving the way for electronic document (e-document) processing platforms and shorter customs procedures. They raised awareness among exporters and government officials that provisions authorizing e-documents and e-signatures were critical. These improvements led to faster clearance times for import and export transactions, and a reduction in the number of steps necessary for clearance. (Based on CIPE, 2019)

sharing that it would consider permissible under the Act, rather than just communicating what it might prohibit.

Weak online supplier protection vis-à-vis digital platforms limits market dynamism. The Philippines lacks a dedicated law that to protect either online suppliers or merchants. MSMEs and online contractors face challenges when selling through online platforms, when dependence on one or few platforms leads them to accept exclusionary and unfair contract terms. In addition, there are documented cases in which platforms directly engage in anti-competitive behavior,

e.g., by preventing firms to offer products and services elsewhere under better conditions (i.e., 'most-favored nation' provisions), self-preferencing their own products on the platform, or delisting suppliers' products or accounts without prior notice and justification.

Key Challenges to E-transactions, Cross Border Trade and Data Transfers

The Philippines imposes few restrictions on and engages with partners to support international data transfers. The country does not impose data localization requirements concerning personal data, but certain data remain restricted from international transfers on grounds of national security. This provides a favorable environment for integrating the country into global data value chains. In addition, the government has joined efforts to support international data transfers through the APEC Cross-Border Privacy Rules System—a government-backed data privacy certification scheme, which the Philippines has not yet fully implemented. Without the ability to manage international data transfers, service exporters, such as those operating in the IT-BPO sector will gradually lose competitiveness and find themselves unable to become the next generation of international businesses.

There is an umbrella framework that supports the validity of electronic documents, but equivalency between paper and electronic documents falls below par. The legal basis of electronic transactions was cemented in 2000, and the authorities recently issued guidelines on the use of electronic documents, signatures, and digital signatures in government transactions, as well as on the use of electronic collection and payment for government transactions. These new guidelines can increase uptake of electronic transactions by easing concerns that electronic documents are not recognized by government auditors. However, the absence of rules on electronic notarization, persistent official requirements on paper documents and manually signed forms, limitations on the issuance of individual digital certificates, and lack of accreditation of certification authorities limit the adoption of electronic contracts, receipts, invoices, and supporting documents for government transactions. Furthermore, the risk of differing interpretation of contractual rules on cross-border contracts deters commerce. If the problems to build equivalence between paper and electronic documents are not addressed, then the pace of digitalization of the economy will slow significantly.

3.8 Way forward (Reform Agenda)

The following section presents the key areas for reform, based on the barriers identified in the previous section.

ENABLER	KEY POLICY RECOMMENDATIONS
Digital infrastructure	<p>Expand pro-competition legislation for shared deployment of network infrastructure and streamlining of permitting. Competition will help accelerate access to mobile and broadband infrastructure, the quality of which remains poor and unequal across regions in the Philippines. The government has taken steps to promote market entry and simplify complex permitting processes for cell site construction and cable laying through the passage of the implementing rules and regulations of the Public Services Act amendment, the National Broadband Plan, and the Common tower and pole attachment policy. However, more can be done in terms of enacting regulations for passive infrastructure sharing (ducts for optical fiber) and regulations for active infrastructure sharing (mobile). The operationalization of the Public Service Act IRR will lower barriers to entry for foreign investments. In addition, the DICT and National Telecommunications Commission (NTC) can revise and streamline parallel permitting provisions for certificates of public convenience and necessity for new firms.</p> <p>Promote investment in connectivity by ensuring an efficient allocation of spectrum and advancing public private partnership models for infrastructure. The government, through the DICT, can stimulate increased mobile network expansion in rural areas through an efficient spectrum allocation by the operator (for 4G/LTE and 5G). This would entail reviewing and revising regulations on spectrum allocation for mobile broadband. In addition, the Philippine government should leverage public private partnerships to attract private investment and manage government assets, including physical assets, right-of-way, aggregated demand to create alternative sources of international bandwidth, the submarine cable landing station, and the domestic backbone network, especially in far-flung areas. Consideration may be given to the creation of incentives for attracting additional investment in broadband internet in underserved and unserved regions.</p>
Digital financial services and national digital id	<p>Accelerate adoption of PhilSys to underpin growth in digital financial services. PSA and DICT should promulgate use-cases for the greater use of the National ID. Enhance PhilSys—enabled KYC framework by issuing supplemental guidelines to allow underserved segments to access financial services. The implementation of the national ID system is going to play a key role in expanding digital finance (access and use of accounts) and economy by facilitating mechanisms for knowing your customer. The law was enacted in 2018, but smooth implementation remains challenging, particularly with its linking with other existing identification databases. The BSP and Bureau of Internal Revenue (BIR) should generate regulations for private electronic payment systems, while the Department of Finance (DOF), Commission on Audit (COA) and BTr can work on government e-payment regulations. Revisions to the rules pertaining to electronic ledgering, receipting, eKYC, contracting with payments services, and auditing by the BTr, COA, and BIR to facilitate greater adoption by the government for existing payment systems.</p> <p>Ease regulations to promote entry and innovation of fintech and non-banks in the provision of DFS. Expanding the availability of DFS could be achieved through open finance and data sharing. This would entail effective implementation of an open finance framework by the establishment of Open Finance Oversight Committee and the adoption of industry accepted standards that allow for data sharing. In addition, the BSP and the Securities and Exchange Commission (SEC) could introduce measures to promote digital transformation of rural financial institutions and microfinance institutions and increase penetration of financial</p>

services in underserved geographic areas. The financial sector forum could issue guidelines for the implementation of industry sandbox for digital finance innovations. The recently approved guidelines from the Insurance Commission (IC) to advance the regulatory framework for insurtech is a good example. Finally, the Securities and Exchange Commission (SEC) could introduce guidelines to enhance the framework for crowd-funding platforms to increase uptake and diversify sources of finance to SMEs.

Promote stronger coordination for better enforcement of the consumer protection framework. Policymakers should strengthen regulatory and supervisory framework for financial consumer protection, including cybersecurity by the passage of the Financial Products and Services Consumer Protection Act. This is especially important as different agencies in the Philippines share consumer protection responsibilities in their respective fields: e.g., Central Bank, BSP, for electronic payments; the DA for agricultural and fishery products; the DOH through the Food and Drug Authority in relation to the health and safety hazards with respect to food, drugs, cosmetics, medical devices. Horizontal coordination mechanisms to learn, identify synergies and avoid duplication, can improve enforcement across agencies. This mechanism could include, for example, establishing international cooperation frameworks to support overseas enforcement of consumer protection; adopting interoperable digital platforms to address complaints and reducing duplication of efforts for certain markets – ridesharing, e-commerce, and e-banking.

Digital skills

Educational and training institutions need to enhance the digital competency of the work force to meet the increasing demands for customer services, technical support, data scientists, software, and engineering. Digital competency is not just about technology but also about digital knowledge, technical skills, and attitude formation, as well as complementary (soft) skills (e.g., team building, cross-functional collaboration, and problem solving). Fostering digital competency must start at the basic education level (under DepEd) to include foundational skills on how to find information in the internet, send emails, and use software such as word processors. The competency progresses into higher education levels with more advanced topics on programming, AI, etc. Knowledge of basic cybersecurity and data protection merits policy attention for skills development and strengthening, as business and government transactions are increasingly digitalized. DepEd's latest Basic Education Development Plan aims to strengthen students' competency in using digital technologies, data, and information to stay relevant in the evolving economy, and this requires continued policy attention.

HEIs, supported by the CHED, should expand upskilling and reskilling for highly specialized 4IR skills and deepen linkages with industry. With the changing nature of work, individuals will need to learn new skills for existing jobs (upskill) or learn new skills for different jobs (reskill). Upskilling strategies include updating HEI curricula and training opportunities to fit the needs of 4IR. HEIs can also participate in reskilling by strengthening opportunities for lifelong learning and providing alternative credentials such as digital badges and micro-credentials, which current employees may undertake through industry partnerships. Strengthening academe-industry linkages can help close skills gaps by ensuring the current supply of worker skills meets industry needs.

Strengthen digital skills training under TESDA. The TESDA Online Program—a free online platform seeking to expand access to high quality technical and vocational education and training has seen a high concentration of demand for courses in ICT. The uptake of courses on digital skills is particularly pronounced. In 2021, TESDA announced an expansion of its offerings on digital skills training in partnership with the Asia Foundation under the Go Digital ASEAN program. This program seeks to equip SMEs with the needed capacity to bring their businesses online. Efforts to enhance e-commerce potential include instructions on how to utilize social media to expand markets and customer base as well as skills-building on digitizing business

operations (Cruz 2021, TESDA 2021). The offerings on TESDA's online portal cater to in-demand skills, especially under the new normal, with a particular emphasis on digital and ICT skills—animation, web, and game development, among other high-level digital skills (World Bank 2021). While strengthening the online courses and offerings for mass training for ICT skills, TESDA would need to continue to incorporate digital competency into its overall class based and enterprise-based training.

Boost skills qualification and accreditation to reflect changing skills demand and enhance skills portability. The national qualifications system known as the Philippine Qualifications Framework (PQF) was introduced in 2012 and its Implementing Rules and Regulations was developed in 2019. To implement the PQF, a National Coordinating Council was constituted to guide the implementation of multiple agencies including DepEd, TESDA, CHED, and DOLE. While PQF is anticipated to promote lifelong learning and skills mobility by a qualification and accreditation mechanism recognized in the regional market (especially that of ASEAN countries), its implementation is at the nascent stage, with limited description on proficiency of digital skills. Meanwhile, the demand for skills is rapidly changing; many of the jobs in high demand today can no longer be demanded soon. For instance, call center services that consist of 50-60 percent of jobs in the business process management (BPM) sector in the Philippines are highly vulnerable to developments in AI and emergence of chatbots. To promote lifelong learning, reflect rapidly changing skills demand, and promote recognition of skills and experiences, there is a need for PQF to be strengthened.

Conducive regulations for digital market access

Learn from international experiences which can help Philippines policymakers to improve regulatory practice in the platform economy. The Philippine's Internet Transactions Act contains provisions for new Online Dispute Resolution mechanisms that offer protection for both consumers and merchants. However, this ex-post dispute resolution alone is unlikely to achieve sufficient protection for online suppliers. Policymakers in other countries have used complementary approaches to protect online suppliers. The European Union (EU) uses its Platform-to-Business Regulation to ensure basic protections that ex-ante establishes a requirements and codes of conduct under which platforms must adhere to (e.g., scope and processes around terms and conditions, transparency, dispute resolution). Another approach relies on using traditional anti-trust tools to redress abuses of market dominance by platforms. Finally, another approach is to designate platform operators with superior bargaining position (ASBP) platforms to target potential abuse and reduce the relative dominance by ruling out certain actions toward small suppliers. In Brazil, the National Consumer Secretariat introduced the ODR portal *consumidor.gov.br* in 2014. Customers and companies voluntarily register on the website and settle their disputes. As of 2017, 80 percent of complaints were resolved and took on average seven days. The ODR has more than 2.2 million registered users and 860 registered companies, processed more than three million cases up until August 2020.

Improve current guidelines on accreditation of private CAs and electronic notarization to stimulate the adoption of digital certificates. No private CAs have been accredited to date, and only the DICT has been able to issue digital certificates as the Government CA. In addition, the issuance by the Supreme Court of guidelines supporting electronic notarization will increase uptake of digital transactions. A positive step – induced by the pandemic – was the Supreme Court's rule allowing the notarization of paper documents and instruments with handwritten signatures or marks, using videoconferencing facilities, in areas covered by community quarantine restrictions. Lessons from the adoption of these interim rules may inform the finalization of rules on electronic notarization, to further build trust in electronic documents. Another opportunity is the transition to digital invoices, which are likely to simplify accounting systems for MSMEs.

Strengthen enforcement and communication on enforcement actions on consumer and supplier protection and privacy. While the current regulatory framework confers enforcement powers to both the DTI and the NPC, those have been underutilized, particularly regarding the imposition of sanctions for relevant cases. This weakens any perception of trust on the regulatory framework and its relevance. The DTI and the NPC should strengthen their enforcement capabilities, with more training and resources dedicated. This should include better communication and increased transparency on enforcement actions, and enhanced consumer and supplier education on the remedies available to them.

Strengthen international cooperation on rules and certification for transmittal and processing of personal data to accelerate data transfers. While the DPA was based on international best practice, it lacks recognition by the EU in providing adequate protection of data privacy. This limits the potential for transferring personal data to and from the EU, Norway, Liechtenstein, and Iceland. As more countries implement the EU framework for transfer restrictions, which allows data transfers only to third countries that have laws with adequate protection, the government needs to strengthen the DPA and encourage organizational measures by data processors and controllers. The Philippines should continue working on harmonizing cross-border data rules with its main trading partners, providing businesses and consumers more legal certainty, and supporting the APEC Cross Border Privacy Rules framework. Through the Ease of Doing Business Act, the Anti-Red Tape Authority can support the establishment of a one-stop shop for virtual businesses and gig economy workers and advance e-government initiatives (e.g., a whole-of-government approach) to support formalization and make it easier for gig workers (and others) to make social security contributions.

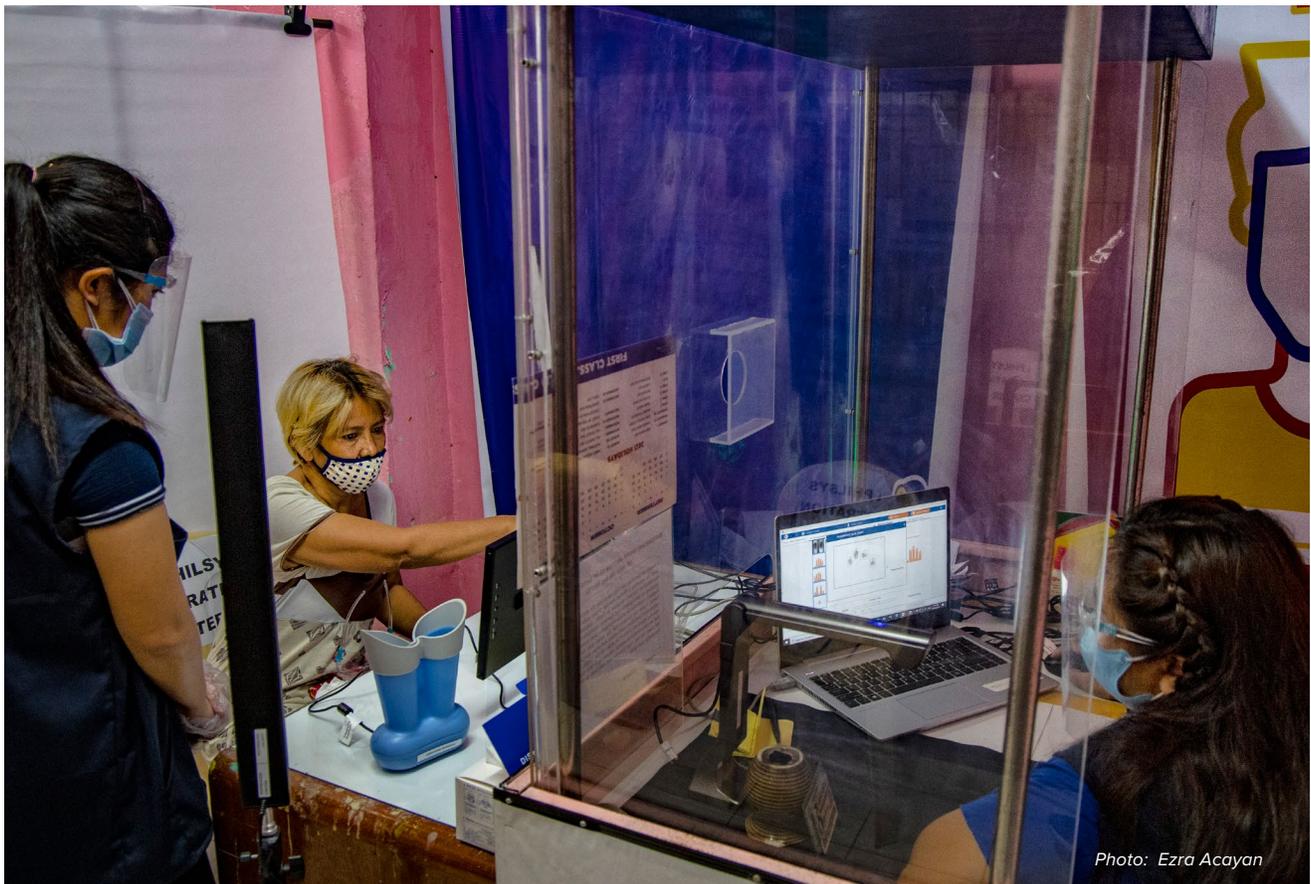


Photo: Ezra Acayan

3.9 Conclusion

Digitalization will be a key driver of long-term economic growth. The benefits of digitalization are extensive and can be shared by all sectors of society. It can enhance productivity by aiding the private sector in increasing production efficiency, reducing operational costs, and delivering economies of scale. Digitalization empowers firms of all sizes to access markets beyond traditional boundaries. Even local MSMEs find themselves competing in the global market. Digital solutions have also reduced the need for face-to-face interaction, allowing for remote delivery of services and opening opportunities to expand telehealth, fintech, and travel tech business models. These capabilities have become especially important during the pandemic, as firms have depended on digital platforms to survive.

The authorities have introduced important reforms at an accelerated pace over the past three years, while the rate of digital uptake has accelerated during the pandemic; however, the Philippines has yet to fully leverage the digital technologies. COVID-19 has accelerated the adoption and use of digital technologies. However, digitalization is constrained by the country's low high-speed broadband penetration, which lags neighboring middle-income countries. Moreover, digital adoption diverges significantly between small and large firms, and firms operating in different sectors. While there is convergence in digitalization on front-end technology, including online sales, social media, and consumer-facing technology, a wide divergence remains in the use of sophisticated back-end technologies, which are linked to higher productivity. The adoption of digital technology has also been slower in areas outside the National Capital Region and key metropolitan cities. This note focuses on digital enablers, which include Digital infrastructure, Digital financial services, and national digital ID, Digital skills, and Conducive regulations for digital market access. The table below summarizes the main challenges and the key policy reforms for each of the enablers.

While there has been progress in expanding digital connectivity, challenges remain. Overall broadband penetration is lower in the Philippines than in neighboring economies, despite the entrant of a third full-service operator in 2021. The country's fixed broadband, which is important for high-volume data transmission and typically required by large businesses and institutions, continues to lag that of regional comparators. A key challenge is underinvestment owed to decades of insufficient competition and outdated legal, policy, and regulatory frameworks. Franchising requirements, complex permitting for network equipment, and lack of policy on infrastructure sharing are slowing the network rollout. These challenges can be addressed by introducing pro-competition legislation for shared deployment of network infrastructure and

streamlining of permitting, efficiently allocating spectrum, and advancing public private partnership models for infrastructure.

DFS have remained in their infancy and take up has been bound by limited financial inclusion of consumers and businesses alike. Enabled by fintech innovations, DFS have the potential to lower costs, increase the speed of transactions, and allow for more tailored financial services to serve the needs of underserved segments of the population at scale. However, there has been a limited uptake of DFS in the country (they are used by barely 10 percent of households), while fintech development remains nascent. While challenges to growing DFS are wide-ranging, two critical ones are: (i) the limited coverage of payment infrastructure in the last mile; and (ii) low levels of consumer trust that impede wide-scale adoption. Addressing these challenges require promoting the adoption of PhilSys to underpin the growth of DFS; easing regulations to promote entry and innovation of fintech and non-banks in the provision of DFS; and establishing stronger coordination and better enforcement of consumer protection.

Demand for digital skills is growing steadily, but the market does not seem ready to meet the rising demand. While digital occupations have figured heavily on the list of the country's most in-demand jobs, workers' digital skills and literacy have not caught up. In the World Digital Competitiveness Ranking 2021, the Philippines ranked 54th on digital/technological skills, reflecting weak talent and training, and education. Results from the 2019 National ICT Household Survey reveal that over a quarter of Filipinos do not use the Internet because they do not know how to use it. The government has embarked on efforts to address this gap, but more can be done, such as: (i) fostering digital competency through basic education to build the foundational skills for digital hardware and software usage; (ii) increasing upskilling and reskilling for highly specialized 4IR skills; (iii) strengthening linkages with industry; (iv) improving digital skills training under TESDA programs; and (v) ensuring skills qualification and accreditation reflect changing skills demand and enhance the portability of skills.

The explosive digitalization during the pandemic has emphasized the need for regulations that keep in pace with the development of the digital economy. Well-designed regulations are needed to achieve inclusive market participation and promote deeper digitalization. Digital consumers and operators need to feel confident and safe from undue risk of personal data breaches, unscrupulous vendors, and infringement on their privacy. While the government has passed laws and regulations to promote trustworthiness, some seem inadequate to protect consumers online. Meanwhile, the legal basis of electronic

transactions was cemented in 2000, and the authorities recently issues guidelines on electronic documents, signatures, and digital signatures in government transactions. However, the absence of rules on electronic notarization, persistent official requirements on paper documents and manually signed forms, limitations on the issuance of individual digital certificates, and the absence accredited CAs limit the adoption of electronic contracts, receipts, invoices, and supporting documents for government transactions. Finally, contestability in digital markets is affected by a range of issues that Philippine regulators need to account for, including online supplier protection, dominance of 'gatekeeping' platforms, and government open data or industry data policies.

Policymakers need to act in earnest to advance critical reforms and support deeper digitalization in the Philippines. There is a need to increase digital adoption by the private sector to accelerate the recovery from the COVID-19 economic shock. The digital economy can drive growth and leapfrog the economy toward the aspirations laid out in Ambisyon Natin 2040. The government must therefore urgently take an active role in creating and delivering an enabling environment through priority policy and regulatory reforms that reduce the digital divide, expand the use of digital payments and national IDs, improve the availability of human capital and digital skills, and create a more conducive business environment. The payoff of reforms will be enormous, while the lack of action will be consequential.



Photo: Philippine Statistics Authority

Summary of challenges and recommendations.

Enabler	Challenges	Key Policy Recommendations
Digital infrastructure	<ul style="list-style-type: none"> Insufficient competition and outdated legal, policy, and regulatory frameworks. Inefficient digital spectrum management results in an uneven playing field for new prospective entrants. Restrictions on investment and competition are deterring further expansion of digital infrastructure. Complex permitting for network equipment and lack of policy on infrastructure sharing are slowing the network rollout. 	<ul style="list-style-type: none"> Expand pro-competition legislation for shared deployment of network infrastructure and streamlining of permitting. Promote investment in connectivity by ensuring an efficient allocation of spectrum and advancing public private partnership models for infrastructure.
Digital financial services and national digital ID	<ul style="list-style-type: none"> Underlying collateral requirements, along with difficulties in evaluating borrowers' creditworthiness, reduce the demand for DFS. Low levels of consumer trust and awareness of electronic payments impede wide scale adoption of DFS. 	<ul style="list-style-type: none"> Accelerate the adoption of PhilSys to underpin growth in DFS. Ease regulations to promote the entry and innovation of fintech and non-banks in the provision of DFS.
Digital skills	<ul style="list-style-type: none"> There are considerable gaps in digital skills and other skills among students, although they vary by field of study Limited digital skills and low level of digital literacy in the Philippines are obstacles to digital transformation. Despite the Government's recent efforts to bridge the gap, qualification and accreditation of new skills remain imperatives 	<ul style="list-style-type: none"> Enhance the digital competency of the work force and meet the increasing demands of the changing work environment. Expand upskilling and reskilling for highly specialized 4IR skills and strengthen linkages with industry. Strengthen digital skills training under the Technical Education and Skills Development Authority.
Conducive regulations for digital market access	<ul style="list-style-type: none"> Enforcement of consumer protection falls short on sanctioning transgressors. The Philippines imposes few restrictions on and engages with partners to support international data transfers. There is an umbrella framework that supports the validity of electronic documents, but equivalency between paper and electronic documents falls below par 	<ul style="list-style-type: none"> Improve regulatory practice in the platform economy by improving guidelines on accreditation of private certification authorities and electronic notarization, which can stimulate the adoption of digital certificates. Strengthen international cooperation on rules and certification for transmitting and processing personal data, which can accelerate data transfers.

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