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PHILIPPINE ECONOMIC UPDATE

MOVING FULL SPEED AHEAD: ACCELERATING REFORMS TO CREATE MORE AND BETTER JOBS

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Macroeconomics and Fiscal Management Global Practice
Philippines
East Asia and Pacific Region

PREFACE

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

The PEU is a report of the World Bank's Macroeconomics and Fiscal Management (MFM) Global Practice (GP). It was prepared by Kevin Cruz, Joseph Louie Limkin, Noel Del Castillo (all Research Analysts), Karl Kendrick Chua (Senior Country Economist), and Rogier van den Brink (Lead Economist and Program Leader) all from the MFM GP, and Roberto Galang (Operations Officer) from the T&C GP. The team worked under the guidance of Mathew Verghis (Practice Manager) and Mara Warwick (Country Director).

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

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

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EXECUTIVE SUMMARY

The Philippines remained a strong performer in the region, despite slow global growth. Coming from a slow start in the first half (H1) of 2015 due to weak government spending, the economy bounced back in H2, bringing full year growth to 5.8 percent in 2015. Among the major economies in the region, the Philippines is behind China and Vietnam only. On the supply side, the services sector remained the main engine of growth, while agriculture continued to underperform as El Niño intensified. On the demand side, robust growth of private consumption and the rebound in government spending in H2 compensated for weak external demand.

Stronger growth in H2 led to significant improvement in unemployment, but job losses and increased underemployment in agriculture due to El Niño dampened net job creation. Between January 2015 and January 2016, the unemployment rate improved from 6.6 to 5.8 percent—among the lowest in a decade. The services sector generated some 1.2 million jobs, while industry provided another half a million jobs, with manufacturing and construction contributing the biggest shares. However, intense drought brought by El Niño shed some 935,000 jobs in agriculture, bringing net job creation to only 752,000 jobs in the same period. It also increased the number of underemployed in the agricultural sector by six percentage points. As a result, underemployment worsened to 19.7 percent compared to 17.9 percent the previous year.

However, sustained high non-agricultural growth and effective government programs are helping to improve the welfare of the poor. Recent estimates suggest that extreme poverty decreased gradually between 2012 and 2014. Extreme poverty is estimated to have decreased from 10.6 percent in 2012 to nine percent in 2014. Despite the impact of Typhoon Yolanda in November 2013 and the artificially high rice prices created by the state monopoly on rice imports, income growth of the poor helped to improve poverty reduction, led by non-agricultural households and substantial increases in cash transfers to the bottom quintile. After a decrease of only 0.3 percentage points between 2009 and 2012, poverty fell more rapidly between 2012 and 2014, according to revised purchasing power parity (PPP) estimates. However, high rates of structural poverty remain, especially among households depending on agriculture.

Growth prospects for the Philippines remain positive due to its favorable macroeconomic and policy environment. The country continues to benefit from solid macroeconomic fundamentals, with strong growth, low and stable inflation, sustainable fiscal position, healthy current account surpluses, and more-than-adequate international reserves. This provides the country with the flexibility to use a range of policy tools to withstand shocks from the weaker global environment.

In the near-term, economic growth is likely to remain strong and is projected to accelerate to 6.4 percent in 2016 before tempering slightly to 6.2 percent in 2017. Faster growth in 2016 would be driven by favorable domestic factors. Private consumption would remain robust, aided by low inflation and spillovers from increased spending due to the upcoming general elections. Investments will likely support growth as implementation of public-private partnership (PPP)

projects accelerates. In 2016, PPP projects are estimated to contribute some 0.8 percent of GDP in additional investment spending. Meanwhile, government spending is expected to improve as budget planning and execution continue to be addressed. In 2017, growth is projected at 6.2 percent as the economy normalizes from the election cycle.

These growth projections incorporate a number of risks which have remained broadly the same since the October edition of the Philippine economic update. The key risks are uneven recovery of high income economies, slower than anticipated growth of large emerging market economies, financial market volatilities, slower remittance growth from oil exporting economies, the continuation of El Niño in H1 2016, delays in PPP projects, and uncertainty around the outcome of the election.

Poverty reduction is expected to continue if the country is able to maintain the relatively high economic growth and the more positive job trends in recent years, despite recent shocks to agriculture. Recent trends show an improvement in the country's growth-poverty elasticity, which means growth is becoming more inclusive. However, the recent increase in the underemployment rate and weak agricultural output in 2016 will need to be countered by sustained increase in per capita income growth and a continued focus on supporting the structurally poor through effective social protection programs. Under these assumptions, extreme poverty is projected to further decrease from nine percent in 2014 to 6.8 percent in 2018.

With solid macroeconomic fundamentals and significant fiscal space in place, the Philippines can now accelerate the reforms needed to achieve more inclusive growth to reduce poverty and boost shared prosperity. Trends in recent years point to the beginnings of a more inclusive growth pattern, which needs to be sustained over a longer period before the poor can feel the impact of higher growth and better governance in their daily lives. In the last six years, the government preserved macroeconomic stability, promoted transparency, and directed the growing fiscal space towards pro-poor infrastructure and social services.

What is needed now is to consolidate the reforms made, embark on the next set of reforms and move ahead at full speed. In the short-term, deepening reforms in budget execution will allow the country to use its growing fiscal space to increase investments in both human and physical capital, with positive contributions to near-term growth and quality of jobs. Over the medium-term, accelerated structural reforms are needed to enhance competition in sectors with high impact on jobs (such as rice, shipping, and telecoms), securing property rights through more systematic and administrative adjudication of land rights, and simplifying business regulations to encourage the growth of firms of all sizes, while increasing tax effort and reforming the budget execution system in order to sustainably ramp up public investments in infrastructure and social services. In all these, priority is needed in Mindanao, where decades of conflict and weak, Manila-centric policies have kept it from reaching its potential. To accelerate reforms in the future, the government, business, labor, and civil society need to work more closely together to support a package of reforms that will help the country move full speed ahead to create more and better jobs.

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Output and demand

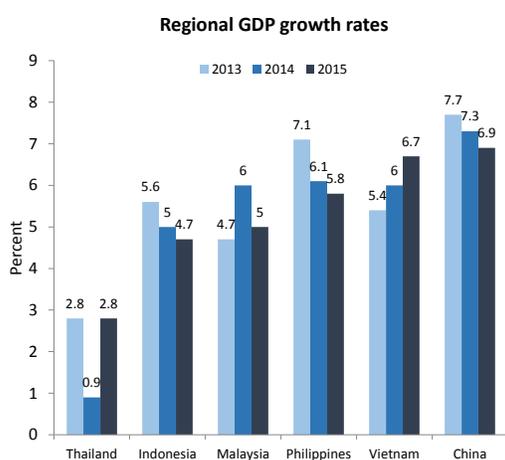
- 1. The Philippines remained a strong performer in the region, despite slow global growth.¹** Coming from a slow start in the first half (H1) of 2015 due to weak government spending, the economy bounced back in H2, bringing full year growth to 5.8 percent in 2015. Among the major economies in the region, the Philippines is behind China and Vietnam only (Figure 1). On the supply side, the services sector remained the main engine of growth while agriculture continued to underperform as El Niño intensified. On the demand side, robust growth of private consumption and the rebound in government spending in H2 compensated for weak external demand.
- 2. On the supply side, the services sector continued to drive growth while industry decelerated** (Figure 2). The services sector grew by 6.7 percent, contributing 3.8 percentage points (ppt) to overall growth in 2015. The business process outsourcing (BPO) industry remained a key driver of services sector growth, with 2015 revenue estimated at USD 21 billion² and value-added equivalent to five percent of GDP. This 16-year old industry has become the third largest source of foreign earnings after electronics (USD 28.5 billion) and remittances (USD 25.8 billion) and is well-poised to overtake these sectors in the coming years. Its strong multiplier effect is driving growth in the trade, finance, real estate, and other services sub-sectors—estimated at another 10 percent of GDP. Meanwhile, low oil prices are fueling growth in the transport sector. On the other hand, industry growth decelerated to six percent in 2015 from 7.9 percent a year ago. Slower manufacturing growth reflects the slowdown in external demand, especially for electronics, food products, and furniture.
- 3. The anemic agriculture sector weakened further as El Niño intensified in H2.** In 2015, the agriculture sector barely grew at 0.2 percent compared to 1.6 percent in 2014. As El Niño intensified in H2, production of major crops declined by 2.4 percent, led by rice, corn, and sugarcane. The brunt of El Niño was felt strongly in Mindanao, the country’s main agriculture region, prompting several provinces to declare a state of calamity. Moreover, warmer waters and

¹ The period since the October 2015 East Asia and Pacific Economic Update has been characterized by i) disappointing growth outcomes in the US, Europe, and Japan, ii) a further slowdown in a number of developing EAP countries, including China, iii) renewed volatility in financial markets and capital flows, iv) further declines in oil prices, v) and continued weakness in international trade. While the move towards normalization in US monetary policy was well-anticipated, uncertainties surrounding the growth outlook in major economies, and the associated policy responses, prompted a resurgence in volatility in capital flows, exchange rates, and financial asset prices in early 2016. Overall, growth in developing East Asia and Pacific eased over the second half of 2015, driven primarily by the slowing in China’s GDP growth to 6.9 percent in 2015. See the accompanying East Asia and Pacific Update (April 2016 edition) for more discussion.

² Source: Information Technology and Business Process Association of the Philippines (IBPAP).

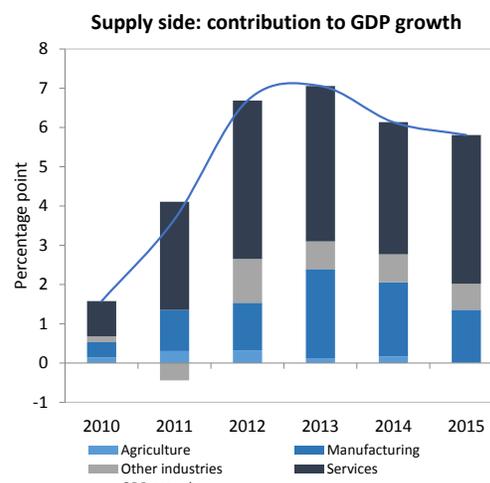
reduced rainfall resulted in the contraction of the fisheries sub-sector by 1.8 percent.³ However, the livestock and poultry sub-sector appeared to be unaffected by El Niño, growing by nearly five percent.

Figure 1. In 2015, the Philippines remained a top performer in the region, behind China and Vietnam among the major economies.



Source: World Development Indicators (WDI) and Bloomberg

Figure 2. The services sector continued to be the main source of growth on the supply side as it benefitted from strong services exports, robust remittances, and lower oil prices.



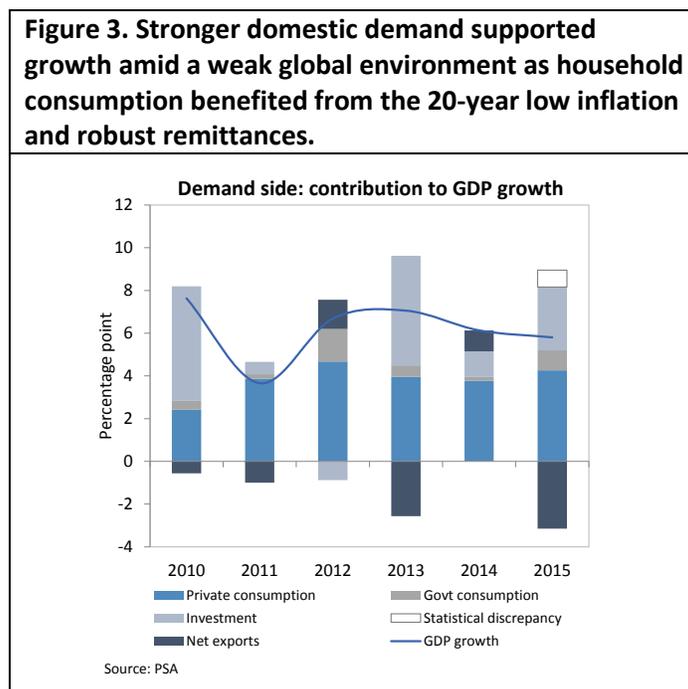
Source: Philippine Statistics Authority (PSA)

4. **On the demand side, private consumption remained the engine of growth.** In 2015, household consumption grew by 6.2 percent and contributed 4.3 percentage points (ppt) to overall growth (Figure 3). Food, non-alcoholic beverages, and transport spending were the main contributors to robust consumption growth. The acceleration of private consumption reflects the 20-year low inflation (at 1.4 percent in 2015) and rising remittances in real peso terms. Although remittance growth slowed in 2015, the depreciation of the peso against the US dollar (given financial market volatility) helped offset the deceleration in dollar remittance growth.

5. **Meanwhile, higher capital formation and accelerated government spending supported growth.** After a slowdown in 2014, capital formation expanded by 13.6 percent. Private sector investment was fueled by a 20 percent jump in durable equipment purchases of mining and construction machineries as well as land transport vehicles. Higher capital formation somewhat reflected the sustained inflow of foreign direct investments valued at USD 5.7 billion in 2015, the second highest in history. Meanwhile, government spending grew by 12 percent, with significant increases in H2, as the government began to address budget execution bottlenecks. In particular,

³ Reduced rainfall adversely affects fish pens because of low water level and reduced stocking rates. Meanwhile, municipal fishing operators nearshore experienced lower catch because small pelagic fish (e.g., sardines) moved from shallow to deeper waters to avoid warmer temperature (Guerrero III, R.D. 1999. *The impacts of El Niño on Philippine fisheries*. The ICLARM Quarterly. Volume 2, No. 3. Accessed through: http://pubs.iclarm.net/Naga/na_2178.pdf.

strong recovery of public infrastructure spending bolstered growth in H2 (see the fiscal policy section for more discussion).



6. **Weaker external demand, coupled with El Niño, tempered exports while imports continued to grow.** In 2015, total export growth was halved to 5.5 percent, driven by weak merchandise export growth (2.4 percent)⁴ despite the solid performance of services export (18.7 percent) (i.e., the BPO industry). El Niño contributed to the slump in agricultural exports, which contracted by 32 percent with sugar and banana recording the biggest contraction at 81 and 61 percent, respectively. In the case of banana, the country's top food export, a Chinese ban due to phytosanitary concerns and the recent spread of the panama disease significantly affected exports. Meanwhile, imports expanded by 11.9 percent, driven by electronics, machinery and mechanical appliances, as well as medical and pharmaceutical products. This trend suggests a near-term expansion of investment and electronics exports. Finally, with record low oil prices, the volume of imports of petroleum products rose by 18 percent while car sales increased by 23 percent in 2015.

7. **With a sustained current account surplus and improving financial account position, the balance of payments (BOP) returned to a surplus in 2015.** The country's BOP realized a USD 2.6 billion surplus from a deficit of USD 2.9 billion in 2014, aided by sustained current account surplus and a slowdown in net capital outflows in Q4. In turn, gross international reserves (GIR) increased by USD 1.2 billion to USD 80.7 billion. At this level, it comfortably covers 10.1 months of imports,

⁴ Weaker export growth was driven by the declines in merchandise exports to key trading partners, such as China (-20.4 percent), Singapore (-18.1 percent), and Japan (-11 percent).

which is more than three times the required reserve adequacy level and more than four times the size of the country's short-term external debt based on residual maturity.

Employment and poverty

8. **Stronger growth in H2 led to significant improvement in unemployment, but job losses and increased underemployment in agriculture due to El Niño dampened net job creation.** Between January 2015 and January 2016, the unemployment rate improved from 6.6 to 5.8 percent—among the lowest in a decade. The services sector generated some 1.2 million jobs, while industry provided another half a million jobs, with manufacturing and construction contributing the biggest shares. However, intense drought brought by El Niño shed some 935,000 jobs in agriculture, bringing net job creation to only 752,000 jobs in the same period. It also increased the number of underemployed in the agricultural sector by six percentage points. As a result, underemployment worsened to 19.7 percent compared to 17.9 percent the previous year.

9. **However, sustained high non-agricultural growth and effective government programs are helping to improve the welfare of the poor.** Recent estimates suggest that extreme poverty decreased gradually between 2012 and 2014. Extreme poverty, using the new international poverty line of USD 1.90/day PPP⁵ and new 2011 PPP prices, is estimated to have decreased from 10.6 percent in 2012 to nine percent in 2014.⁶ Despite the impact of Typhoon Yolanda in November 2013 and the artificially high rice prices created by the state monopoly on rice imports, income growth of the poor helped to improve poverty reduction, led by non-agricultural households, and substantial increases in cash transfers to the bottom quintile. After a decrease of only 0.3 percentage points between 2009 and 2012 (in 2011 USD PPP prices and taking into account spatial price of living differences), poverty fell more rapidly between 2012 and 2014, according to revised PPP estimates. However, high rates of structural poverty remain, especially among households depending on agriculture.

Financial markets

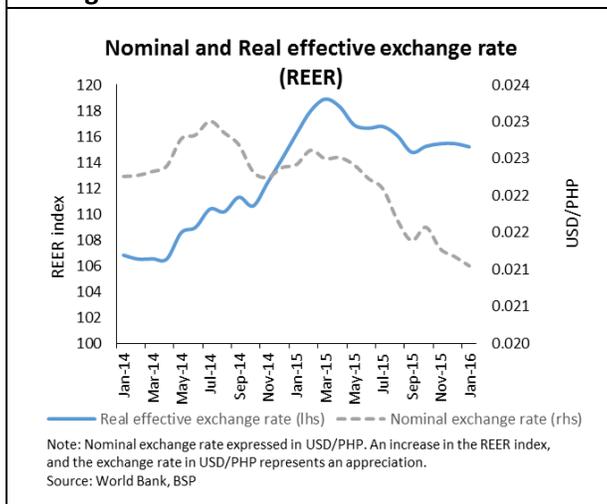
10. **The domestic financial market experienced sharp volatilities in 2015 and early 2016.** In 2015, global financial volatilities led to a USD 600 million net outflow in foreign portfolio investments (FPI), led by net foreign selling of stocks. The outflow of FPI continued in the first two months of 2016 with the latest data indicating a net outflow of USD 175 million. Capital outflow, together with rising interest rates in the US, contributed to the peso's depreciation. From PHP 44.6 to a dollar in January 2015, the peso depreciated by some seven percent by February 2016. Despite its depreciation, exports hardly increased as the real exchange rate remained high (Figure 4). Domestic financial volatility reflects three main developments: i)

⁵ PPP refers to purchasing power parity.

⁶ These estimates are based on the World Bank's methodology: it accounts for both food and non-food inflation as well as spatial cost of living differences which impact the poverty line.

concerns about the outlook for global and regional growth and, relatedly, global commodity prices, ii) concerns about the ability of China to engineer a smooth rebalancing of its economy, and iii) uncertainty about the path of monetary policy in advanced economies, and in particular the potential for further divergence in monetary conditions between the US and other major economies.

Figure 4. The peso depreciated by some seven percent in nominal USD terms, yet remains strong in real terms.



11. **The equity market’s weak performance in 2015 has begun to turn around in early 2016, in part due to sound fundamentals.** The Philippine Stock Exchange Index (PSEi) had a strong start in 2015 with a record high of 8,127 points in April 2015 but declined by 25 percent from its peak in January 2016 (Figure 5). Several episodes of sell-offs reflected the turbulent Chinese stock market and oil price slumps. Since February 2016, the stock market gradually improved, in part due to the solid outlook for the Philippine economy, and helped by the latest decision of the US Fed to keep interest rates unchanged after raising it in December 2015. By end-March 2016, the stock index grew by seven percent year-to-date.

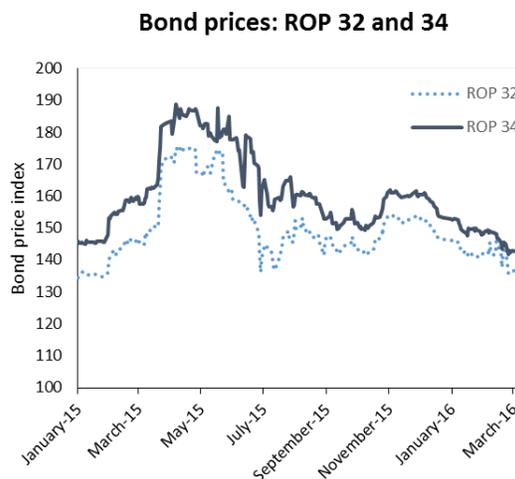
12. **Meanwhile, bond prices resumed their decline in response to the change in US monetary policy.** Bond prices of the benchmark ROP 2032 and 2034 (i.e., government external debt papers) declined by 6.4 and 3.4 percent, respectively, between August 2015 and March 2016 (Figure 6). The fall in bond prices reflects narrowing interest differentials between US and Philippine fixed income instruments and the volatility in global financial markets. Its fall, however, was muted by investors shifting from equity to traditionally safer fixed income instruments following the stock market sell-off in 2015.

Figure 5. In Q1 2016, the equity market began to recover from its slump in 2015.



Source: Philippine Stock Exchange

Figure 6. Bond prices resumed their decline, reflecting US monetary policy changes and financial market volatilities in recent months.



Source: Bloomberg

Prices and monetary policy

13. **In 2015, inflation slowed to a 20-year low of 1.4 percent and continued to decelerate in early 2016.** From 1.3 percent in January, CPI inflation further slowed to 0.9 percent in February (Figure 7). The continued deceleration of inflation is largely explained by record low oil prices and ample food supply despite El Niño. The decline in oil prices, by an average of 47 percent in 2015, slowed down overall consumer prices as utility prices fell by 1.3 percent. Meanwhile, timely and sufficient importation of rice, as well as building up of rice stocks in 2015, contributed to lower food inflation at 2.5 percent in 2015 compared to 6.7 percent in 2014.

14. **Given low inflation and a stable domestic economy, the central bank kept key interest rates unchanged.** While the Fed increased its rates by 0.25 ppt, the central bank maintained its key rates, citing strong growth and low inflation. Rates for special deposit accounts remained at 2.5 percent while overnight borrowing and lending rates were unchanged at 4 and 6 percent, respectively. The reserve requirement ratio was likewise left unchanged at 20 percent. These have supported the stable growth of the money supply (M3) at 9.2 percent in the last twelve months since January 2016, compared to an average of 21.3 percent in the previous period (Figure 8).

Figure 7. CPI inflation continued to decelerate in 2016 after a 20-year low of 1.4 percent in 2015, bringing much relief to households.

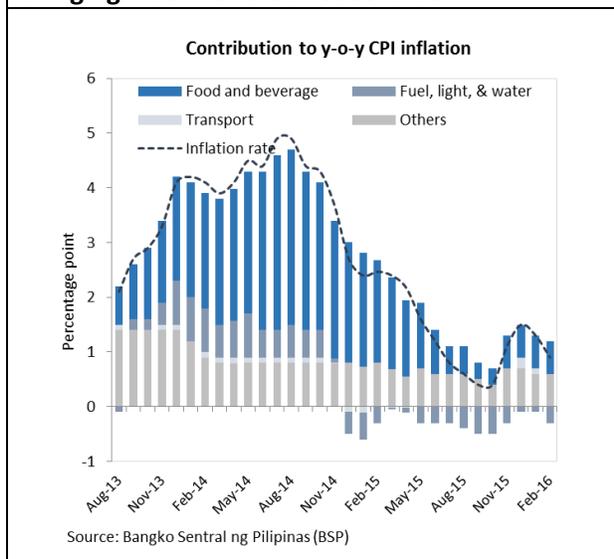
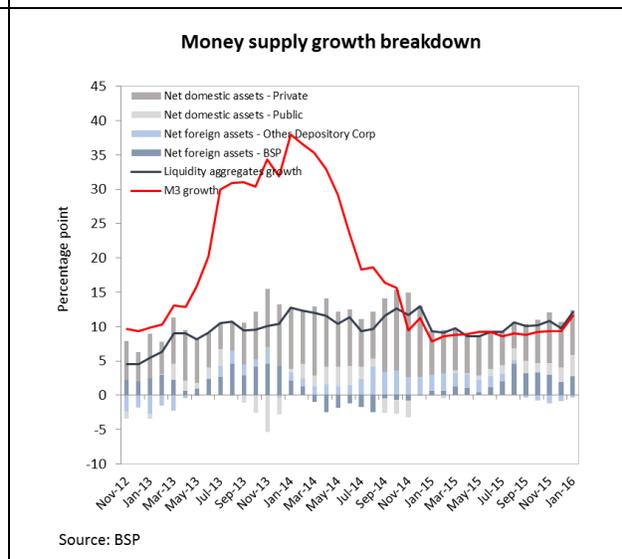


Figure 8. Prudent monetary policy is supporting stability of money supply and inflation.



Fiscal policy

15. **After a slow start in H1 2015, government spending accelerated in H2 as budget execution bottlenecks began to be addressed and priority projects expedited.** In 2015, government spending grew by 13 percent to PHP 2.2 trillion, but this was only equivalent to 87 percent of the budget. Tax effort marginally increased to 13.7 percent of GDP, aided by sustained improvements in tax administration and strong growth. However, without tax policy reforms (discussed in the policy section⁷), increasing the tax effort to finance the government's inclusive growth programs will prove to be a challenge. Higher spending relative to 2014 led to a wider budget deficit of 0.9 percent of GDP. Given the country's sustainable fiscal stance, this fiscal outturn suggests room for further investment in infrastructure and social services to make growth more inclusive.

16. **In 2015, tax effort improved only marginally, suggesting that improvements in tax administration need to be complemented by tax policy reforms.** In the Bureau of Customs (BOC), collection declined by 0.5 percent, driven by lower VAT collection from oil due to lower prices and a slowdown in the reform momentum. A speedy passage of the Customs Modernization and Tariff Act could help improve customs modernization to control smuggling

⁷ For a more detailed discussion, please see the August 2014 edition of the Philippine economic update. This is available at: <http://www.worldbank.org/en/country/philippines/publication/philippines-accelerating-public-investment-to-sustain-growth-that-benefits-the-poor>.

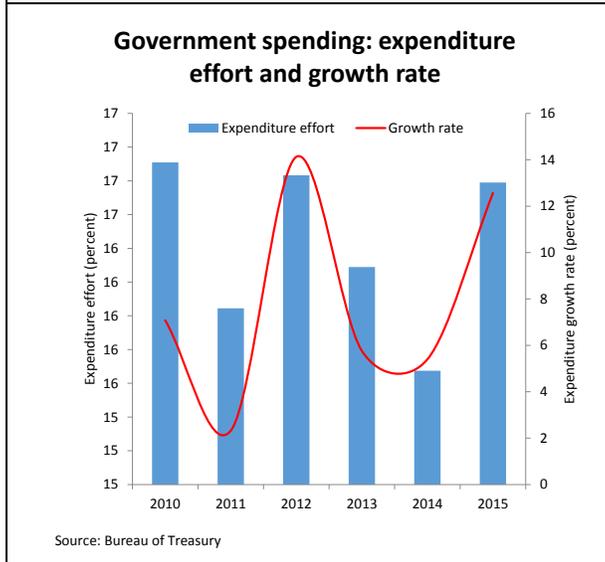
and improve trade facilitation.⁸ In the Bureau of Internal Revenue (BIR), sustained tax administration reforms continue to support BIR revenue growth at 7.4 percent. However, a further increase in tax effort is unlikely unless more fundamental tax policy reforms are implemented to first broaden the base and then reduce the rates. Key reforms currently being considered by the government include the rationalization of fiscal incentives, hike in petroleum excise taxes, and reducing income tax rates.

17. While government spending accelerated in H2 2015, significant project execution problems remain. Government spending increased by 13 percent in 2015 as infrastructure spending picked up in H2. However, government spending, which doubled in the last six years, continues to struggle to meet budget and growth targets. As discussed in the October 2015 edition of the Philippine economic update, disbursement bottlenecks are due to structural weaknesses in implementing agencies, which include: i) poor planning, ii) weak program and project design, and iii) procurement and implementation difficulties such as a) frequent bid failures, b) weak capacity to procure, c) right-of-way-issues, d) difficulties in securing permits, and e) coordination problems. Cognizant of these problems, the government is addressing them by expediting the implementation of priority programs and projects, strengthening procurement and implementing units, including provision of extra staff positions in the bids and awards committee, and setting up “full-time delivery units” in all major implementing agencies. Full-time delivery units are headed by an Undersecretary and track progress and troubleshoot with respect to program or project implementation. Moreover, congress recently passed the Right-of-Way Act (RA 10752), which is expected to accelerate infrastructure projects as right of way issues can be resolved quicker. In this regard, preparing the implementing rules and regulation of the act needs to be prioritized.

18. In the medium-term, a more comprehensive overhaul of the budget execution system is needed (Figure 9). Lengthy, complicated, and sometimes unclear procurement and disbursement processes are challenges which exist government-wide, across agencies, as well as in spheres of government. The next administration could consider the enactment of a comprehensive legislation to improve budget and financial management. While it will inherit a substantial budget to be implemented, the capacity of the existing budget systems to spend these resources efficiently and effectively is severely constrained by a combination of incoherent or unclear rules and regulations, and low execution capacity of key agencies already strained to the limit.

⁸ The senate has approved its version already and is waiting for the House of Representatives to approve its version before reconciling in the bicameral committee.

Figure 9. Although improving, government spending continues to be hampered by institutional bottlenecks.



PROSPECTS AND RISKS

19. **Growth prospects for the Philippines remain positive due to its favorable macroeconomic and policy environment.** The country continues to benefit from solid macroeconomic fundamentals, with strong growth, low and stable inflation, sustainable fiscal position, healthy current account surpluses, and more-than-adequate international reserves. This provides the country with the flexibility to use a range of policy tools to withstand shocks from the weaker global environment.

20. **With solid macroeconomic fundamentals and significant fiscal space in place, the Philippines is now in a position to accelerate the reforms needed to achieve more inclusive growth to reduce poverty and boost shared prosperity.** In the short-term, reforms in budget execution will allow the country to use its growing fiscal space to increase investments in both human and physical capital, with positive contributions to near-term growth and quality of jobs. Over the medium-term, accelerated structural reforms are needed to enhance competition, simplify business regulations, secure property rights, and accelerate investments in human and physical capital.

21. **In the near-term, economic growth is likely to remain strong and is projected to accelerate to 6.4 percent in 2016 before tempering slightly to 6.2 percent in 2017** (Table 1). Faster growth in 2016 would be driven by favorable domestic factors. Private consumption would remain robust, aided by low inflation and spillovers from increased spending due to the upcoming general elections.⁹ Investments will likely support growth as implementation of public-private partnership (PPP) projects accelerates. In 2016, PPP projects are estimated to contribute some 0.8 percent of GDP in additional investment spending. Meanwhile, government spending is expected to improve as budget planning and execution continue to be addressed. In 2017, growth is projected at 6.2 percent as the economy normalizes after the election cycle.

22. **On the supply side, the outlook on services and manufacturing is positive, while agriculture is expected to recover moderately.** The BPO industry will remain a key driver of the services sector, with revenues expected to surpass remittances by 2018.¹⁰ Meanwhile, fiscal incentives offered under the Comprehensive Automotive Resurgence Strategy program are expected to boost car assembly and other related industries, which can support the recovery of manufacturing. Agricultural production is expected to pick up in H2 2016 as El Niño eases. However, downside risks remain, as climate change and the wet season typically bring stronger typhoons in H2 that could lead to major crop damages and thus weaken food production.

⁹ The May 2013 edition of the Philippine economic update estimates that H1 GDP growth is typically up to two ppt higher during a presidential election year, as advance spending due to the election ban, campaign spending, and transfers lift both private consumption and government spending. This is available at: http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/Philippine_Economic_Update_May2013.pdf

¹⁰ With average revenue growth of 14.8 percent, BPO revenues are expected to reach USD 35 billion in 2018, surpassing the projected value of remittances at around USD 34 billion given prevailing growth rates.

23. **These growth projections incorporate a number of risks, which have remained broadly the same since the October edition of the Philippine economic update.** The key risks are uneven recovery of high-income economies, slower than anticipated growth of large emerging market economies, financial market volatilities, slower remittance growth from oil exporting countries, the continuation of El Niño in H1 2016, delays in PPP projects, and uncertainty around the outcome of the elections.

Table 1. Philippine, East Asian, and global growth projections

	2016	2017	2018
Philippine GDP growth			
Previous projections	6.4	6.2	-
Revised projections	6.4	6.2	6.2
East Asian growth			
Previous projections	5.8	5.8	-
Revised projections	5.7	5.7	5.8
Global growth			
Previous projections	3.0	3.1	-
Revised projections	2.5	2.9	3.0

Source: World Bank staff projections

24. **On the external front, sluggish trade recovery will weigh down Philippine external demand.** Slower growth of large emerging economies such as China and uneven recovery among high-income economies, such as Japan, the US, and the Euro zone, all major trading partners with a combined 60 percent market share, will impede the recovery of Philippine exports. Growth in merchandise exports may show an uptick if the slowdown in China is moderated by its recently announced stimulus, and if high-income economies, such as the US, continue to show stronger signs of recovery. This period of slow external demand provides the country with a window of opportunity to address competitiveness constraints such as power, logistics, and non-tariff barriers.

25. **Developments in China can negatively affect the Philippines.** Developments in China can dampen expectations in the local financial markets and hold back Chinese investment, given increasing investment links between China and the Philippines. In addition, exports to China¹¹ and receipts from Chinese tourists¹² can also be affected should China's growth edge lower than expected.

¹¹ Philippine exports to China account for around 13 percent of total exports, and thus could have some effect on growth.

¹² China was the fifth largest tourism market in 2015 with receipts of PHP 10 billion. In 2015, half a million Chinese tourists visited the Philippines. Source: Department of Tourism.

26. **Downside risks to consumption growth may come from the slowdown of remittances, especially from oil exporting countries.** From a 7.2 percent growth in 2014, cash remittances slowed to 4.6 percent in 2015. In 2015, some 1.5 million overseas Filipino workers in the Middle East held temporary contracts and for some of them, especially those working in the construction sector, continuation of their contracts may be more uncertain in the future.

27. **Moreover, increasing global concerns over money laundering could affect the cost of sending remittances, if there is an increase in closures of bank accounts of remittance forwarding companies.** While the Philippine Anti-Money Laundering Act (AMLA) brings the country's regulatory regime on money laundering closer to international standards, better compliance with these standards, through further legal and regulatory reform, is needed. For instance, the coverage of the Act should be expanded to include sectors such as casinos. In addition, the country's bank secrecy laws, among the strictest in the world, hamper the execution of AMLA's compliance review programs and the conduct of investigations.

28. **On the domestic side, the effect of El Niño on growth could be significant if food imports are inadequate.** The direct effect of El Niño on economic growth is likely to be small, as agriculture comprises only a small share of the Philippine economy.¹³ While the peak of El Niño has passed, the country is still expected to feel its effects through Q2 2016 and the indirect impact on prices and consumption growth can be high if food supply is not managed well. High food prices could lead to an uptick in poverty as the poor are susceptible to food price shocks. The key response for the government is to maintain an adequate stock of food through timely importation, including by the private sector, and management of key food items such as rice.

29. **The uncertainty over the outcome of general elections pose some uncertainties.** The country will hold general elections in May 2016 and a new government will be inaugurated in July 2016. While the foundations for more inclusive growth have been put in place, there is still the risk of reversals of hard won gains in securing macroeconomic stability and deepening governance, especially in public spending. As discussed in the policy section of this update, a key priority for the new government will be to create more and better jobs through an accelerated structural reform agenda.

30. **In terms of prices, inflation is expected to remain low and stable at two percent in 2016.** With a combination of low oil prices and food inflation, CPI inflation will likely fall at the low end of the central bank's two to four percent target for 2016. Low inflation will provide the central bank room to maintain its accommodative monetary policy stance, which could further support growth. Downside risks remain however, as the presence of El Niño in H1 2016 and typhoons in the second half of the year can lead to disturbances in food supply and thus lead to higher food inflation¹⁴ if food supply is not managed well.

¹³ Agriculture accounts for only around 10 percent of GDP.

¹⁴ The 1998 episode of El Niño saw food inflation increase to 8.3 percent and would have increased even more had the Philippines not imported adequate stock of rice.

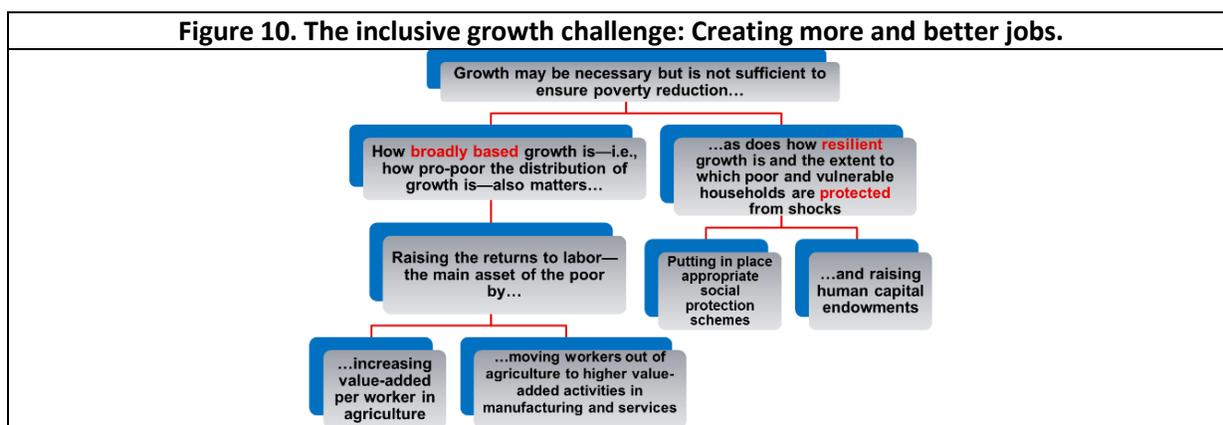
31. **Poverty reduction is expected to continue if the country is able to maintain the relatively high economic growth and the more positive job trends in recent years, despite recent shocks to agriculture.** Recent trends show an improvement in the country's growth-poverty elasticity, which means growth is becoming more inclusive. However, the recent increase in the underemployment rate and weak agricultural output in 2016 will need to be countered by sustained increase in per capita income growth and a continued focus on supporting the structurally poor through effective social protection programs. Under these assumptions, extreme poverty is projected to further decrease from nine percent in 2014 to 6.8 percent in 2018.

32. **To conclude, trends in recent years point to the beginnings of a more inclusive growth pattern, which needs to be sustained over a longer period before the poor can feel the impact of higher growth and better governance in their daily lives.** In the past six years, the government has preserved macroeconomic stability, promoted transparency, and directed the growing fiscal space towards pro-poor infrastructure and social services. What is needed now is to consolidate the reforms made and to accelerate the economic reform agenda by moving ahead at full speed. This includes further enhancing competition in sectors with a high impact on jobs, such as rice, shipping, and telecoms; securing property rights through more systematic and administrative adjudication of land rights; and simplifying business regulations to encourage the growth of firms of all sizes, while increasing tax effort and reforming the budget execution system in order to sustainably ramp up public investments in infrastructure and social services. In all these, priority is needed in Mindanao, where decades of conflict and weak, Manila-centric policies have kept it from reaching its potential. To accelerate reforms in the future, the government, business, labor, and civil society need to work more closely together to support reforms that will help the country move full speed ahead to create more and better jobs.

POLICIES: A RETROSPECTIVE AND FORWARD LOOK ON HOW TO CREATE MORE AND BETTER JOBS

Introduction

33. **Despite the improvements made in recent years, the central policy challenge facing the Philippines is still how to accelerate inclusive growth — the type that creates more and better jobs and reduces poverty at a faster rate.** As the Philippines continues to benefit from improved macroeconomic stability, attention must now focus on policies to make sure growth is more inclusive and that the poor and vulnerable households are protected from shocks (Figure 10). In order to make growth more broad-based, returns to labor must be raised, as this is the main asset of the poor. Raising the returns to labor of the poor usually means starting in agriculture, as this is where most of the poor are located. Rising agricultural productivity then paves the way for the development of a vibrant labor-intensive manufacturing sector, which can facilitate the migration of agriculture workers to higher value-added activities in manufacturing and eventually services. In addition, to make sure that the poor and vulnerable households are protected from shocks, appropriate social protection schemes must be put in place, and human capital endowments of the poor must be raised so that the poor can weather these shocks.



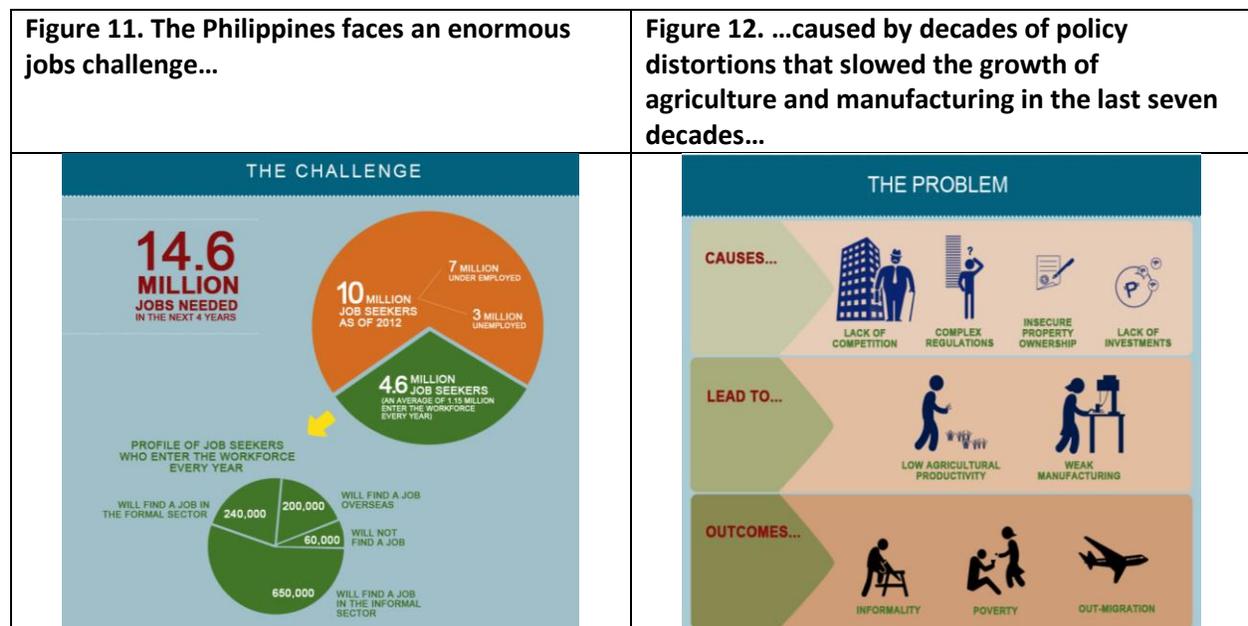
34. **At the heart of this inclusive growth challenge is the jobs challenge that the Philippines faces** (Figure 11). It was calculated in 2012, that 14.6 million good jobs — meaning jobs that raise real wages and bring people out of poverty — needed to be provided to around 10 million Filipinos who were either unemployed¹⁵ (three million) or underemployed¹⁶ (seven million), and

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

¹⁶ Underemployment is defined to include all employed persons looking for more work.

to around 1.15 million potential entrants to the labor force¹⁷ every year from 2013 to 2016.¹⁸ In addition, better jobs needed to be provided to another 21 million Filipinos who were informally employed.¹⁹

35. **This enormous jobs challenge is caused by a number of underlying issues that have slowed good job creation in the Philippines.** Specifically, the lack of competition in key sectors, insecurity of property rights, complex regulations, and severe underinvestment by the government and the private sector have led to a growth pattern where agriculture has remained depressed, manufacturing has failed to grow sustainably, and a low-productivity, low-skill services sector has emerged as a dominant sector of the economy, which is not the norm in the East Asia region (Figure 12). As a result, job creation in both agriculture and manufacturing, which are typically the sectors where pro-poor labor-intensive growth can be created, have been weak (Figure 13).



¹⁷ The labor force is defined to include persons 15 years old and over, who are either employed or unemployed. Examples of persons who are not included in the labor force are full time housewives, students, and retirees.

¹⁸ For more details on the analysis, please see the Philippine development report “Creating more and better jobs.” This is available at:

<http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/PDRFullReport.pdf>.

¹⁹ This is operationally defined to include all self-employed workers (excluding employers), unpaid family workers, and wage workers with no written contract, social insurance, or protection from dismissal using the 2008 Informal Sector Survey (ISS) of the Philippine Statistics Authority (PSA).

Figure 13. ...leading to weak job creation in agriculture and manufacturing—the two sectors that can provide tens of millions of jobs to the poor.

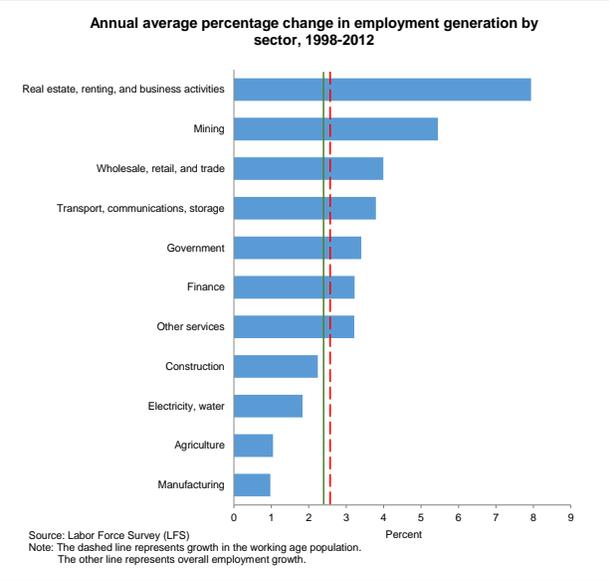


Figure 14. As a result, the pace of poverty reduction has been slower, albeit improving in recent years.

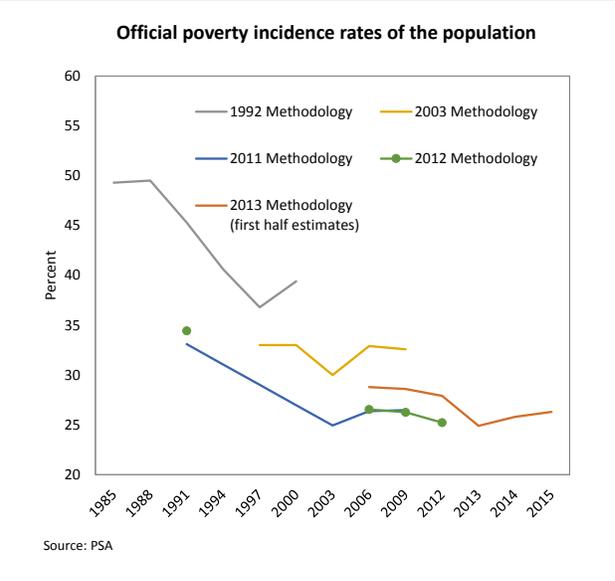
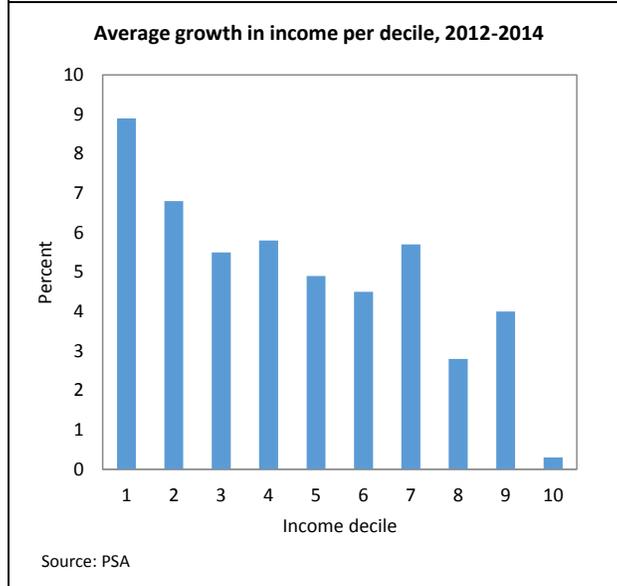


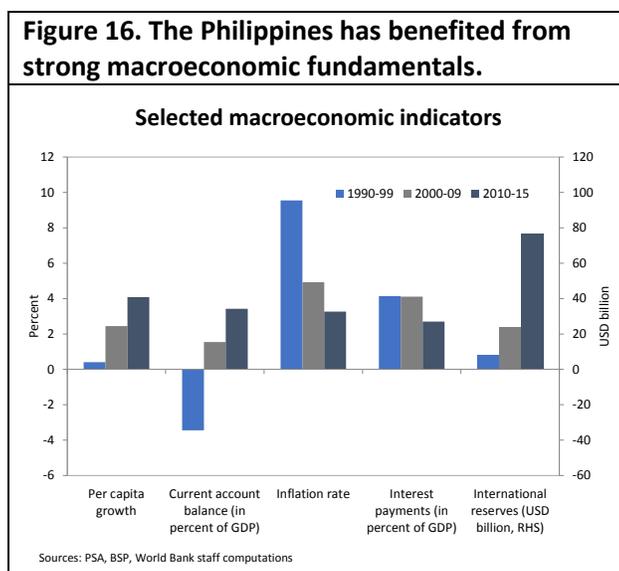
Figure 15. Recent income growth is more pro-poor, driven by conditional cash transfers.



36. **Consequently, poverty reduction has been slow, although recent trends are moving in the right direction** (Figure 14). Since 2012, poverty and underemployment were reduced by the lagged effect of higher growth and effective targeting of spending towards the poor. After a decrease of only 0.3 percentage points (ppt) between 2009 and 2012, first half poverty estimates fell by 1.3 ppt from 27.9 to 26.3 percent from 2012 to 2015 according to official estimates.

Strong macroeconomic fundamentals and fiscal space: the prerequisite to inclusive growth

37. **In order to address the structural reform issues surrounding the jobs challenge, the government first established the necessary conditions for inclusive growth.** In the past decade, macroeconomic management was strengthened, while in recent years, the positive impact of the government’s strong commitment to good governance has been recognized locally and globally.²⁰ As a result, growth accelerated, and the country is now increasingly characterized by robust economic growth, low and stable inflation,²¹ healthy current account surpluses,²² more-than-adequate international reserves,²³ and a sustainable fiscal position (Figure 18). Confidence was further boosted by the strong anti-corruption image and efforts displayed in recent years. In this way, several necessary conditions for inclusive growth were achieved, while the government began to address some of the structural reforms to put the economy on a path leading to inclusive growth.



38. **The government’s focus on improving fiscal revenues and public financial management has created substantial fiscal space** (Figure 17). Tax effort improved from 12.1 percent of GDP in 2010 to 13.7 percent of GDP in 2015. This was a significant improvement considering that the government took office with a pledge of “no new taxes.” The main thrust of the government was to intensify reforms in tax and customs administration. Together with higher economic growth, this led to an unprecedented increase in the tax effort without major policy changes. This is all

²⁰ The country is now rated two notches above investment grade by all three major credit rating agencies—a testament to the country’s strong macroeconomic fundamentals.

²¹ The BSP uses inflation targeting at its main policy tool to promote price stability and growth. This includes publicly announcing a medium-term inflation target to provide transparent guidance to the public and the private sector. It is currently set at three percent per year, plus or minus one percent.

²² The current account has been in strong surplus for the past fifteen years, after being in deficit in the decade prior.

²³ The level of gross international reserves is currently equivalent to 10.1 months of imports and 4.1 times the value of the country’s short-term external liability by residual maturity. This level is well in excess of the IMF’s suggested reserve adequacy.

the more remarkable since the existing system has built-in erosion (through a lack of indexation to inflation and several creeping exemptions as several government agencies have the authority to provide tax breaks to the private sector without reference to the oversight agencies or the budget law). For example, tax erosion from petroleum excise taxes and fiscal incentives are estimated at around 0.5 percent of GDP since 2010.

39. Moreover, prudent fiscal management, together with stronger growth and sound macroeconomic policies, translated into better financing terms for government borrowing. Upgrades in the country's credit rating caused borrowing costs²⁴ to decline from an average of 800 basis points (bps) in 2004 to below 200 bps in 2015 for the 91-day, 6-month, and 1-year T-bill rates. However, instead of pursuing expansionary fiscal policies, the government took advantage of the decline in borrowing costs to swap old, high cost, short-term debt for newer, lower cost, long-term debt (i.e., average borrowing costs for long-term debt have gone down from over 10 percent in 2004 to below four percent in 2015).²⁵ This has meant that debt servicing was reduced considerably. For instance, in 2010, the country had to pay PHP 57 of every 100 pesos collected in revenues on debt servicing. By 2015, this had been reduced to PHP 25. Similarly, debt service payments as a share of exports declined from 20.1 percent in 2010 to 12.2 percent in 2015. As a result, the country's debt stance is sustainable.²⁶

40. This increased fiscal space allowed a considerable ramping up of spending, including on programs which benefit the poor directly. The 2016 budget is nearly double than that of 2010, implying an annualized growth rate of about 12 percent. This is substantial by international standards. The growing fiscal space was rightly targeted towards priority areas, led by social services (Figures 18 and 19). The budget for education, health, and social protection grew by almost three times between 2010 and 2016. As a result, the country today has a world class conditional cash transfer (CCT) program that replaced an often patronage-based system of subsidies. The public education system now provides 13 years of free schooling. Universal healthcare coverage is close to being achieved. A larger budget for community-driven development and bottom-up budgeting programs is giving the people direct voice in development interventions. Infrastructure spending, while progressing slower, has also been ramped-up, with the aim of reaching five percent of GDP by 2016. These spending reforms were made possible by better tax administration and the passage of the "sin tax" law, both of which created significant fiscal space of around 1.6 percent of GDP, and by better transparency and accountability of public spending.

²⁴ The government funds the fiscal deficit (target of two percent of GDP) from a mix of local and foreign sources (currently at a ratio of 75:25 but moving towards a ratio of 90:10).

²⁵ For instance, the latest domestic debt swap enabled the government to save PHP 2.4 billion in interest expense. Source:<http://www.bworldonline.com/content.php?section=TopStory&title=philippines-launches-bond-swap&id=114222>.

²⁶ A recent debt sustainability analysis projects that with a generally prudent debt management policy, the national government debt-to-GDP ratio would continue to trend downwards to 38.2 percent of GDP by 2018. The same downward trajectory is also seen in the consolidated public sector debt and total external debt. Standard shocks on interest rates (i.e., one standard deviation from the historical mean), and on the exchange rate (i.e., 30 percent real depreciation) would increase the debt stock to between 41 and 42.3 percent of GDP. These levels represent debt ratios that are still considered sustainable.

Figure 17. The country has benefitted from improved revenues and fiscal management...

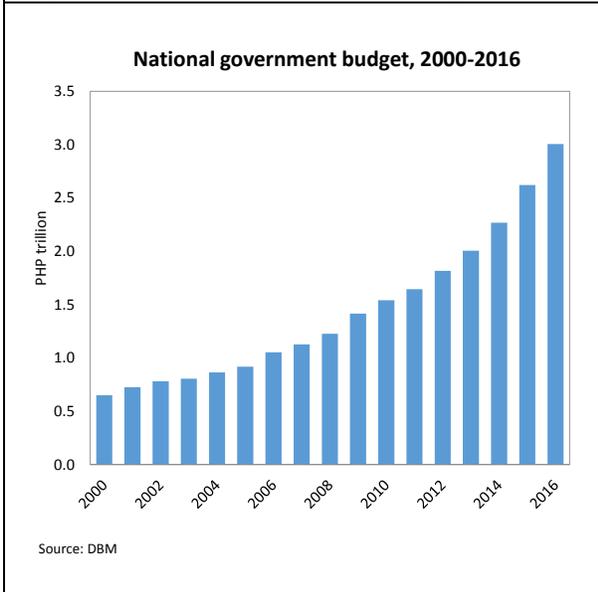


Figure 18. ...that are used to create the necessary fiscal space for improved social service delivery...

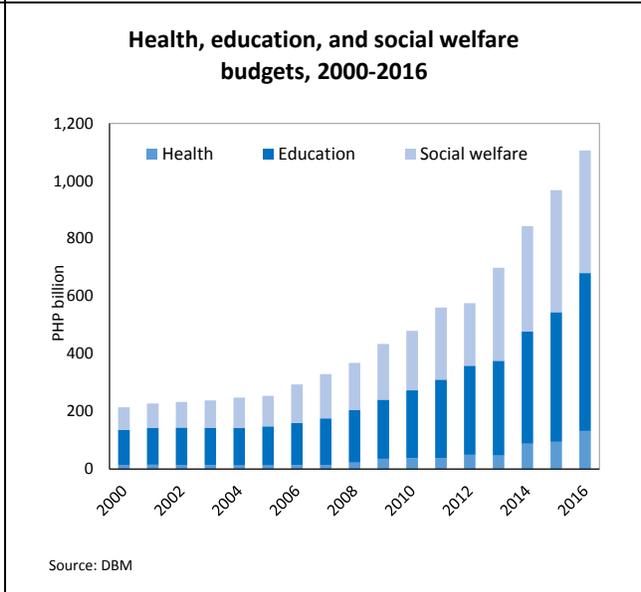
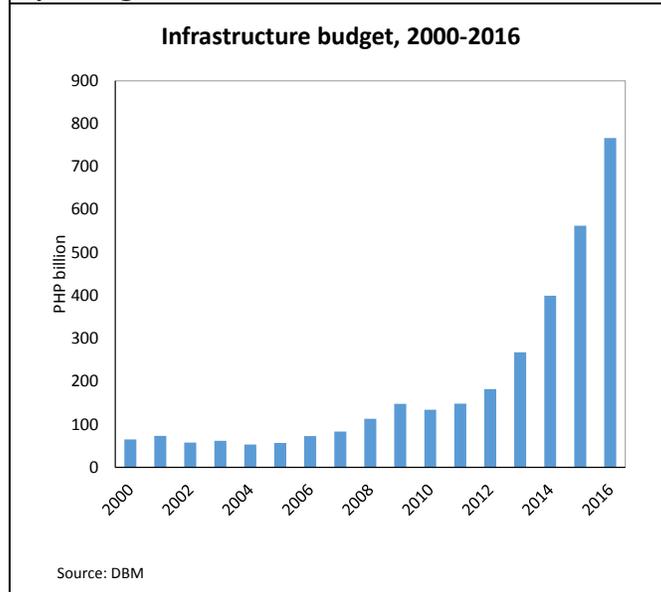


Figure 19. ...and greater allocation for infrastructure spending.



Structural transformation

41. With the necessary conditions in place, the Philippines now needs to pursue policies to enable it to undertake a more successful structural transformation of the agriculture, manufacturing, and services sectors—whose key dividend is the creation of more and better

jobs. Agricultural productivity growth keeps food prices relatively low, thereby keeping wages internationally competitive while also allowing consumers to spend more on non-food items. This further boosts the manufacturing sector and allows it to absorb excess agricultural workers created by agricultural productivity growth. As agriculture and manufacturing provide more jobs to the poor, poverty can go down faster. Continued growth in manufacturing productivity and increased aggregate demand then opens up the economy to a new stage: growth led by a high-skilled services sector. Such a pattern of structural transformation is the experience in most developed countries, including the high-performing economies in East Asia. This is not presently the case in the Philippines.

42. The development of the rural sector is a crucial first step for the country to provide more and better jobs for the poor. Three-quarters of the poor are found in rural areas and agriculture employs the majority of the poor. This means that agriculture can play a key role in efficiently reducing poverty. In turn, productivity improvements in agriculture can help the country expand its manufacturing sector through lower minimum wages (as transmitted by lower food prices), and input costs. To create more productive jobs in rural areas and enhance agricultural productivity, reforms are needed to i) improve security of property rights, ii) increase the level, efficiency, and cost-effectiveness of public goods spending, and iii) liberalize the market for rice and other key crops.

43. The Philippines has proven that it can compete globally in manufacturing (e.g., electronics) by addressing investment climate issues and connecting to global value chains. While the country's manufacturing sector has historically been protected and thus created very few jobs, lessons from industries that were liberalized, such as electronics, suggest that there is strong potential for Philippines to expand its manufacturing base, especially in light of the global and regional rebalancing. The manufacturing sector can be reinvigorated by increasing competition in the economy and investing more in infrastructure. Reforms include: i) strengthening competition policy, ii) enhancing competition in key sectors such as ports, shipping, water utility, power, airlines, oil, cement, chemicals, and agriculture, and iii) opening the economy further to foreign competition. Having more contestable markets can spur investment from both domestic and foreign sources, bring down the cost of manufacturing inputs and logistics, provide workers in agriculture and informal services with better jobs in manufacturing, and increase real household income by reducing consumer prices.

44. In services, as a start, the country must continue to support its fast-growing, internationally competitive business process outsourcing industry. The expansion of this sector is responsible for over a million jobs in the country and has total revenues exceeding USD 20 billion. Its indirect effects (through growth and job multipliers) are even more significant, due to linkages in retail trade, construction, transportation, and finance. However, to continue this stellar performance, several challenges need to be addressed. Key reforms are needed to further liberalize the telecommunications sector, which could boost the expansion of BPOs into secondary cities. Moreover, investment in human capital and relevant skills must be facilitated, as higher demand for more knowledge process outsourcing services continues.

Accelerating the reform agenda

45. **The government has begun to address decades-long constraints that have held back the potential of the private sector to create a more inclusive growth pattern.** The key economic reforms addressed by the government include:

- **Fostering more domestic competition by simplifying business registration and by passing an overarching competition policy law.** On simplifying business registration, progress was made on key aspects of the investment climate for small and medium enterprises (SMEs), including the cost of starting a business. However, the positive legal and regulatory reforms undertaken seem to need stronger coordination and enforcement on the ground to ensure that SMEs actually experience an improved investment climate. Meanwhile, with the passing of an overarching competition policy law, economic agents can be charged with monopolistic behavior. The law has been decades in the making, as in the past it was always successfully opposed by the large business conglomerates.
- **Opening up the economy to more foreign competition by allowing foreign transshipment of goods and by opening up the banking industry to foreign competition.** With the passing of RA 10668, or the “Foreign ships co-loading” Act, foreign ships are allowed to load and off-load foreign freight along domestic routes, instead of being forced to completely load and off-load in one international port. The reform is not a full liberalization, as foreign ships will not be allowed to take in domestic cargo, but it is a good start (See Box 1 for a more detailed discussion on the domestic shipping industry). In addition, implementing rules and regulation still need to be issued. Furthermore, the banking sector liberalization fully opened up the sector to foreign competition, by removing foreign ownership restrictions, allowing 100 percent foreign ownership. Thus far, six foreign banks²⁷ have been approved for entry, with the entry for more banks under discussion.²⁸

46. **Going forward, a package of economic reforms is necessary to address long-standing impediments to more inclusive growth.** Specifically, policies are needed to promote more competition, make it easier to do business, secure property rights, and ramp up investment through a simpler, fairer, and more efficient tax system, to create more and better jobs.

Box 1. Promoting competition in the Philippine domestic shipping industry

The Philippine domestic shipping industry is characterized by high costs, low quality of service, and a poor safety record. Logistics costs account for 24 to 53 percent of wholesale price in the Philippines

²⁷ These are Sumitomo Mitsui Banking Corp (Japan), Shinhan Bank (South Korea), Cathay United Bank (Taiwan), Industrial Bank of Korea (South Korea), Yuanta Commercial Bank (Taiwan), and United Overseas Bank (Singapore).

²⁸ Recently, the Philippines and Malaysia have agreed on the bilateral guidelines on the entry of Qualified ASEAN Banks (QABs). The agreement will be regulated within the legal framework of RA 10641.

compared to less than 20 percent in other countries in the East Asia region. In addition, the Philippines trails behind its neighbors in various logistics performance and connectivity indices. Moreover, in terms of maritime accidents, from 2004-2012 the country had the highest casualty rate among its neighbors in the region.²⁹

Among the probable causes of the poor state of the domestic shipping industry is the limited competition in the sector. Significant barriers to market entry exist. Until recently, regulations favored incumbents and made it hard for new firms to enter the industry. Incumbents were allowed by regulations to object to the granting of a certificate of public convenience (CPC), which authorizes the operation of a ship to new entrants. Cumbersome and costly procedures and the lack of transparency surrounding the CPC process also deterred entry of new firms. In addition, the country's laws restrict foreign shipping companies from serving domestic routes. This is known as cabotage.

International evidence suggests that opening up the domestic shipping industry to competition can improve efficiency. In New Zealand, freight rates declined between 25 and 50 percent following cabotage liberalization in 1995. For the Philippines, the use of larger and more advanced foreign-flagged vessels can reduce costs by taking advantage of economies of scale and cargo optimization. In fact, the benefits can materialize even without actual entry of new shipping companies into the market. This is because the mere threat of competition from more efficient shipping companies can serve as a disciplining force or an incentive to be more efficient, thereby lowering shipping costs.

In 2013, cabotage liberalization was identified as a priority reform. Congress was asked to amend the cabotage provisions "in order to foster greater competition and to lower the cost of transportation for agricultural sector and other industries." However, the 1987 Constitution restricts the ownership and operation of public utilities to citizens of the Philippines or to corporations with at least 60 percent Filipino equity. Since shipping is considered a public utility, constitutional amendments would need to be made to fully liberalize cabotage.

Nonetheless, the Philippine government passed three landmark regulations to foster greater competition in the domestic shipping sector. In March 2014, the Maritime Industry Authority streamlined their shipping licensing procedures to reduce the ability of incumbents to challenge the entry of new vessels into the sector. The licensing procedures were also streamlined to allow for parallel rather than sequential processing of registration, safety, and franchising requirements. These reforms have led to a 40 percent reduction in the issuance times for shipping licenses.

In July 2015, the Philippines passed RA 10668, or the "Foreign Ships co-Loading Act" which allows foreign vessels to transship imported and exported cargo throughout the islands. Currently, the government is working on completing the implementing rules and regulations for RA 10668. Once the law is fully implemented, the Philippines is expected to attract more foreign ships to serve secondary ports that do not have sufficient trade volumes for direct regular ship calls. The primary objective of the reform is to lower the logistics costs for firms operating from outside the main ports of Manila and Cebu.

In that same month, the Philippine Competition Act was passed, creating an overarching policy framework for enforcing competition, not just in domestic shipping but in all sectors. The law includes crucial provisions to review mergers and prevent monopoly power. All five commissioners of the

²⁹ Source: ASEAN-Japan Transport Partnership.

Philippine Competition Commission were appointed in February 2016 and are in the process of completing the implementing rules and regulations for the full implementation of the law.

Promoting more competition

47. **The Philippines is a relatively open economy, however, it has a number of policies which limit both domestic and foreign competition.** In terms of trade, exports and imports account for about 60 percent of GDP. In addition, the country has generally low tariff rates, except in agriculture. The average most favored nation (MFN) tariff stood at 6.3 percent in 2015. Inadequate competition policy explains in part why the country's oligopolistic market structure persists. While a number of sector or industry-specific competition laws existed, as well as regulatory arrangements to regulate natural monopolies, they have not consistently dealt with the wide range of anti-competitive behaviors which exist in several sectors. Moreover, constitutional restrictions exist on foreign ownership in a range of key sectors, and a negative foreign investment and professions list also exists, which has been expanded in recent years. In July 2015, the Philippine Competition Act was passed, creating the Philippine Competition Commission and a policy framework for enforcing competition. The law had been in the making for fifteen years. The next step is the formulation of its implementing rules and regulations, expected to be finalized in the next few months.³⁰ However, more reforms are needed to address the remaining barriers to more competition.

48. **For example, there are restrictions on practice of professions for foreigners. Although the Philippines is greatly benefiting from the export of skilled labor (through migration) and services (through the business processing outsourcing industry), the country restricts a large number of professions from foreign entry.** As a result, the services trade restriction index score is well above the average in the region.³¹ For example, professions such as engineering and medical service are almost exclusive to Filipinos, even though current laws governing professions allow for reciprocity.³² While this restriction has ensured employment for many Filipino professionals, it also limits access to new knowledge and technology, especially in engineering and science. Relaxing restrictions in some lagging fields, especially in light of the Association of Southeast Asian Nations (ASEAN) Economic Community 2015 and other trade agreements which the Philippines can benefit from (e.g., Trans-Pacific Partnerships), could improve knowledge and skills accumulation of Filipino professionals, as foreign professionals bring in new knowledge and expertise.

49. **The long foreign investment negative list has limited FDI growth that could have enhanced competition and contributed to more job creation.** This list comes with a 40-percent

³⁰ Source: <http://www.philstar.com/business/2016/02/01/1548275/balisacan-seeks-irr-philippine-competition-act>.

³¹ Source: World Bank. 2011. Services Trade Restrictions Database.

³² According to the Joint Foreign Chambers of the Philippines (2012), there are 46 individual laws that provide for the regulation of as many professions. All laws allow for reciprocity. When a foreign national applies to practice in the Philippines, the Professional Regulatory Commission decides whether there will be pertinent reciprocity.

cap on foreign equity ownership in most sectors. Restrictions are particularly tight in the media sector (zero percent), followed by mining, agriculture, transport, and telecommunications (40 percent), while controlling interests (66 percent foreign ownership) are allowed in the electricity sector. In all these sectors, restrictions in the Philippines are more stringent than in other countries in the region (Table 2). Across sectors, access of foreign investors to land is highly restricted. Even when long-term lease of land is allowed, regulations and red tape can provide significant *de facto* constraints, and thus deterrents, for foreign companies to invest. US investors cite these restrictions and constraints as one of the main reasons why Americans do not invest much in the Philippines.³³ As a result, FDI inflows to the Philippines are among the lowest despite posting record highs in the past two years. It rarely exceeded USD 2 billion in the past four decades and only exceeded USD 4 billion in the last two years.

Table 2. Foreign ownership restrictions are more stringent in the Philippines.

Foreign ownership restrictions (percentage of foreign ownership)											
Sector Group	Philippines	China	Indonesia	Japan	Malaysia	Singapore	South Korea	Thailand	Vietnam	IAB regional average	IAB global average
Mining, oil & gas	40	100	98	100	70	100	100	49	50	78	92
Agriculture & forestry	40	100	72	100	85	100	100	49	100	83	96
Light manufacturing	75	75	69	100	100	100	100	87	75	87	97
Telecom	40	49	57	83	40	100	49	49	50	65	88
Electricity	66	85	95	100	30	100	85	49	71	76	88
Insurance	100	50	80	100	49	100	100	49	100	81	91
Transport	40	69	49	40	100	47	80	49	69	66	79
Media	0	0	5	60	65	27	40	28	0	36	68
Construction, tourism & retail	100	100	85	100	90	100	100	66	100	93	98
Health care & waste management	100	85	83	50	65	100	100	49	76	84	96

Source: Investing Across Borders (IAB) database of the World Bank

50. **There are also substantial tariff barriers in several key industries, mostly in agriculture.** Even under the minimum access volume (MAV) system, inbound trade for specific commodities is subject to high in-quota tariffs. These are mostly in agriculture: rice (35 percent), sugar (50), corn (35), coffee (30), potatoes (40), pork (30), and poultry (40). To be able to continue the state monopoly over rice imports, the government negotiated a second extension (lasting from 2014 to 2017) of the WTO waiver to the obligation to convert the quantitative restrictions (quotas) to tariff measures. When the extension expires and the quotas disappear, tariffs on rice, meat, turkeys, and other prepared or preserved meat and potatoes will be raised by 5 to 35 percent.

51. **Non-tariff barriers in agriculture are also significant.** In February 2015, the Bureau of Customs published the consolidated requirements of the various national agencies for all regulated products. The consolidation reform highlighted the existence of duplication and the Department of Agriculture's use of sanitary and phytosanitary permits to limit the importation of certain products during certain times of the year, without legal authority to do so. In the case of

³³ Source: "US envoy gives reasons why Americans not investing in country" BusinessWorld, October 3, 2012.

garlic, an investigation by the Department of Justice revealed that import permits had only been given to one group, causing the price of garlic to skyrocket by 74 percent in one year.³⁴

52. A key practical recommendation moving forward is to further open up the economy to more competition by reducing the investment negative list.³⁵ Following the passage of the Competition Policy Act and its speedy implementation, further opening up priority sectors of the economy to international players is recommended by removing them from the foreign investment negative list. The following sectors are likely to have the largest gains in terms of competition, capital, technology, and improved governance: telecoms³⁶, shipping, construction, and rice. They are also the sectors likely to generate jobs, increase real income, and improve quality while lowering prices. In addition, the push for the rationalization of fiscal incentives will likely attract rather than discourage both domestic and foreign investment, as the playing field will be more predictable and leveled, compared to the current system in which there is a perception of policy uncertainty and successful incumbent firms are treated as “infants” with unfair incentives.

53. Second, rice trade policy needs to be liberalized. First, the import quota for rice can be replaced with an import tariff initially set at 30 percent.³⁷ This could be followed by a plan to gradually reduce import tariff to around 15 percent.³⁸ Second, the government could consider redefining the National Food Authority’s (NFA) role in formulating and implementing rice policies. The first best scenario would be to fully and permanently transfer rice importation to the private sector as it has proven to be capable of efficiently filling the gap between consumption and production in recent years. For its part, NFA could focus on emergency buffer stocking and disaster mitigation programs to reduce risks on agricultural production brought about by natural calamities. Simulations show that moving away from quantitative restrictions and reducing tariffs result in lower rice prices and significant poverty reduction (Cororaton, Clarete, and Sharma

³⁴Source: <http://www.doj.gov.ph/news.html?title=DOJ:%20High%20garlic%20prices%20caused%20by%20collusion,%20cartel&newsid=306>

³⁵ For more discussion, please see the January 2015 edition of the PEU. This is available at: <http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/PEU%20Jan%202015%20PDF.pdf>.

³⁶ For instance, in its 2015 household download index, internet metrics provider Ookla (which owns the popular website speedtest.net), ranked the Philippines as 21st out of 22 countries in Asia in terms of average internet speed at 3.64 megabytes per second (mbps), behind Laos and Myanmar, and only ahead of Afghanistan. Comparing the Philippines to its neighbors, the country’s average internet speed is dwarfed by Thailand at almost 20 mbps, and even Vietnam at 18 mbps. As a reference, high-income economies like Singapore and Hong Kong both have average internet speeds of over 100 mbps. More glaringly, despite being particularly slow, internet costs in the Philippines are extremely expensive, costing around USD 18 per mbps against a global average of around USD 5 per mbps, as measured by Ookla.

³⁷ This corresponds to the current effective import tariff estimated as the difference between wholesale price in the Philippines and landed import price from Vietnam, adjusted for transport costs. At this rate, there would be no significant immediate impact on domestic prices.

³⁸ This rate would be high enough to continue providing incentives to rice farmers but adequate to discourage illegal importation of rice, currently a widespread phenomenon in the Philippines, and to promote diversification of agricultural production.

2013³⁹). For instance, eliminating the import quota on rice would lift 424,000 people out of poverty. Converting the quota into a lower tariff of around 25 percent would lift 647,000 people out of poverty. On the other hand, a more restrictive quota would raise rice prices by 10 percent and push 393,000 people into poverty.

Simplifying business regulations

54. **The Philippines is known for the complexity of its business regulations but progress was made on several fronts, making the Philippines one of the most improved countries in the Ease of Doing Business rankings.** Between 2010 and 2015, the country moved from 136th to 103rd place in the rankings. However, more needs to be done as the Philippine regulatory framework continues to pose a major obstacle to attaining a better investment climate. For instance, incorporating a business still takes 16 procedures and 29 days, longer than in most countries in the region. The government continues to implement reforms to improve the ease of doing business, led by the National Competitiveness Council and a number of key line agencies. For example, a new online business registration system is reducing the number of steps and days it takes to register a business.⁴⁰ Moreover, these efforts are being pushed at the local government level as well, where the Department of Trade and Industry (DTI) and the Department of Interior and Local Government (DILG) are working with local government units to streamline the business permit and license system, to reduce steps and processing time for the release of new permits and renewal of existing permits.⁴¹

55. **The complex and costly regulatory environment hurts micro and small firms the most, limiting their ability to create more and better jobs.** In starting a business, firms in Quezon City, for instance, spend 29 days securing licenses required to start a business and incur costs of around PHP 22,000 for these (equivalent to 16.1 percent of the country's per capita income)—an amount very high relative to the micro firm's startup capital. Another key constraint to firm entry and expansion in the Philippines is limited access to finance. This issue weighs heavily on micro, small, and medium-size enterprises (MSMEs), preventing the majority of micro and small

³⁹ Cororaton, C., Clarete, R., and Sharma, M. 2013. *Impact of alternative Philippine rice policies on poverty and income distribution [draft]*. Philippines: World Bank.

⁴⁰ With respect to business name registration, the Department of Trade and Industry (DTI) has begun to implement a new web-based Enhanced Business Name Registration (E-BNR) system, including a mobile phone cash transfer, which is designed to make business name registration faster and easier for sole proprietorships. DTI has also initiated the Philippine Business Registry (PBR) project in order to facilitate business registration-related transactions among a set of national government agencies and local government units (LGUs). The project's objectives are to establish a fully-secured national business registry database, to harmonize business registration, and to facilitate transactions among agencies and the business sector through a single online registration system. However, the implementation of this system is significantly delayed (more than three years since the pilot).

⁴¹ At the local government level, the business permit and license system (BPLS) reform led by the Department of the Interior and Local Government (DILG) and DTI seeks to encourage all LGUs to streamline their processes.

rural enterprises from growing. It is also a main obstacle to rural development. This leads to overall large-scale informality⁴² and weak entrepreneurship⁴³ as a consequence.

56. **Moreover, huge opportunity costs are incurred by the economy in terms of lost income, investment, and jobs arising from complex regulations.** Overall, the cost imposed on MSMEs in starting a business is very high. They not only have to pay for legitimate fees equivalent to 16 to 36 percent of per capita income (PHP 22,000 to 45,000), they also spend a considerable amount of time moving from one agency to another and waiting in line to process their documents, often resulting in significant loss of productive time and income. In some instances, businesses report that they need to pay bribes or give gifts to obtain various permits and government services. After a business commences, numerous annual regulatory requirements are needed to maintain the business, which can take many days every year. Moreover, there are tax and contribution payments that have to be paid frequently within the year. This productive time lost translates to an estimated annual opportunity cost of at least PHP 100 billion annually. Moreover, opportunity cost of around PHP 40 billion can arise from discouraged Filipinos who could have started a business if only the cost was reasonable. This translates to forgone employment of around 60,000, which is equivalent to about five percent of new labor force entrants every year.

57. **Recognizing the adverse impact on the economy of costly business start-up, the government has begun to address a number of doing business constraints.** For instance, the government enacted the “Go Negosyo Act” in 2014, which calls for the establishment of service centers to facilitate business start-up and operations of MSMEs, and re-engineered the process of starting a corporation in several cities, including Quezon City, the city sampled for the World Bank’s annual Ease of Doing Business survey. However, more can be done to unleash the full potential of MSMEs. This includes: i) further simplifying and automating key business registration processes, ii) fully implementing the Philippine business registry and the regulatory simplification program, iii) introducing alternative payment systems such as online and mobile payments, iv) reducing the frequency of renewals of government licenses, permits, and clearances for employment purposes, v) adopting a risk-based approach for business permitting purposes, and vi) simplifying the tax regime for micro and small businesses to reduce compliance costs and encourage movement of firms to the formal sector.

Securing property rights

58. **Weak governance exists in the areas of property rights recognition, public provision of land information, land use planning and management, and property valuation and taxation.** Together, these impede effective use and allocation of land to its best use, discourage investments in property development, and undermine government’s ability to collect taxes on

⁴² Around 75 percent of Filipino workers are informally employed based on the 2008 Informal Sector Survey.

⁴³ This is evident in a number of indicators such as the small size of firms, lack of registration, necessity as main intention for starting a business, low productivity, and limited options.

land. Weak land governance favors the well-connected and is biased against the poor, leaving them without secure property rights.

59. Overlapping institutional mandates, complex regulations and weak coordination among a multiplicity of agencies characterize the current institutional framework for land administration. There are at least four agencies issuing first time titles, two agencies involved in review and approval of survey plans, and multiple agencies in charge of land management. There is weak coordination between the agencies that handle land surveys, acquisition and redistribution of public and private lands. Since many agencies are involved in land administration, each of these agencies create records and maps without much coordination and systematic data sharing. This increases the likelihood of conflicting rights being assigned to the same plot of land and of relevant restrictions not being reflected in the registry. Together with high registration fees, this increases transaction costs and encourages informality.

60. The country's land information is not up to date and does not reflect the reality on the ground. This is a result of the following factors: i) high transfer costs which discourages many property owners from registering their transactions, ii) the high proportion of untitled properties,⁴⁴ and iii) incomplete cadastral surveys and outdated tax maps. Outdated and inaccurate land records have the effect of reducing overall investor confidence in the registry and in the country's property rights system.

61. Untitled properties are estimated to cover around 11 million parcels throughout the country (out of a total of 24 million). This is an indirect estimate, as the property rights system itself is incapable of directly quantifying these numbers. The high percentage of parcels lacking documentation is brought about by slow progress in the titling program and delays in the passage of a law authorizing streamlined titling of residential lands, and the absence of a complete cadastral map which keeps track of the total lots during subdivision and consolidation.

62. In addition, land use planning and zoning in the Philippines have been mostly reactive, resulting in the proliferation of informal settlement enclaves, uncontrolled spatial development, land speculation and undue pressure on public investments and public provision of services. More effective planning would help manage urban growth, allocate land to its best use, contribute to food security, manage migration, reduce informal settlement, minimize land disputes, control negative externalities (e.g., congestion, pollution, crime), and raise revenues equitably and efficiently. Overall, there is a rising concern that cities in the Philippines are not fully functional places to live. Public investments in infrastructure and regulations on land use for housing, commerce, and industry are spatially uncoordinated which reduces the connections between workers and jobs, and residents and amenities, and adds to sprawl and related costs from congestion and pollution.

⁴⁴ This results in transactions on these properties that are outside the formal system.

63. **Moreover, local government units (LGUs) are not maximizing the potential of real property taxes to raise funds for local development.** Average collection efficiency (i.e., actual collection as a share of potential collection) is only 49 percent in 2014.⁴⁵ LGU records do not contain updated property information, as tax mapping is not done regularly, and LGUs do not have access to records from the Registry of Deeds. Very few LGUs update their schedule of market values (SMVs): only 27 percent of provinces and cities have done so as of 2015. More importantly, LGUs grant tax exemptions beyond their authority. These result in outdated property registers, rampant land speculation, inefficient land sale and rental markets, and continuing dependence on national government (NG) transfers (an average of 81 percent for provinces, 44 percent for cities, and 81 percent for municipalities) to finance local investments.

64. **Finally, the slow moving agrarian reform has undermined investment incentives.** The Philippines has a decades old agrarian reform program, which is based on lengthy processes of compulsory acquisition, state-led creation of beneficiary cooperatives, and lack of integrated, demand-driven support services, including the timely issuance of collective and individual titles. As a result, investment incentives are undermined, both of beneficiaries and potentially affected large farms.

65. **To unleash the potential of land as a means to raise investment, securing property rights through land governance reforms is needed.** The following reforms are needed in rural and urban areas.

66. **In rural areas, the process of administrative and systematic adjudication of property rights in areas of high agricultural potential needs to be accelerated in the short-term.** This entails going from plot to plot and determining in a transparent and participatory way who owns the plot and immediately issuing a patent. If successfully implemented, this would significantly simplify and decentralize the lengthy and onerous procedures of acquiring land, which continue to prevent the majority of the population from obtaining secure rights to their property. Moreover, this would help complete the cadastral survey. In the medium-term, the process of administrative and systematic adjudication can be gradually expanded from high agriculture potential areas to other rural areas.

67. **In the medium-term, complementary reforms in land administration are also needed to improve security of property rights and make land markets more flexible and responsive.** Legal, institutional, and administrative reforms are both needed to address problems in land administration. These include i) strengthening the administrative titling procedures through decentralization of its implementation, ii) consolidation of various property titles (e.g., patents, CLOAs, CADTs, etc.) into a single certificate of title, iii) recognition of continuous possession by conferment of title following a probationary issuance of a provisional title, iv) enactment of a National Land Use Code to improve land management, v) generation of a comprehensive mapping and database of land describing categories, land use interest (e.g., lease, ownership,

⁴⁵ Source: Bureau of Local Government Finance (BLGF)

etc.), and property boundaries that covers all tenure and titles issued by different agencies, which should be freely shared among agencies (the computerization of DENR records towards this end has started and will be completed by 2018),⁴⁶ vi) simplification of the cumbersome Torrens title deed procedures, and vii) removing the bias against rural titles: at present, it requires 30 years of uncontested possession to obtain a rural title, as compared to 10 years for urban land, thereby reducing rural investment incentives for those who are actually farming the land, and the efficiency of the rural credit market. The number of years can be set at 10 for both urban and rural land.

68. Over the long-term, there is a need to harmonize or unify the various legal frameworks for land and reduce overlaps (i.e., agrarian, forestry, mining, ancestral domain, watershed, etc.). In addition, land administration and management reform can be improved by passing a land administration reform act which would establish a single agency out of LRA, DENR, and the National Mapping and Resource Information Authority (NAMRIA).

69. In urban areas, the following recommendations can help reduce informality, improve land use planning, and increase local revenue generation: i) accelerate implementation of the residential free patent law, ii) enact a national land use code to guide local land use planning, iii) ensure timely update of comprehensive land use plans that is complemented with land tenure improvement planning to maximize the benefits from secure property rights and minimize land conflicts particularly in rapidly growing sections of the cities, iv) generate a comprehensive mapping and database of land parcels describing categories, land use, and property boundaries with the aid of a unified land information system at the LGU level, which integrates information from the Registry of Deeds (RoD), the Department of Environment and Natural Resources (DENR), v) develop a zoning plan for all types of land (i.e., agricultural, industrial, urban, conservation, etc.), and vi) improve efficiency and equity of real property taxation. A first-best reform should aim for centralized valuation of properties through the establishment of a National Valuation Authority. This would help increase transparency, ensure that properties better reflect market prices, and depoliticize the valuation process. Actual collection of the property tax can remain with local government units.

Ramping up investment through simpler, fairer, and more efficient tax system

70. One of the major reasons why the country has not created more and better jobs is its low levels of investment in human and physical capital, alongside the lack of technological improvement. A simple growth decomposition analysis covering the period 1961 to 2000 shows

⁴⁶ Effective land administration requires free access to reliable and up to date information from the registry. However, the Land Titling Computerization Project (LTCP) of LARES and LRA currently makes it very expensive to access vital land records and transactions even by government offices. Addressing this begins with reviewing and possibly amending the existing BOO contract between the government and the LTCP contractor to enable government offices to access registry information at lower cost. Moreover, Section 209 of the Local Government Code, which mandates RODs to provide local governments with annual abstracts of their registries, needs to be implemented.

that the contribution of physical capital to Philippine growth is only 0.9 ppt compared to an average of 2.4 ppt in East Asia. The contribution of human capital at 0.4 ppt is comparable to the regional average of 0.5 ppt, but this figure does not capture large differences in the quality of the labor force. The contribution of total factor productivity was negative at 0.3 ppt. Since 2000, growth has increased, including the components of growth, but these numbers still suggest a big room for catching up with the Philippines' fast growing neighbors.

71. Higher and more efficient public spending, underpinned by increased revenue mobilization, is needed to raise physical and human capital and sustain inclusive growth. A high-case scenario calls for spending (relative to 2010) an additional 2.5 ppt of GDP in infrastructure and an additional 5.5 ppt of GDP in social services, for a total of eight ppt of GDP over the next decade. This will bring national government spending level to around 25 percent of GDP and more in line with the spending patterns of the country's neighbors, allowing the government to reduce poverty and help create jobs at a much faster pace. Between 2010 and 2015, tax effort improved by 1.6 ppt from 12.1 to 13.7 percent of GDP, reducing the revenue gap from eight ppt to around 6.4 ppt.

72. Higher revenues do not necessarily mean higher tax rates as tax administration can be improved substantially. For instance, in 2013, the Bureau of Internal Revenue (BIR) announced a campaign to boost tax collection from self-employed and professionals (SEPs) such as doctors, lawyers, and traders. The government estimates that only about 403,000 out of 1.8 million SEPs paid taxes and the average income declared by SEPs was not far from the income of a minimum wage worker. This represents potential source of additional revenue for the government.

73. However, relying solely on tax administration reforms may not yield the expressed revenue target, making the country fall short of its development targets. The government has laudably collected around 1.6 ppt of GDP in additional taxes from improved administration and higher growth in the last five years. Assuming that high growth is sustained and the pace of administrative effort accelerates over the medium-term, the government will be able to collect another 0.5 ppt of GDP in taxes without tax policy reform. While this would easily count as a significant accomplishment, tax effort would still fall short of the tax revenue target needed to sustain inclusive growth (i.e., 20 percent of GDP).

74. Moving forward, the government may also craft a simpler, more equitable, and more efficient tax system to sustainably finance an investment-led growth:⁴⁷ A two-phased approach can be considered. The first phase should focus on raising tax revenues. The second phase can target lowering tax rates and further broadening the base. The following measures can be considered: i) rationalize tax incentives by making them more targeted, transparent, performance-based, and temporary, including timely release of a tax expenditure statement, which enumerates all existing and proposed tax incentives and who benefits from them, ii) index tax rates and valuations which have not kept up with inflation, such as petroleum excise taxes

⁴⁷ For more discussion, please see the August 2014 edition of the PEU and the upcoming report "Tax policy for more inclusive growth."

and property valuations, and iii) removal of VAT exemptions that have no clear economic rationale (a better system such as the CCT program can be used to better protect vulnerable groups). Rapidly falling oil prices provide an opportunity to adjust petroleum excise taxes to make the tax system more equitable. Only if new revenues are raised should reforms to reduce tax rates be considered. These reforms could include i) lowering the top marginal income tax rate to 25 percent, ii) reducing the gap between regular and special corporate income tax rates, and iii) simplifying the tax regime for micro and small enterprises. For tax policy to be effective, improved tax administration is necessary. Relaxing the bank secrecy law when fraud is detected would help improve tax administration significantly.

Working together

75. **The future reform agenda is ambitious and for it to be successful, it will be important to create coalitions of reformers to accelerate the economic reform agenda.** Reformers inside and outside government should work together to help the next administration move quickly, as the first year of a new administration provides the best opportunity to tackle difficult reforms. The needed reforms are well-known, but may be difficult to implement due to the challenging political economy. Past experience, for instance with the passage of the sin tax (Box 2), suggests that fostering broad-based coalitions around a package of policy reforms would be the most effective way of accelerating the agenda.

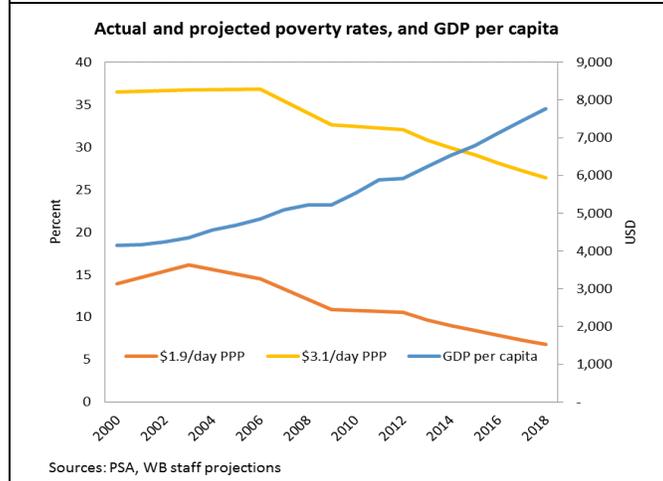
Conclusion

76. **Achieving inclusive growth in the Philippines is within reach, now more than in any previous period.** Recent trends show an improvement in the country's growth-poverty elasticity, which means growth is becoming more inclusive. Going forward, the government, the private sector and civil society need to maximize the chances that the country will follow a more inclusive growth path by accelerating reforms to promote more competition, simplify regulations to trigger more private investments by firms of all sizes, and secure property rights, while sustainably ramping up public investments in infrastructure, education, health, and social protection^{48,49}. If these well-known structural reforms are implemented, and recent trends are sustained, the Philippines will be able to reach its goal of eradicating poverty within one generation (Figure 20).

⁴⁸These reforms are discussed in depth in the Philippine development report "Creating more and better jobs The 2013 Philippine Development Report "Creating more and better jobs" is available at: <http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/PDRFullReport.pdf>.

⁴⁹ Reforms are also further detailed in previous editions of the Philippine Economic Update. The past editions of the PEU are available at: <http://www.worldbank.org/en/country/philippines/publication/philippine-economic-updates>

Figure 20. If the Philippines is able to sustain high growth and the structural reform agenda implemented, the country can eradicate poverty within one generation.



Box 2. The Philippines excise tax or “sin tax” reform story

In June 2010, the government was confronted with a challenge on how to finance its development plans. With a budget deficit surpassing 3.7 percent of GDP, the government needed to improve tax administration, raise revenues, and spend prudently. With revenue stagnating from alcohol and tobacco taxes, introducing a revised law became the consensus goal. Many recognized the enormity of the challenge, with one company controlling 90 percent of the cigarette market and a conglomerate controlling 85 percent of the beer market. In addition, both had a reputation of providing among the largest electoral campaign contributions.

The enormity of the challenge required the support of a coalition for reform, which would need to coordinate both the technical and political aspects of the reform. Since the sin tax not only covers the revenue issue, the coalition grew organically, but eventually was composed of the executive agencies (e.g., Department of Finance, Department of Health, and the Bureau of Internal Revenue), the Action for Economic Reform (an NGO, financed by Australia under its Coalitions for Change program), several business and civil society organizations, and development partners such as the World Bank and the World Health Organization.

Defining the reform package. Consistent with the government’s promise of “no new taxes”, the reform package was defined as the updating and amending of a poorly crafted existing law, while linking it to the sustainable expansion of universal health care. In addition, to pass the law, it was necessary to broaden the coalition beyond the Department of Finance and the BIR. Based on international experience, the decision was made to change the debate from a revenue issue into a health issue and to directly link excise tax revenues to increases in universal health care. This instantly broadened the coalition to include the Department of Health, National Health Insurance Corporation, government hospitals, provincial governors, professional medical associations and schools, anti-smoking and health advocates, and many more.

During the process, coalition partners had to continuously update their analytical work to arrive at new estimates for revenue projections and health impacts, depending on the possible scenarios. The coalition partners also had to react to intense media campaigns by the stakeholders who opposed the reforms.

In the end, the draft law by the bicameral committee was successfully passed in both the lower and upper houses, although the senate ratification was won with a margin of one vote only. On December 20, 2012, the excise tax on alcohol and tobacco was signed into law. In the face of powerful interests, the coalition was able to design and implement a reform, which contributed to increasing government revenue and funding for universal health care, and reducing smoking prevalence.

The key lessons of this reform process highlight the importance of:

1. The ability of the executive branch to coordinate a broad-based stakeholder coalition, which can rally around the potential benefits of the reform, given the political economy.
2. Ensuring enough flexibility to turn the reform into a “package” with the purpose of building a strong coalition. In this case, the original reform was a tax reform, but it was turned into a tax-and-universal-health-care reform package to broaden the coalition.
3. The presence of a small, but dedicated team to support the process and coordinate across the coalition.
4. The capacity to conduct the analytics in real time, including establishing and updating the analytical basis for the reform, being able to adjust the reform impact estimates to the emerging consensus, and responding to the critique of the opponents of the reform.
5. The coalition’s readiness to influence the public debate effectively, based on solid evidence and communications material, which resonates in the public arena.

DATA APPENDIX

Table A.1. Key economic indicators (2014 to 2018)

	2014	2015	2016	2017	2018
	Actual		Projections		
Growth and inflation	(in percent of GDP, unless otherwise indicated)				
Gross domestic product (percent change)	6.1	5.8	6.4	6.2	6.2
Inflation (period average)	4.1	1.4	2.0	2.5	3.0
Savings and investment					
Gross national savings	24.6	24.6	25.5	26.0	26.4
Gross domestic investment	20.8	21.7	23.0	23.7	24.4
Public sector					
National government balance (GFS basis) ^{1/}	-0.7	-1.0	-2.1	-2.1	-2.1
National government balance (gov't definition)	-0.6	-0.9	-2.0	-2.0	-2.0
Total revenue (government definition)	15.1	15.9	16.1	16.4	16.6
Tax revenue	13.6	13.7	13.9	14.3	14.5
Total spending (government definition)	15.7	16.8	18.1	18.4	18.6
National government debt	45.4	44.8	42.6	40.4	38.2
Balance of payments					
Merchandise exports (percent change)	11.9	-13.1	4.0	7.0	8.5
Merchandise imports (percent change)	6.3	-3.2	6.0	8.0	9.0
Remittances (percent change of USD remittance)	7.2	4.6	4.0	5.0	5.5
Current account balance	3.8	2.9	2.5	2.3	2.0
Foreign direct investment (billions of dollars)	5.7	5.7	3.5	4.0	4.5
Portfolio Investment (billions of dollars)	-0.3	-0.6	0.3	0.5	1.0
International reserves					
Gross official reserves ^{2/} (billions of dollars)	79.5	80.7	81.8	83.1	84.5
Gross official reserves (months of imports) ^{3/}	9.9	10.1	9.5	8.7	7.8
External debt ^{4/}	27.3	26.5	25.2	24.7	24.3

Sources: Government of the Philippines for historical and World Bank for projections.

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

2/ Includes gold

3/ Defined as the total of goods and services imports

4/ Central Bank definition

Table A.2. National government cash accounts (GFS basis) (2014 to 2016)

	2014	2015	2016
	Actual	Estimate	Budget
	(in percent of GDP, unless otherwise indicated)		
Revenue and grant	15.1	15.9	17.5
Tax revenue	13.6	13.7	16.5
Net income and profits	6.2	6.3	8.1
Excise tax	1.1	1.2	1.2
Sales taxes and licenses	2.7	2.7	2.6
Others	0.6	0.8	1.4
Collection from Customs	2.9	2.8	3.2
Nontax revenue ^{1/}	1.5	2.2	1.0
Grant	0.0	0.0	0.0
 Total expenditure	 15.7	 16.8	 19.5
Current expenditures	12.8	13.7	14.3
Personnel services	4.8	5.2	5.3
MOOE	2.4	2.6	3.2
Allotment to LGUs ^{2/}	2.2	2.9	2.2
Subsidies	0.6	0.6	0.9
Tax expenditures	0.2	0.1	0.2
Interest payment	2.5	2.3	2.6
Capital outlays	2.8	3.0	3.9
Net lending	0.1	0.1	0.2
 Balance (GFS definition)	 -0.7	 -1.0	 -2.1
Balance (GOP definition)	-0.6	-0.9	-2.0
Primary Balance (GFS)	1.9	1.4	0.6
 <i>Memorandum items</i>			
Privatization receipts (PHP billions)	1.9	62.8	2.0
Nominal GDP (PHP trillion)	12.6	13.3	15.4

Sources: Department of Finance, Bureau of Treasury, and

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

2/ Allocation to local government units (LGUs) excludes capital transfers, which are included in capital outlays.

3/ For 2015, revenue and components are based on World Bank staff estimates due to unavailability of final data