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BUILDING A RESILIENT RECOVERY

PHILIPPINES ECONOMIC UPDATE • **DECEMBER 2020 EDITION**

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PREFACE

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

The PEU is a biannual publication of the World Bank's Macroeconomics, Trade, and Investment Global Practice (MTI), prepared in partnership with the Finance, Competitiveness & Innovation; Poverty & Equity; and Social Protection & Labor Global Practices (GPs). Lars Christian Moller (Practice Manager for the MTI GP), Souleymane Coulibaly (Lead Economist and Program Leader for MTI), Madhu Raghunath (Sector Leader for Sustainable Development), and Olivier Mahul (Practice Manager for FCI Risk Finance) guided the preparation of this edition. The team consisted of Rong Qian (Senior Economist), Kevin Chua (Economist), Kevin Cruz (Research Analyst), and Karen Lazaro, Zidni Marohombsar, and Eduard Santos (Consultants) from the MTI GP, Isaku Endo (Senior Financial Sector Specialist), Heejin Lee (Private Sector Specialist) from the Finance, Competitiveness & Innovation GP, Nadia Belhaj Hassine Belghith (Senior Economist) and Sharon Faye Alariao Piza (Economist) from the Poverty & Equity GP, and Yoonyoung Cho (Senior Economist), Ruth Rodriguez (Social Protection Specialist), Yasuhiro Kawasoe (Social Protection Specialist), and Arianna Zapanta (Consultant) from the Social Protection and Jobs GP, and Benedikt Lukas Signer (Program Coordinator), Lesley Cordero (Senior Disaster Risk Management Specialist), Tatiana Skalon (Disaster Risk Finance Specialist), Zidni Marohombsar (Public Financial Management Consultant), and Fides Barbara Babiera Borja (Consultant) prepared the Special Focus Note on Disaster Risk Management and Financing. The report was edited by Oscar Parlback (Consultant), and the graphic designer was Christopher Carlos (Consultant). Peer reviewers were Hans Beck (Lead Economist) and Marc S. Forni (Lead Disaster Risk Management Specialist). Logistics and publication support were provided by Elysse Dominguez Miranda (Team Assistant) and Kristiana Gizelle Torres Rosario (Team Assistant). The Manila External Communications Team, consisting of Clarissa David (Senior Communications Officer) and David Llorito (Communications Officer), prepared the media release and web-based multimedia presentation, and Stephanie Margallo provided team assistance.

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

TABLE OF CONTENTS

PREFACE **3**

ABBREVIATIONS AND ACRONYMS **7**

EXECUTIVE SUMMARY **8**

1 **RECENT DEVELOPMENTS** **13**

1.1. Economic Growth: Devastating Impact from the Triple Shock of COVID-19 13

1.2. Exchange Rate and the External Sector: Steady Appreciation 20

1.3. Fiscal Policy: Risking Fiscal Pressure 23

1.4. Inflation and Monetary Policy: Low Inflation Amid Subdued Demand 28

1.5. Employment and Poverty: Household Income Loss Risking Reversals of Gains 31

2 **OUTLOOK AND RISKS** **37**

2.1. Growth Outlook 38

2.2. Poverty and Shared Prosperity 44

2.3. Risks and Policy Challenges 45

3 **BUILDING A RESILIENT DISASTER RECOVERY** **50**

3.1. Disaster Risk in the Philippines 51

3.2. The State of Disaster Risk Management 53

3.3. Public Spending After Disasters 60

3.4. Challenges in Building Disaster Resilience 62

3.5. Policy Recommendations 66

3.6. Area for Further Studies 73

LIST OF FIGURES

Figure 1. The Philippines experienced a recession in over three decades. 15
Figure 2. Industry and services sector contracted sharply. 15
Figure 3. Forty percent of firms reported temporary suspension of operations in July. 16
Figure 4. Economic activity has picked up since April 2020, but it is showing signs of slowing down. 17
Figure 5. Global economic sentiment has improved since April, but remains weak overall. 17
Figure 6. Global new export orders have rebounded from its April trough... 18
Figure 7. ...although global trade remains weak overall. 18
Figure 8. The Balance of Payments remained in surplus, as the current account swung into surplus in H1 2020. 21
Figure 9. Since March 2020, imports have been significantly contracting... 21
Figure 10. ...which partly contributed to the appreciation of the Philippine peso. 21
Figure 11. The fiscal balance widened significantly as public expenditures rose sharply. 25
Figure 12. Resources were shifted towards recurrent spending in response to COVID-19. 25
Figure 13. The government continues to finance its deficit mainly through domestic borrowing. 25
Figure 14. The overall debt-to-GDP ratio rose to its highest level in nearly a decade in H1 2020. 25
Figure 15. The distribution of the 2021 national government budget is similar to previous years. 27
Figure 16. The government remains committed to fiscal consolidation over the medium term. 27
Figure 17. Inflation remained subdued in Q1-Q3 2020. 30
Figure 18. During the pandemic, domestic liquidity has increased rapidly... 30
Figure 19. ...while credit to production and household consumption has declined... 30
Figure 20. ...and the past due loans ratio and the rate of non-performing loans have increased. 30
Figure 21. Unemployment and underemployment remain elevated, despite rebound in July 32
Figure 22. Wage employment has been on the decrease until its rebound in October.... 32
Figure 23. ...also, the share of high skilled occupations declined in recent months until bouncing back in October. 32
Figure 24. Labor force participation returned to pre-pandemic levels in July 2020 but declined in October 2020. 33
Figure 25. ...similar patterns in LFPR were observed across gender. 33
Figure 26. Job losses mounted in both industry and services. 34
Figure 27. Prior to the pandemic, there was a trend of increasing wages contributing to increases in household incomes... 34
Figure 28. ...but a large share of households experienced decreases in income. 34
Figure 29. Significant job losses were reported across all sectors... 36
Figure 30. ...forcing households to resort to various coping mechanisms. 36
Figure 31. Consumer and business sentiments worsened in the third quarter of 2020. 39
Figure 32. Economic growth is expected to rebound in 2021. 39
Figure 33. Global economic growth is expected to contract by 5.2 percent yoy in 2020. 43
Figure 34. Global trade is expected to register its worst contraction in post-war history. 43
Figure 35. Poverty is expected to rise as a result of the COVID-19 pandemic. 44
Figure 36. Infrastructure Outlays and Buildings and Other Structures, FY2019-21. 49
Figure 37. There is a wide disparity in the allocation of the infrastructure budget across regions. 49
Figure 38. Overview of the Philippine Legal and Institutional DRM Framework 53
Figure 39. The Philippines' Risk-Layering Strategy 55
Figure 40. Post-disaster Related Appropriations by Funding Source, FY2015-18 60

LIST OF TABLES

Table 1. Balance of Payments, H1 2018-H1 2020B 22
Table 2. National Government Disbursements 24
Table 3. Economic Indicators for the Baseline Projections 40
Table 4. Real Growth Projections 43
Table 5. Public Infrastructure Budget, FY2019-21 48
Table 6. Challenges and Policy Recommendations 74

LIST OF BOXES

Box 1. Recent Global Developments 17
Box 2. The proposed 2021 national government budget and medium-term fiscal program 26
Box 3. One in four breadwinners have lost their jobs due to the pandemic. 36
Box 4. The Global Economic Outlook 42
Box 5. Proposed 2021 National Government Infrastructure Budget 48
Box 6. Strengthening Private Sector Engagement in DRM 59
Box 7. Best Practices on Coordination across All Levels of Government and Communities in Japan 67
Box 8. Best Practices on Inter-Agency Coordination for Response and Recovery in Japan 68
Box 9. Best Practices on Fiscal Risk Management of Disasters 69
Box 10. Best Practices on Risk Layering and Linking Funds to Implementation in Mexico 71

ABBREVIATIONS AND ACRONYMS

4P	Pantawid Pamilyang Pilipino Program
AIIB	Asian Infrastructure Investment Bank
ARMM	Autonomous Region in Muslim Mindanao
ASP	Adaptive Social Protection
BARMM	Bangsamoro Autonomous Region in Muslim Mindanao
bbl	Barrel
bps	Basis points
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BOP	Balance of Payments
BPO	Business process outsourcing
BSP	Bangko Sentral ng Pilipinas
BTr	Bureau of the Treasury
CALABARZON	Region IV-A (Cavite Laguna Batangas Rizal and Quezon Provinces)
Cat bond	Catastrophe-linked bond
CMI	Centrally-managed items
COVID	Coronavirus disease
COA	Commission on Audit
CPI	Consumer price index
CQ	Community quarantine
DBCC	Development Budget Coordination Committee
DBM	Department of Budget and Management
DILG	Department of Interior and Local Government
DOH	Department of Health
DOST	Department of Science and Technology
DOTr	Department of Transportation
DPWH	Department of Public Works and Highways
DRFI	Disaster Risk Financing and Insurance
DROM	Disaster response operation modality
DRRM	Disaster risk reduction and management
ECQ	Enhanced community quarantine
ECT	Emergency cash transfer
EMDE	Emerging market and developing economies
EWS	Early warning system
FY	Fiscal year
GCQ	General community quarantine
GDP	Gross domestic product
GOCC	Government owned and controlled corporations
GPPB	Government Procurement Policy Board
GVC	Global value chain
ICT	Information and communications technology
IDN	Indonesia
IMF	International Monetary Fund
IRA	Internal revenue allotment
KYC	Know-your-customer
LCU	Local currency units
LDRRMF	Local Disaster Risk Reduction and Management Fund
LFPR	Labor force participation rate
LFS	Labor force survey
LGU	Local government unit
LGSF	Local Government Support Fund
MECQ	Modified enhanced community quarantine
MGCQ	Modified general community quarantine
MSME	Medium, small, and micro enterprises
MYS	Malaysia
NARS	National Asset Registry System
NCDDP	National Community-Driven Development Program
NCR	National Capital Region
NDRRM	National Disaster Risk Reduction and Management
NDRRMC	National Disaster Risk Reduction and Management Council
NDRRMF	National Disaster Risk Reduction and Management Fund
NEDA	National Economic and Development Authority
NEP	National Expenditure Program
NG	National government
NGO	Non-government organization
NHTO	National Household Targeting Office
NIIP	National Indemnity Insurance Program
NPL	Nonperforming loan
OCD	Office of Civil Defense
OECD	Organization of Economic Cooperation and Development
PCIC	Philippine Crop Insurance Commission
PCIF	Philippine Catastrophe Insurance Facility
PDRF	Philippine Disaster Recovery Foundation
PER	Public Expenditure Review
PEU	Philippines Economic Update
PGAMP	Philippine Government Asset Management Policy
PHL	Philippines
Php	Philippine Peso
PMI	Purchasing managers' index
PSA	Philippine Statistics Authority
QRF	Quick Response Fund
READI	Rapid Emergency Action on Disaster Incidence
SAP	Social amelioration program
THA	Thailand
TLP	Total loan portfolio
US	United States
USD	United States dollar
VNM	Vietnam
WB	World Bank
WGI	Worldwide Governance Indicators
YOY	Year-over-year

EXECUTIVE SUMMARY

The Philippine economy contracted by 10.0 percent, year-on-year, in the first three quarters of 2020[1], given the triple shock brought by the Coronavirus disease (COVID-19) pandemic. COVID-19 delivered a triple shock of a health crisis, strict containment measures, and a global recession of unprecedented scale. The sharp contraction in the second quarter was driven by the steep dive in private domestic demand, deep contraction in public investment activities, and the collapse of trade due to the impact of strict containment measures domestically and globally. Most of the country entered a more relaxed community quarantine in mid-August with a gradual opening of businesses and government operations. Yet, the economy further contracted in the third quarter, albeit a modest improvement from the peak of the outbreak. Moreover, the country was hit by a series of strong typhoons which may cause delay on the pace of the recovery as economic activities were affected in some areas. This report will feature disaster risk management (DRM) challenges the country faces and policy recommendations to strengthen its fiscal, physical, and social resilience.

The severity of the recession can be explained, first and foremost, by the collapse in private consumption, as containment measures led to a fall in employment and incomes. Private consumption contracted by 8.2 percent, its worst performance on record. This was in large part due to a combination of factors that crippled domestic demand, including record-high unemployment, declining incomes (including remittances), movement restrictions that suppressed consumption, and a historic decline in consumer confidence. The deepest contraction was registered in the consumption of non-essential goods and services and those that were affected by the implementation of strict containment measures, while essential goods such as food registered small positive growth. In particular, the combination of travel restrictions and weak consumer confidence which weighed on demand, resulted in a collapse in domestic tourism expenditures, which make up a fifth of private consumption.

The collapse in private consumption was compounded by the sharp decline in external demand and exports, due to significant disruptions in domestic and global supply chains and international travel restrictions. Exports fell by 18.7 percent due to contractions in both services and merchandise exports. Transport and travel services were hit the hardest among services exports, as the global tourism industry suffered from strict travel and mobility restrictions. Foreign tourist arrivals contracted by 72 percent in the first seven months of 2020, resulting in a 73 percent contraction in inbound tourism revenue. Merchandise exports contracted by 12.2 percent across all major product categories, a reversal from the 1.8 percent growth recorded in the same period in 2019. The decline in trade activity was caused by disruptions in source countries and a contraction in consumption in destination countries amid the escalating global recession.

The severe recession has impacted positively the Balance of Payment (BOP), but this gain is likely to reverse with the recovery in 2021. Contraction in private consumption, deterioration in private investment activities, and a shift of public resources from public investment spending toward immediate COVID-19 response, resulted in a 27.8 percent goods import contraction in the first half of 2020, a reversal from the 2.3 percent growth in the same period in 2019. As a result, current account turned into a surplus of US$4.4 billion (2.6 percent of GDP) in the first half of 2020 outpacing net capital outflow leading to a balance of payment surplus of US$4.1 billion (2.4 percent of GDP). The significant contraction in imports lessened the demand for U.S. dollars contributing to the appreciation of the Philippine peso in the first nine months of 2020 and record high foreign reserve accumulation.

1 All growth analyses are annual growth of the first three quarters of 2020 unless otherwise stated.

To mitigate the negative impact of COVID-19 on the economy, the government responded swiftly by expanding public spending amid falling revenues. As a result, the fiscal deficit widened to 6.9 percent of GDP from 2.1 percent over the same period in 2019. This is the result of a shrinking tax base amid a slumping global and domestic economy while public spending increased rapidly to mitigate the effects of the crisis. Total public revenues fell by 7.9 percent in nominal terms as a result of a 11.3 percent decline in tax revenues. Public spending increased by 15.1 percent driven by the implementation of the Bayanihan to Heal as One Act. The government prioritized spending in social protection and health to help mitigate the impact of COVID-19 on poor and vulnerable households and firms. The sharp increase in the fiscal deficit resulted in the public debt ratio reaching its highest level in nearly a decade. Yet, the country's long-term fiscal sustainability remains manageable, benefitting from years of prudent fiscal management by the government.

Amid a benign inflation environment, the Bangko Sentral ng Pilipinas (BSP) has adopted an accommodative policy stance since the onset of the crisis, and it has taken extraordinary measures to support the government's COVID-19 response. Headline inflation averaged 2.5 percent in the first nine months of 2020 as elevated unemployment, anemic consumer confidence, and reduced remittances led to lower price pressures. The benign inflation environment has rendered the BSP ample space to implement an accommodative monetary policy to mitigate the impact of the crisis. Since the beginning of the year, the BSP has reduced the key policy rate by a cumulative 200 basis points (bps) to 2.0 percent and the reserve requirement by 200 bps to 12.0 percent. In addition, the BSP has taken unconventional measures to help the government finance its COVID-19 response program by approving a reverse repurchase agreement with the Bureau of the Treasury (BTr) worth Php300 billion (1.6 percent of GDP) and a subsequent provisional advance of Php540 billion (2.9 percent of GDP).

The Philippine economy is expected to rebound in 2021-22 assuming the infection curve would be flattened in 2021. The economy is expected to contract by 8.1 percent in 2020 before it rebounds to 5.9 percent and 6.0 percent in 2021 and 2022, respectively. These projections hinge on China's early recovery, alongside the expected rebound in the global economy in 2021, which will allow for export growth to recover, and larger remittance inflows to stimulate domestic demand. With a further relaxation of community quarantine restrictions, more industries and services will be allowed to operate, creating jobs and income, and supporting private consumption growth. The government is expected to ramp up its infrastructure spending starting in the fourth quarter of 2020, creating jobs in the construction sector. Base effect will come into play and contribute to growth in 2021 considering the deep contraction in 2020. The rollout of vaccines in 2021 constitutes an upside risk to this baseline projection, accelerating the pace of the recovery.

While labor market conditions gradually improved since the peak of the pandemic, it remains weak. Unemployment rate fell from 17.6 percent in April to 10.0 percent in July 2020 when the country gradually eased community quarantine measures. The latest estimate of the unemployment rate in October 2020 suggests that it further decreased to 8.7 percent. However, it remains almost double the rate of those recorded in the same period of 2019 (5.4 percent in July and 4.6 percent in October). Net job losses reached nearly 2.7 million between October 2019 and October 2020, most pronounced among the youth. Job losses were concentrated in the services and industry sectors shedding 1.9 million and 827,000 jobs, respectively, given operational capacity limitations imposed in certain industries. Among subsectors that lost the most jobs were accommodations and food services (-667,000), transportation and storage (-657,000), and manufacturing (-618,000). By contrast, the agriculture sector created 70,000 additional jobs as the sector was allowed to operate in full capacity, even during enhanced community quarantine. This was despite a 1.1 million job loss between July and October 2020, likely due to the consecutive typhoons that struck the country in October 2020.

The COVID-19 pandemic threatens to reverse the trend of a steady decline in poverty in recent years, resulting in an additional 2.7 million poor people. Due to significant job losses and reduced labor supply, many households have reported income losses. The results of a high-frequency monitoring survey on the impact of COVID-19, conducted

in August 2020, show about 40 percent of households reporting a fall in income. Among the sources of income, entrepreneurial income reportedly fell, particularly among households engaged in non-farm business. Remittances from abroad, which have been a constant source of income for most Filipino households, were reported to have fallen for two in five households that receive remittances. As a result, poverty is estimated to increase from 20.5 percent in 2019 to 22.6 percent in 2020 (measured against the lower middle-income poverty line of US$3.2/day).

Further waves of COVID-19 in the Philippines and globally, in addition to natural disaster shocks, are the most significant downside risks to the country's growth outlook. The path to economic recovery will be influenced by the government's effectiveness in flattening the infection curve. New bouts of infection cases may lead to reversal to stricter containment measures, which could dampen economic activities, lower consumption growth, and delay the implementation of public infrastructure projects. New waves of outbreak in advanced economies and in regional trade partners would negatively impact Philippine exports, foreign direct investments, and remittances. Moreover, disruptions in supply chains due to supply and air and sea logistics challenges will ripple through the domestic economy, especially the electronics exports industry. Finally, increased international financial volatility can affect the local economy through the equity, bond, and credit markets that could lead to episodes of capital outflows or a rise in the cost of credit.

Apart from the uncertain course of the virus domestically and globally, natural disaster shocks could derail the government targets and upset our growth and fiscal outlook projections. The International Disaster Database shows that during 2011–2018 a total of 72 storms occurred in the country. They affected about 68 million people, with a total estimated damage of US$15 billion. The economic impact of disasters has been sizable, lowering real GDP, worsening current account balances, and putting pressure on the fiscal sector. It is estimated that each year, the Philippines incurs an average asset loss of US$3.5 billion (approximately 1.1 percent of GDP) because of typhoons and earthquakes.[2] Real GDP growth rate fell in the disaster year for all of the storms; however, the country reverted immediately in the following year due to strong macro fundamentals. In addition, climate change could have a significant negative effect in agriculture through rising temperature and frequency of natural disasters. Therefore, natural disaster shocks could lead to higher fiscal deficits and debt, depending on their size and frequency climate change.

To build a resilient recovery, the government needs to protect the poor, improve preparedness and post-disaster response effectiveness while continuing the effort to flatten the infection curve in the short term. While there are signs that the management of the pandemic may be improving, testing, contact tracing, and isolating efforts need to be sustained to prevent a second wave. Meanwhile effective social protection measures can mitigate the impact of the pandemic and natural disasters on human capital by providing food and subsistence conditions and encourage continued participation education. Given the compounding risk of the pandemic and natural disasters, improving the preparedness for natural disasters is particularly important to minimize the impact of the disasters in the economy and added fiscal pressure. Having contingent plans, identified funding source, and improved coordination of national and local government authorities would help to ensure the timely and efficient post-disaster response.

In the medium term, the government must remain focused on pursuing medium-term structural reforms. In addition to accommodative monetary policies, structural reforms that facilitate private investment and private sector confidence will be critical to drive growth when fiscal policy unwinds. COVID-19 has disrupted key sectors of the economy but has created opportunities in others (e-commerce, digital solutions). As the economy recovers from the pandemic, long-overdue reforms that address limited market competition and high trade costs need to be prioritized to protect the poor and vulnerable, and small and medium enterprises (SMEs) that are less resilient to shocks. Similarly, reforms that can support adaptive business solutions such as digitization of business operations can enhance their resilience. Finally,

2 World Bank (2017). Press Release.

fiscal agility should be maintained to continue protecting the poor and vulnerable against non-health natural shocks.

Building a Resilient Disaster Recovery

The Philippines is among the most disaster-prone countries in the world. At least 60 percent of its total land area and close to 74 percent of its population are exposed to multiple natural hazards, including typhoons, earthquakes, floods, storm surges, tsunamis, volcanic eruptions, and landslides. In the past thirty years, 33,000 people have died, and 120 million people have been adversely affected by disasters. It is estimated that earthquakes and typhoons cause, on average, US$3.5 billion (over 1.0 percent of GDP) per year in direct losses to public and private assets. The 2013 Super Typhoon Yolanda resulted in over 6,000 loss of lives and more than 16 million people affected, with 2.3 million people falling below the poverty line. Damages to public infrastructure were estimated at Php571.1 billion (US$12.9 billion), or 4.6 percent of GDP. It was a tragic reminder of the devastating impact natural disasters can have in the Philippines.

The impact of COVID-19 is exacerbating the country's risk from natural disasters. As the government focuses on strengthening the capacity of the healthcare system and protecting vulnerable households, the Philippines continues to suffer from various disasters. Since May 2020, the country has experienced typhoons, floods, and earthquakes, and the pandemic has made it more difficult for the government to prepare for and effectively respond to these types of events. Disasters are contingent liabilities for governments, as they tend to shoulder a significant share of the cost for response and recovery. Unexpected public spending can have severe fiscal consequences, as unplanned expenditures can drain public finances, leading to budget volatilities and inefficient budget allocation. Since the outbreak of COVID-19, the measures implemented to contain and address the pandemic have significantly affected government resources, decreasing revenues and increasing expenditures, while leaving the population more vulnerable to further income or asset losses caused by natural disasters.

Disaster risk management reforms have thus become an even more urgent concern. Natural and manmade disasters can cause severe economic and fiscal shocks by generating unplanned expenditures that drain public finances and lead to budget volatility. They are contingent liabilities for the government which tend to shoulder a significant share of the cost for response and recovery. A proactive risk management approach with built-in resilience strategy will help address the risk and impact of disasters and climate change. Disaster risk financing is an important instrument to prop up financial resilience by making funding more predictable and effective for disaster-related measures. In addition, investing in green and resilient infrastructure and communities would reduce the future contingent liabilities caused by disasters and climate change, making growth more inclusive and sustainable.

The government has achieved remarkable progress in strengthening policies on financial, physical, and social resilience to disasters and climate shocks – but challenges remain in the implementation of these policies. Over the past decade, the government has implemented policy reforms to transition from reactive to proactive risk management as mandated by the Philippine Disaster Risk Reduction and Management Law in 2010. On financial resilience, the government adopted the Disaster Risk Financing and Insurance Strategy in 2015 and since then focused on building out its menu of risk financing instruments. On physical resilience, the government has developed early warning systems (EWS) employing technology to enhance risk identification. It has mainstreamed disaster risk reduction in key sectors, such as agriculture, housing, and public infrastructure, and for vulnerable Local Government Units (LGUs) – making it a key consideration in development planning. On social resilience, the government has developed adaptive social protection programs through the establishment of an emergency cash transfer (ECT) program to support vulnerable households and the National Community Driven Development Program – Disaster Response Operation Modality (NCDDP-DROM) for disaster-affected communities.

While the country's exposure to disasters is increasing, the national government spending on disaster has been relatively stable over the years. Between 2015 and 2018, post-disaster public expenditure remained flat at around 0.6 percent of GDP while overall government expenditure increased from 16.0 percent of GDP to 18.7 percent. About one-third of post-disaster spending comes from the two pre-arranged budgetary funding sources (i) national government agencies' quick response funds (QRF) for immediate response activities, and (ii) the National Disaster Risk Reduction and Management Fund (NDRRMF), a dedicated budget line for risk mitigation, response, and reconstruction efforts. Although these are pre-arranged funds, access to and execution of these funds are often delayed. The rest of the spending was financed through reallocation of other budget lines and the use of unprogrammed and contingent funds. Most costs related to disaster response activities are covered by the national government despite local government units having the Local Disaster Risk Reduction and Management Funds (LDRRMF) - dedicated funds for disaster response.

To further strengthen the country's resilience to natural disasters and climate change, the government needs to address key institutional and public financial management constraints. First, there is a need to strengthen the integration of disaster risks in fiscal strategy and develop pre-disaster rehabilitation and recovery plans of national government agencies for ready implementation. Second, risk considerations and disaster risk reduction measures need to be integrated in government overall planning to ensure adequate budget allocation. In addition, contingent liabilities related to disasters need to be fully integrated in the management of fiscal risk. Third, the fragmentation and capacity constraints in the implementation and oversight of DRM program needs to be addressed. Past experiences have shown that the current structure lacks the necessary authority, resources, and staff capacity to efficiently mitigate the effects of adverse events and address rapidly evolving disaster risk management (DRM) challenges. Fourth, increase transparency and efficiency of post-disaster spending of local government units. It is crucial to clarify the cost-sharing for disaster response and recovery interventions between the national and local governments. And fifth, promote "Green Recovery" by investing in resilience and integrating resilience as a pillar in recovery planning and spending. Part III of this report will give an overview of the state of DRM and provide policy recommendations to address remaining challenges.

BUILDING A RESILIENT RECOVERY

POLICY RECOMMENDATIONS

1. Strengthen integration of disaster risks in fiscal strategy and develop agency contingency recovery plans for ready implementation
2. Mainstream risk reduction in development planning, infrastructure investments, and ensure adequate budget allocation
3. Address fragmentation and capacity constraints in the implementation and oversight of disaster risk management (DRM) programs
4. Increase transparency and efficiency of LGU post-disaster spending and clarify cost-sharing between the national and local governments
5. Promote "Green Recovery" by investing in resilience and integrating resilience as a pillar in recovery planning and spending

1

RECENT DEVELOPMENTS

The Philippine economy entered a recession in the first half of 2020 as the COVID-19 pandemic delivered a triple shock of a health crisis, strict containment measures, and a global recession of unprecedented scale. Economic activities contracted sharply in the first three quarters of 2020 amid the demand and supply shocks brought by the pandemic. This is the first recession since 1991 and is driven by a sharp dive in domestic demand. Owing to the country's strong macroeconomic fundamentals heading into the crisis, the government has actively supported the economy by increasing public expenditures, including social transfers, and pursuing an accommodative monetary policy and other regulatory measures to minimize the economic fallout of the pandemic. The weak domestic demand has translated into lower imports, lowering the trade deficit and resulting in a balance of payments surplus in the first half of 2020. This has contributed to an appreciation of the Philippine peso and an increase in foreign reserves to an all-time high. While the labor market has rebounded in July, it remains bleak, with a significant share of the population remaining jobless or underemployed. This, together with the economic contraction and income losses, has hampered the steady decline in poverty seen in recent years.

Photo: Jed Regala

1.1 ECONOMIC GROWTH: DEVASTATING IMPACT FROM THE TRIPLE SHOCK OF COVID-19

The economy slipped into recession in the first half of 2020 for the first time since 1991 caused by the COVID-19 outbreak in March and the strict lockdown measures that limited movement. The economy further contracted in the third quarter albeit at a slower pace as the economy gradually reopened. Yet, the recovery remains fragile, uneven, and incomplete.

Among the high COVID-19 case countries in Southeast Asia, the Philippines faces the brunt of the pandemic through external and domestic channels. Indonesia, the Philippines, and Myanmar are among the high COVID-19 case countries in Southeast Asia. Cumulative cases have reached about 512,000 in Indonesia, 423,000 in the Philippines, and 84,000 in Myanmar in the last week of November. This has greatly hampered people's mobility and economic activities, especially in the Philippines with the imposition of stricter lockdown measures. The impact of COVID-19 is transmitting into the local economy through two channels: (i) external, initially through supply chain disruptions, followed by demand disruption on merchandise trade, tourism, remittances, and investment; and (ii) domestic, through lockdown measures, alteration of people's behavior, and income loss dampening demand.

The country continues to reel from the effects of the COVID-19 pandemic. The country registered its worst growth contraction in its post-war history in the second quarter of 2020, as economic activity was brought to a virtual standstill amid strict lockdown measures and a deterioration of consumer and business confidence to among its worst levels in history. Preliminary data suggested an improvement in economic activity in the third quarter of 2020, but a temporary reversion to strict lockdown measures in August amid rising COVID-19 cases slowed down the pace of recovery. GDP growth contracted by 11.5 percent in the third quarter of 2020, a sharp deterioration compared to the 6.3 percent growth a year ago, albeit a modest improvement from the 16.9 percent contraction in the second quarter of 2020.

The economy contracted by 10.0 percent in the first three quarters of 2020, the deepest contraction since the 1985 debt crisis.[3,4] The contraction was driven by the sharp dive in private domestic demand and the collapse of trade due to the impact of strict containment measures domestically and on the global stage (Figure 1). Government consumption ramped up to mitigate the health and socioeconomic impact of COVID-19, driving growth on the demand side. On the supply side, strong containment measures disrupted business activities resulting in a deep contraction in the industry and services sectors while agriculture stagnated (Figure 2). In July 2020, 40 percent of firms reported the temporary suspension of their operations – 20 percent by government mandate and 20 percent voluntarily (Figure 3).[5] Nevertheless, recent progress in flattening the infection curve[6] led to signs of improvements in employment, trade, manufacturing activities and revenue.

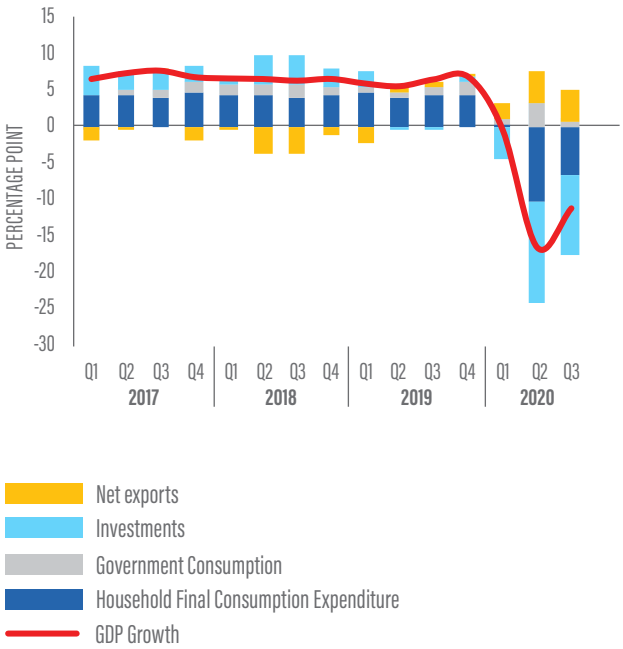
3 All growth analyses are annual growth of the first three quarters of 2020 unless otherwise stated.

4 The Philippine economy contracted by 9.9 percent, year-on-year, in the first half of 1985, as the Philippines experienced its worst debt crisis in its history following years of debt-driven growth and mismanagement of the country's macro-fiscal fundamentals.

5 World Bank (2020). "Impacts of COVID-19 on firms in the Philippines: Results from the Philippines COVID-19 Firm Survey conducted in July 2020."

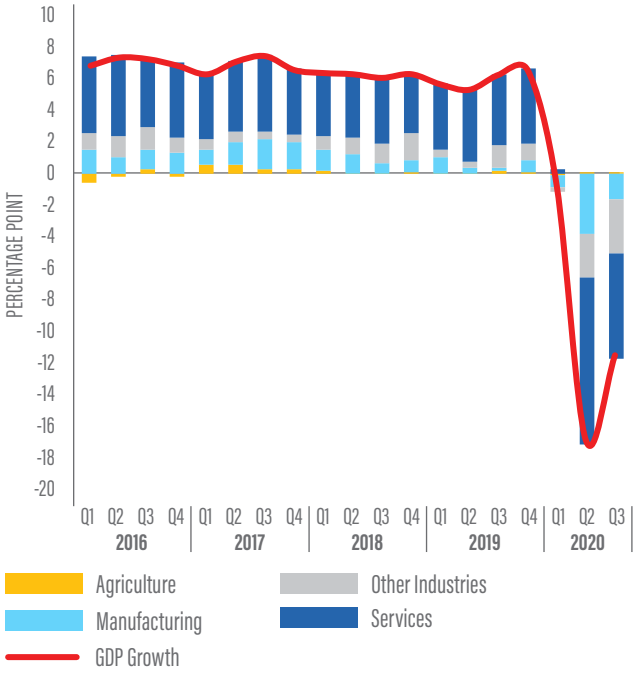
6 The 7-day moving average for confirmed COVID cases has declined to around 1,900 as of November 8, 2020, a significant improvement compared to the peak of 4,500 in August 2020.

Figure 1. The Philippines experienced its worst recession in over three decades.



Source: Philippine Statistics Authority (PSA).

Figure 2. Industry and services sector contracted sharply.



Note: Other industries are mining and quarrying, construction, electricity, gas, and water.
Source: PSA.

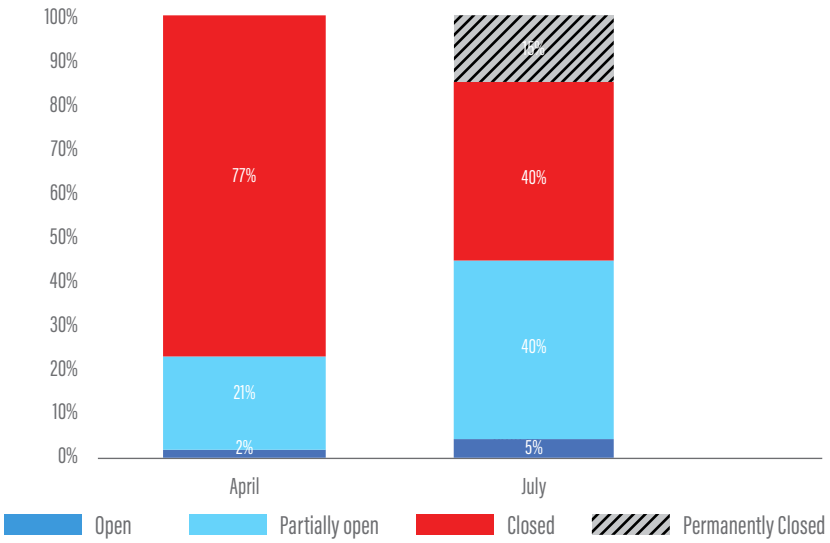
These suggest that as the country has turned the corner in managing the COVID-19 infection curve, economic activity continues to gradually pick up. However, the surge in new cases in highly urbanized areas such as Davao City, Makati City, and Baguio City suggest that this recovery remains fragile and contingent on the sustained progress in managing the COVID-19 pandemic.

The severity of the recession can be explained, first and foremost, by the collapse in private consumption, as containment measures led to a fall in employment and incomes. Private consumption registered its worst performance on record, contracting by 8.2 percent (5.9 percent growth over the same period in 2019). This was in large part due to a combination of factors that crippled domestic demand, including record-high unemployment, declining incomes (including remittances which contracted by 1.4 percent as of September 2020 to reach US$24.3 billion), movement restrictions that suppressed consumption, and a historic decline in consumer confidence which dropped to -54.5 percent in the third quarter, its lowest since the central bank started the Consumer Expectation Survey in 2007. Among major consumption categories, only the consumption of essential items such as food, housing and utilities, and communications products registered small positive growth. Meanwhile, the consumption of non-essential goods and services and those affected by the implementation of strict containment measures experienced deep contractions. In particular, the combination of travel restrictions and weak consumer confidence, resulted in a collapse in domestic tourism expenditures (-33.5 percent with transportation goods and services; -43.1 percent with recreation and culture; and -42.5 percent with restaurant and hotel), which make up a fifth of private consumption.

Investment activity has been repressed by the recession, elevated levels of uncertainty, and a deterioration in business confidence. Fixed capital formation growth contracted by 22.3 percent, a further decline from the tepid investment growth registered over the same period

Figure 3. Forty percent of firms reported temporary suspension of operations in July.

OPERATING STATUS OF FIRMS (% OF FIRMS)



Source: World Bank, Philippines COVID-19 firm survey, July 2020.

in 2019 (3.2 percent).[7] This was driven in large part by the deterioration in private investment activity, as business confidence plunged to -5.3 percent in the third quarter, the first time confidence turned pessimistic since the second quarter of 2009. In particular, durable equipment investments contracted by 33.5 percent due to the negative effects of uncertainty on investment growth, income losses and firm closures, and balance sheet weaknesses. Meanwhile, investments in construction activities, which account for roughly two-thirds of fixed investments, contracted by 28.0 percent as both firms and households opted to delay investments. Likewise, public investment fell as resources shifted toward immediate COVID-19 response measures and containment efforts.

The collapse in private domestic demand was compounded by the sharp decline in external demand and exports, due to significant disruptions in domestic and global supply chains and international travel restrictions. Export growth fell by 18.7 percent due to contractions in both services and merchandise exports, as external demand suffered from a deepening global recession amid the COVID-19 pandemic (Box 1). In particular, transport and travel services were hit the hardest among services exports, as the global tourism industry suffered from strict travel and mobility restrictions. The implementation of strict cross-border travel restrictions resulted in a 73 percent drop in foreign tourist arrivals through the first seven months of 2020, resulting in a 72 percent decline in inbound tourism revenues. In addition, merchandise exports experienced a sharp broad-based contraction of 12.2 percent across all major product categories (1.8 percent growth over the same period in 2019). The decline in trade activity was caused by a combination of production disruptions in source countries and a contraction in consumption in destination countries, amid the escalating global recession. Imports contracted by 23.0 percent, a sharp reversal from the 2.7 percent growth in the same period in 2019, as a result of tepid domestic demand, most notably in private consumption and investment, and widespread disruptions in global supply chains.[8]

7 Fixed capital investment growth was sluggish in the first six months of 2019, as investment growth softened to its lowest rate since 2011. Fixed investments were weakened by a contraction in public investment spending and dampened investment growth in the private sector due to policy uncertainty around the government's proposed corporate tax-reform package.

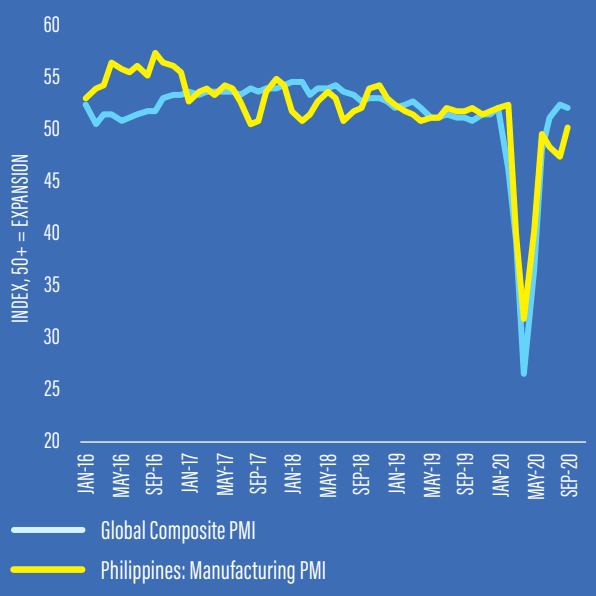
8 The fall in imports reflected weaker consumption activity during the first three quarters of 2020, the fall in capital goods imports as investment contracted, and a contraction in raw materials and imports of intermediate goods due to disruptions in global value chains caused by the COVID-19 pandemic.

Box 1. Recent Global Developments

The global pandemic continues to weigh heavily on the economic recovery. The number of confirmed cases of COVID-19 has reached more than 60 million globally, with more than 1.4 million deaths as of end-November 2020. The accelerating spread of new daily COVID-19 cases in many parts of the world, including countries where the spread of the virus had previously been partly brought under control, has hampered the global economic recovery. Combined with renewed lockdowns of varying degrees, this has contributed to a slowdown in the pace of the recovery in many countries, with the global composite Purchasing Managers' Index (PMI) sliding 0.3 point to 52.1 in September, ending four consecutive months of increase. Furthermore, the Sentix global economic sentiment index remains in negative territory, despite rising from its trough of -32.2 in April to -2.9 in September. These improvements notwithstanding, high-frequency data suggest that the recovery is far from complete and remains both fragile and uneven.

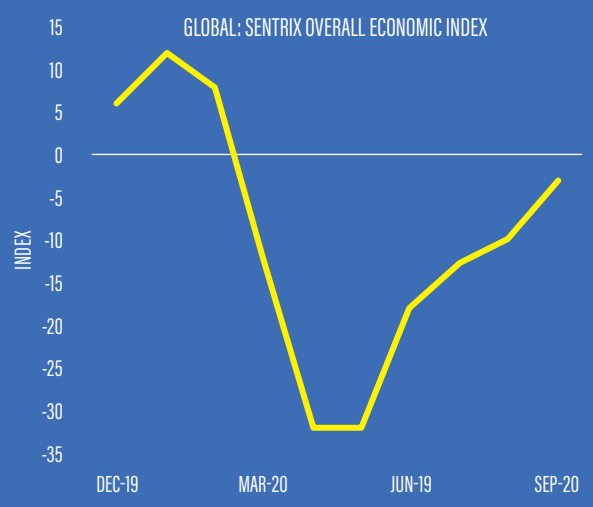
Advanced economies have experienced a swift rebound in economic activity following an historic contraction in output, although the recovery is losing steam amid persistently high COVID-19 cases in the United States and the resurgence of COVID-19 in the Euro Area and Japan. In the United States, output fell by 9.0 percent, year-on-year, in the second quarter of 2020, the worst contraction on record, amid a virtual shutdown of the U.S. economy for a significant part of the second quarter. Meanwhile, the rebound in economic activity, which began in May, is quickly running out of steam. Growth in retail sales inched up by 1.9 percent, month-on-month, in September, down from a peak of 18.3 percent in May, weighed down by persistently high daily COVID-19 cases and the expiry of several emergency income-support programs at end-July. The pace of improvement in the labor market has also slowed, with initial jobless claims averaging nearly one million over the four weeks leading up to September 12th—well above its peak during the global financial crisis, though lower than the peak of 6.9 million in late March. In the Euro Area, output collapsed by 14.8 percent, year-on-year, in the second quarter, driven by a 16.0 percent decline in private consumption. Still, the rebound in consumer activity since April has

Figure 4. Economic activity has picked up since April 2020, but it is showing signs of slowing down.



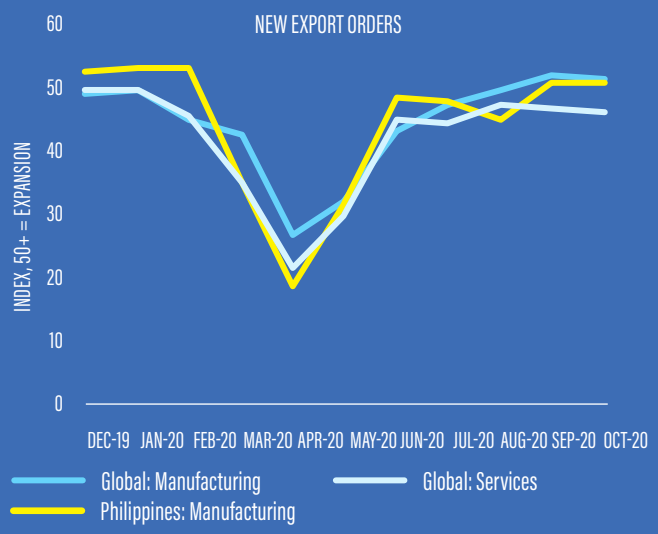
Source: Haver Analytics.

Figure 5. Global economic sentiment has improved since April, but remains weak overall.



Source: Sentix Global Economic Indices.

Figure 6. Global new export orders have rebounded from its April trough...



Source: Haver Analytics.

Figure 7. ...although global trade remains weak overall.

Source: Haver Analytics.

been remarkably swift, with real retail sales returning to positive year-over-year growth in many countries by June. More recently, however, economic activity is showing signs of stalling due in large part to a resurgence of COVID-19 cases across several large Eurozone members, including France and Spain. In Japan, GDP shrank by 10.1 percent, year-on-year, in the second quarter of 2020, reflecting weak consumption, exports, and investment. The nationwide resurgence of COVID-19 cases dampened the recovery of private consumption, offsetting better-than-expected manufacturing-related indicators.

Emerging market and developing economies (EMDEs) face an uneven rebound in economic activity. After output fell by an estimated 10.4 percent, year-on-year, across EMDE commodity exporters in the second quarter of 2020, new data suggest an improvement in the third quarter. However, the recovery is uneven, with the manufacturing PMI increasing in August in some economies (e.g., Brazil, Indonesia, and Russia) while remaining subdued in others (e.g., Nigeria and Saudi Arabia). Output contracted across EMDE commodity importers by an estimated 4.9 percent, year-on-year, in the second quarter of 2020 (excluding China, output declined by an estimated 16.4 percent), reflecting a pandemic-driven double-digit collapse in economic activity in several large economies. Similarly, China's economic recovery continued into the third quarter of 2020, as GDP growth accelerated from 3.2 percent in Q2 2020 to 4.9 percent, although it remained below the 6.0 percent growth registered in Q3 2019. The recovery in China is led by robust growth in industry, driven by strong growth in exports and investment. However, the country's recovery remains uneven, as private consumption is sluggish, with retail sales far below pre-pandemic levels, and imports continue to trail exports.

Following a double-digit contraction in the first half of 2020, global trade improved in the third quarter but remained weak. Global goods trade continues to recover, while trade in services is lagging. The global new export orders PMI for manufacturing increased to 51.7 in September —its highest value since 2018. Global shipping volumes now exceed pre-pandemic levels—led by China, where both exports and imports have picked up sharply in recent months. However, services activity remains weak, weighed down by a continuing depression in tourism activity as international tourist arrivals continue to be more than 90 percent below last year's levels in many countries. While the number of global commercial flights more than tripled between April and August, it remained around 20 percent below the pre-crisis level.

Source: World Bank, Global Monthly Economic Monitor, October 2020.

Photo: Ezra Acayan

The implementation of strict containment measures and the sharp decline in global and domestic demand resulted in the worst contraction in the industry sector in over three decades. Soft demand and disruptions in production caused by tight supply conditions, mobility constraints affecting manpower, and logistics restrictions, led to the contraction of industry output by 14.3 percent (4.2 percent growth over the same period in 2019). The contraction was broad-based, with mining and quarrying contracting by 20.6 percent, construction by 26.4 percent, and manufacturing by 11.5 percent. Meanwhile, gross value added in the electricity, gas, and water supply sectors registered a marginal contraction of 0.7 percent, as non-essential private establishments were temporarily closed at the height of the enhanced community quarantine (ECQ).

The implementation of social distancing measures and mobility restrictions has led to a similarly strong decline in the services sector, which accounts for roughly 60 percent of total output. The services sector contracted by 9.5 percent, a sharp reversal from the 7.3 percent growth registered over the same period in 2019. The impact on services was particularly deep for tourism, transport, and leisure and recreation services, as restrictions particularly affected these industries. The financial and insurance industry as well as information and communication industries have shown some resilience. In particular, the information and communication industry expanded by 5.3 percent benefitting from increased demand for information and communication technologies (ICT) services amid the transition to home-based work for many workers and an increasing shift toward digital commerce and payments.

The agriculture sector was the main growth driver on the supply side, despite structural weaknesses and its continued vulnerability to natural disasters. Growth in the agriculture sector remained stagnant, as output increased marginally by 0.8 percent, slightly less than the 1.4 percent growth over the same period in 2019. The tepid growth was the result of the sector's perennially low productivity and the impact of natural disasters on agricultural output, such as the eruption of the Taal Volcano and typhoons Ursula and Ambo.[9]

9 Natural disasters in the first half of 2020 resulted in agricultural damages worth Php7.2 billion. Source: Department of Agriculture and National Disaster Risk Reduction and Management Council.

1.2 EXCHANGE RATE AND THE EXTERNAL SECTOR: STEADY APPRECIATION

A significantly lower trade deficit led to a balance-of-payments surplus in the first half of 2020, which contributed to the appreciation of the Philippine peso and an increase in foreign reserves to an all-time high.

The current account swung to a surplus in the first half of 2020, driven by a lower trade deficit. The current account improved from a deficit of US$2.6 billion (1.5 percent of GDP) in the first half of 2019 to a surplus of US$4.4 billion (2.6 percent of GDP) in the same period in 2020 (Figure 8). The positive position was driven by a significantly lower goods trade deficit (Figure 9), which compensated for the decline in remittances and net services exports. In particular, goods imports contracted by 27.8 percent in the first half of 2020, reversing the 2.3 percent growth in the same period in 2019, as the imports of capital goods, raw materials and intermediate goods slowed. Meanwhile, goods exports contracted by 20.4 percent in the first half of 2020, from the 0.2 percent growth in 2019, driven by weakness in global demand[10]. Foreign remittance inflows fell by 4.2 percent in the first half of 2020, a sharp reversal from the 2.9 percent growth in the same period last year, given the significant decline of remittances from countries in Europe and the Middle East. Nonetheless, the contraction was lower than the initially expected double-digit contraction by analysts back in July.[11] Finally, net services exports also declined, marked by inactivity in the tourism sector and disruptions in the business process outsourcing industry.

The rise in current-account surplus outpaced net capital outflows, leading to a balance-of-payments surplus. The capital and financial accounts registered combined net outflows of US$3.9 billion (2.3 percent of GDP) in the first half of 2020, reversing the US$5.5 billion (3.1 percent of GDP) in net inflows registered in the first half of 2019. Portfolio investments registered US$1.5 billion in net outflows in the same period (compared with US$4.9 billion in net inflows same period last year), partly driven by the exit of foreign funds through the equity market. This is in spite of the inflow of foreign currency through the government's foreign borrowings during the first half of the year. Meanwhile, foreign direct investment declined by 10.9 percent to US$3.8 billion in the first seven months of 2020 due to increased uncertainty. Other investments, consisting mainly of domestic deposits in foreign banks and non-resident net loans from local banks, contributed to US$4.8 billion in net outflows. Nevertheless, with the current-account surplus, the balance-of-payments surplus reached US$4.1 billion (2.4 percent of GDP) in the first half of 2020.

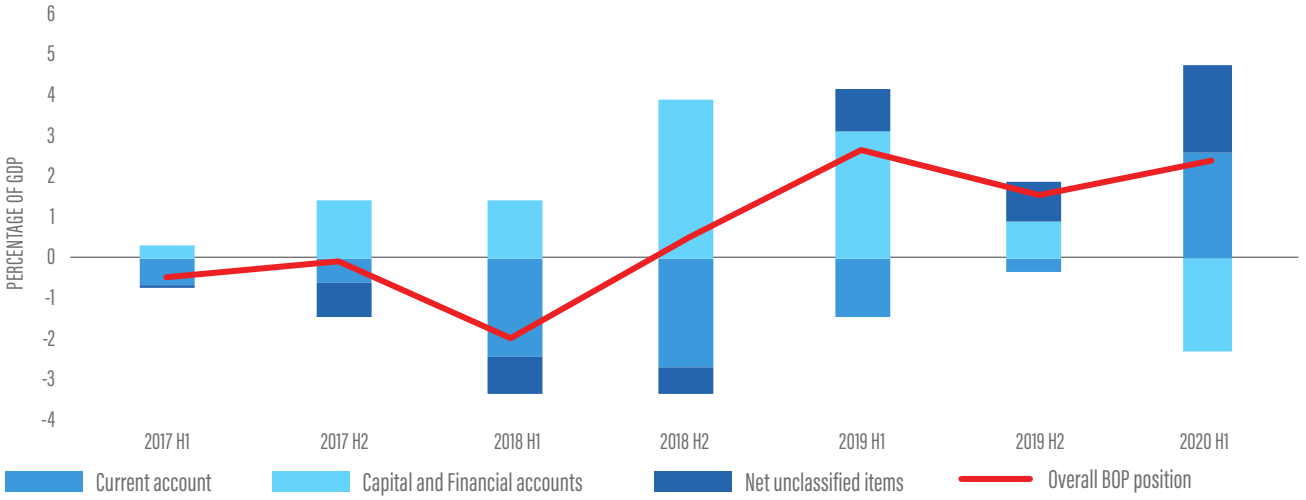
The significant contraction of imports lessened the demand for U.S. dollars, contributing to the appreciation of the Philippine peso in the first nine months of 2020 (Figure 9 and Figure 10). In the first three quarters of 2020, the Philippine peso appreciated by 3.9 percent. The appreciation happened at a time when other regional currencies such as the Indonesian Rupiah and Thai

10 The net exports discussion in section 1.1 pertains to values at constant 2018 prices as reported by PSA, which is different from the net exports discussion in this section which pertains to values at current prices as reported by BSP.

11 For instance, the Institute of International Finance forecasted a decline of 15 percent in remittance flows to the Philippines as overseas workers lose their jobs or see their wages reduced. US-based credit rating agency Moody's Investor Service reported a decline by around 10 percent this year.

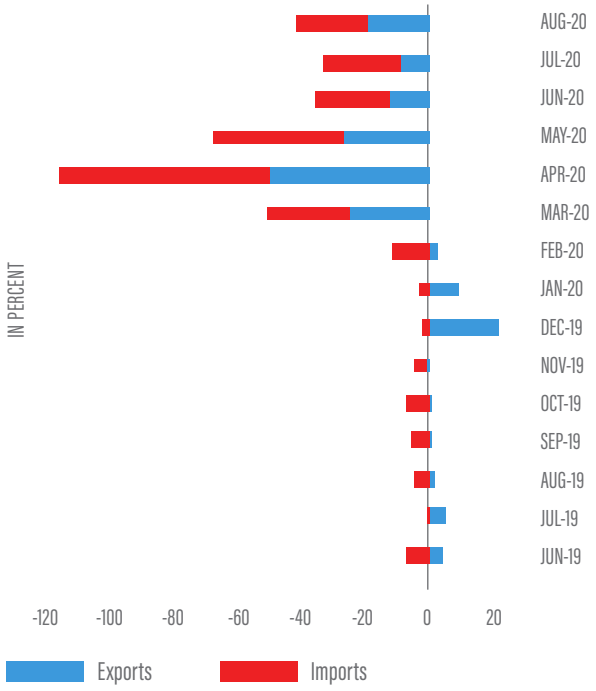
Baht depreciated. The peso nominal effective exchange rate appreciated by 4.7 percent during the same period, while the real effective exchange rate appreciated by 6.1 percent. The latter was indicative of a reduced price competitiveness in the country's exports. The currency appreciation was accompanied by a spike in foreign reserves from US$85.6 billion in September 2019 (7.4 months worth of imports) to an all-time high of US$100.5 billion (10.0 months' worth of imports) in September 2020.

Figure 8. The Balance of Payments remained in surplus, as the current account swung into surplus in H1 2020.



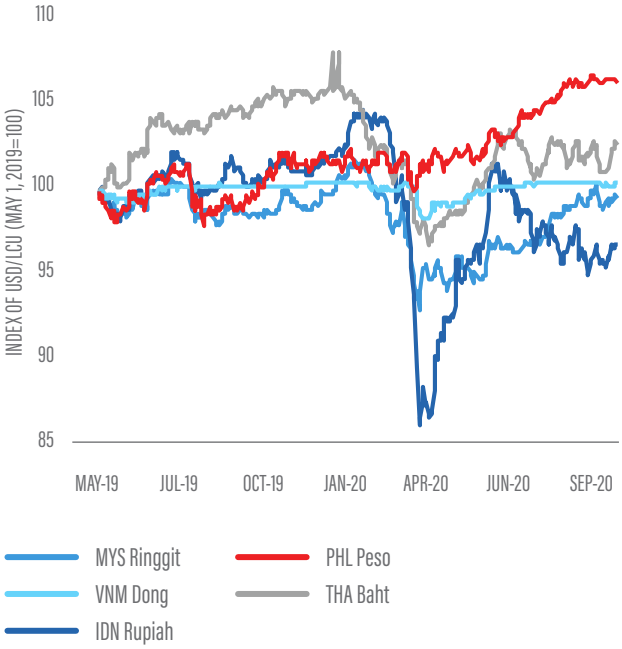
Source: BSP.
Note: Net unclassified items is an offsetting account to the overstatement or understatement in either receipts or payments of the recorded BOP components vis-à-vis the overall BOP position.

Figure 9. Since March 2020, imports have been significantly contracting...



Source: PSA.
Note: Percentage refers to growth rates.

Figure 10. ...which partly contributed to the appreciation of the Philippine peso.



Source: WSJ Markets.
Note: Decrease denotes depreciation.

Table 1. Balance of Payments, H1 2018-H1 2020B

In percentage of GDP	H1 2018	H2 2018	H1 2019	H2 2019	H1 2020
Current account	**(2.4)**	**(2.7)**	**(1.5)**	**(0.4)**	**2.6**
Goods	(14.0)	(15.4)	(13.7)	(12.5)	(9.3)
Exports	15.6	14.5	14.6	13.8	12.2
Imports	29.6	29.8	28.4	26.3	21.5
Services	2.8	3.9	3.3	3.5	3.1
Primary Income	0.8	1.3	1.4	1.4	1.3
Secondary Income	7.9	7.6	7.5	7.2	7.5
Capital and Financial accounts	**1.4**	**3.9**	**3.1**	**0.9**	**(2.3)**
Capital account	0.0	0.0	0.0	0.0	0.0
Financial account	(1.4)	(3.9)	(3.1)	(0.9)	2.3
Direct Investment	(2.1)	(1.3)	(1.0)	(1.3)	(1.3)
Net acquisition of financial assets	1.4	1.0	1.1	0.7	0.5
Net incurrence of liabilities[1/]	3.5	2.3	2.1	2.0	1.8
Portfolio investment	1.6	(0.7)	(2.8)	0.7	0.9
Financial derivatives	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)
Other investments	(0.8)	(1.9)	0.7	(0.2)	2.8
Net unclassified items[2/]	**(1.0)**	**(0.7)**	**1.0**	**1.0**	**2.2**
Overall BOP position	**(2.0)**	**0.5**	**2.7**	**1.5**	**2.4**
Memo:					
Basic Balance	(0.3)	(1.4)	(0.5)	0.9	3.8
Gross International Reserves (in billions USD)	77.5	79.2	84.9	87.8	93.5
Import Coverage (in months)	7.1	6.9	7.3	7.6	9.3

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

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

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

1.3 FISCAL POLICY: RISING FISCAL PRESSURE [12, 13]

The government fiscal response to mitigate the impact of the COVID-19 pandemic coupled with revenue shortfall amid a slumping global and domestic economy led to a rapid increase in fiscal balance. As a result, the public debt ratio has increased to its highest level in nearly a decade.

To mitigate the impact of the COVID-19 pandemic, the government responded by expanding public spending amid sharp decline in tax revenues. The fiscal deficit widened to 6.9 percent of GDP in the first three quarters of 2020 from 2.1 percent of GDP over the same period in 2019. The deficit is within the government's revised deficit target of 10.1 percent of GDP for the period, providing additional fiscal space to respond to the health and socioeconomic impact of the COVID-19 pandemic. The smaller-than-programmed deficit[14] was due to delays in the implementation of government's infrastructure program (as a result of complying with community quarantine restrictions), the limited operating capacity of public agencies, and challenges to implementing various COVID-19 response programs.

Tax revenues declined amid a sharp deterioration in the country's tax base as both the global and domestic economy were ravaged by the pandemic. Total public revenues fell by 7.9 percent (10.2 percent growth over the same period in 2019) to 16.7 percent of GDP, driven by a sharp erosion in the tax revenue base. Tax revenues declined by 11.3 percent (10.3 percent growth over the same period in 2019) to 14.5 percent of GDP. Tax collections by the Bureau of Internal Revenue (BIR), which relies heavily on indirect taxation, declined by 9.9 percent in nominal terms, driven by lower domestic demand. Tax revenues from the Bureau of Customs (BOC) fell by 15.3 percent as a result of lower import volumes due to the impact of COVID-19 on global supply chains, external demand, and the precipitous decline in investment activities. The loss in tax revenues was cushioned by the increase in non-tax revenues by 21.6 percent (10 percent growth over the same period in 2019) to reach 2.3 percent of GDP, as a result of early dividend remittances from government-owned and controlled corporations (GOCCs).

Public spending rose sharply as the government adopted measures to mitigate the health and socioeconomic impact of the pandemic, reallocating budgets from the public infrastructure program. Government spending increased by 15.1 percent (5.5 percent growth over the same period in 2019) to reach 23.6 percent of GDP. The substantial increase was driven by the sharp pickup in recurrent expenditures due to the implementation of the *Bayanihan to Heal as One Act*.[15] The government prioritized spending in social protection and health to help mitigate the impact of COVID-19 on poor and vulnerable households and firms – trends

12 Growth rates are expressed in nominal terms unless stated otherwise.

13 All fiscal analyses are annual growth of the first three quarters of 2020 unless otherwise stated.

14 The national government's fiscal deficit of Php 879 billion was 22.3 percent short of the programmed deficit of Php 1.3 trillion for the first three quarters of 2020, as public spending fell short of its target by 7.5 percent.

15 Current operating expenditures increased by 25.8, year-on-year, in nominal terms to 17.6 percent of GDP in the first three quarters of 2020 (from 14.6 percent in the previous year). The sharp increase in recurrent spending was driven by a substantial increase in maintenance and operating expenditures (65.0 percent), allocations to local government units (36.9 percent), and subsidies to GOCCs (27.1 percent).

that are expected to continue into the 2021 national government budget (Box 2). Resources were shifted toward maintenance and operating expenditures[16], subsidies to GOCCs, and transfers to local government units. The reallocation of resources came at the expense of the government's infrastructure program for 2020, which was revised downward from Php1.1 trillion (6.0 percent of GDP) to Php785.5 billion (4.2 percent of GDP) in 2020. As a result, public investment spending continued to contract by 16.5 percent, a substantial deterioration compared to the same period in 2019 (-4.3 percent of GDP).[17]

The sharp increase in the fiscal deficit resulted in the public debt ratio reaching its highest level in nearly a decade. The national government's public debt as percent of GDP increased from 39.6 percent in end-2019 to 51.1 percent as of end-September 2020—its highest level since 2010 (50.2 percent of GDP). While publicly guaranteed debt remained low at 2.4 percent of GDP, the sharp downturn of activities and consecutive episodes of strong typhoons in November this year may lead to elevated risks of a rise in contingent liabilities. Despite the significant increase in the public debt, debt metrics suggest that the country's long-term fiscal sustainability remains manageable, benefitting from years of prudent fiscal management by the government. To keep debt levels sustainable, the government is pursuing fiscal consolidation over the medium term by tempering the growth of public expenditures and increasing tax revenues (Box 2). Moreover, though a portion of the debt mix relies on external funding, nearly 70 percent of outstanding debts are from domestic lenders, while long-term debt accounts for 93.6 percent of the external portfolio.

Table 2. National Government Disbursements
(% of GDP)

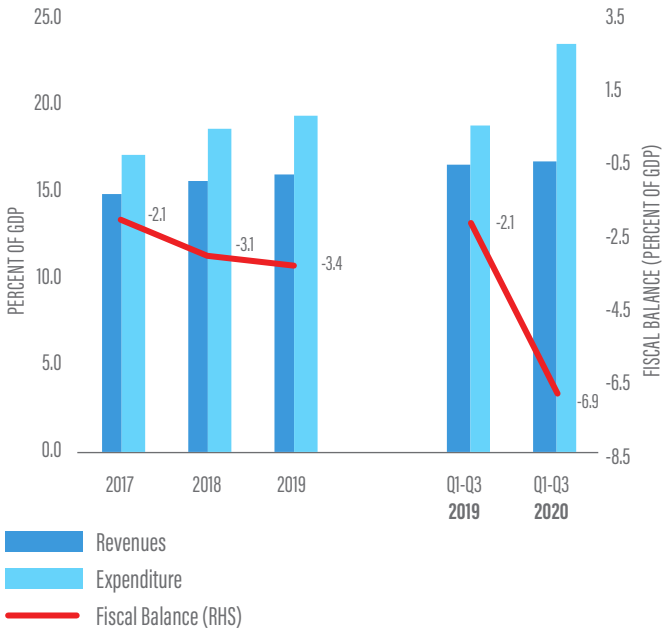
	2018				2019				2020		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Current operating objectives	**14.8**	**13.2**	**14.8**	**13.3**	**13.4**	**13.7**	**16.8**	**14.9**	**13.5**	**22.2**	**17.4**
Personnel Services	5.3	5.8	5.3	6.1	5.2	6.2	5.4	7.0	4.9	7.1	5.4
Maintenance and other operating expenditures	2.8	3.0	3.0	3.1	2.6	2.9	3.3	3.4	2.3	6.6	5.1
Subsidy	1.2	0.5	1.4	0.2	0.2	0.4	2.8	0.8	0.7	3.0	0.7
Allotment to Local Government Units	2.7	2.4	2.5	2.1	2.7	2.5	2.6	2.2	3.0	4.0	3.2
Interest Payments	2.7	1.3	2.5	1.6	2.6	1.6	2.5	1.3	2.4	1.5	2.7
Tax Expenditures	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.1	0.0	0.1	0.3
Capital outlays	**5.2**	**5.6**	**6.0**	**5.3**	**5.1**	**3.6**	**6.3**	**7.3**	**4.0**	**4.1**	**4.5**
Infrastructure and other capital outlays	4.0	4.5	5.2	4.7	4.2	2.9	5.2	6.5	3.2	3.1	3.3
Equity	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital transfers to local government units	1.1	1.1	0.8	0.6	0.8	0.7	1.1	0.8	0.8	0.9	1.1
Total	**20.0**	**18.9**	**21.0**	**18.6**	**18.5**	**17.6**	**23.0**	**22.2**	**17.3**	**25.8**	**22.0**

Source: Department of Budget and Management (DBM), PSA.

16 Spending on the country's various cash transfer programs can be found in maintenance and operating expenditures.

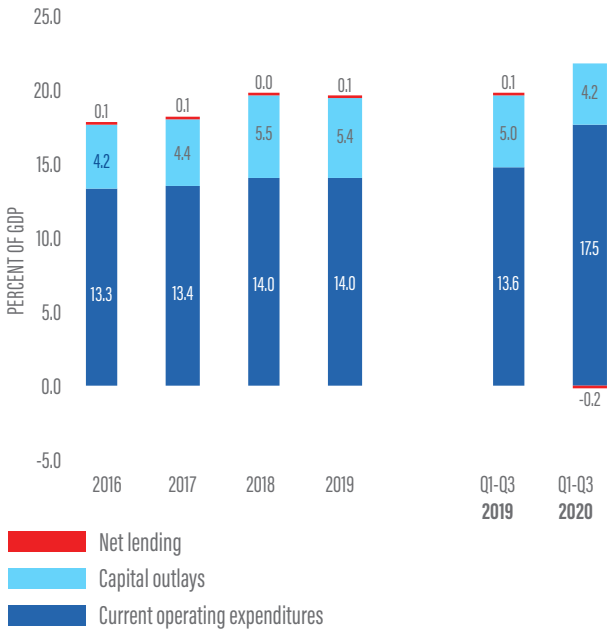
17 After experiencing significant delays in 2019 due to the delayed passage of the 2019 budget, the implementation of the public infrastructure program was expected to accelerate in 2020.

Figure 11. The fiscal balance widened significantly as public expenditures rose sharply.



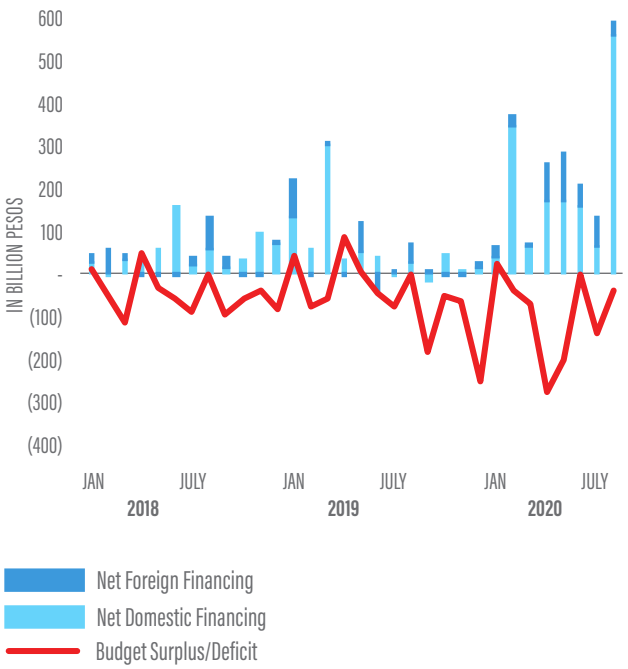
Source: DBM, PSA.

Figure 12. Resources were shifted towards recurrent spending in response to COVID-19.



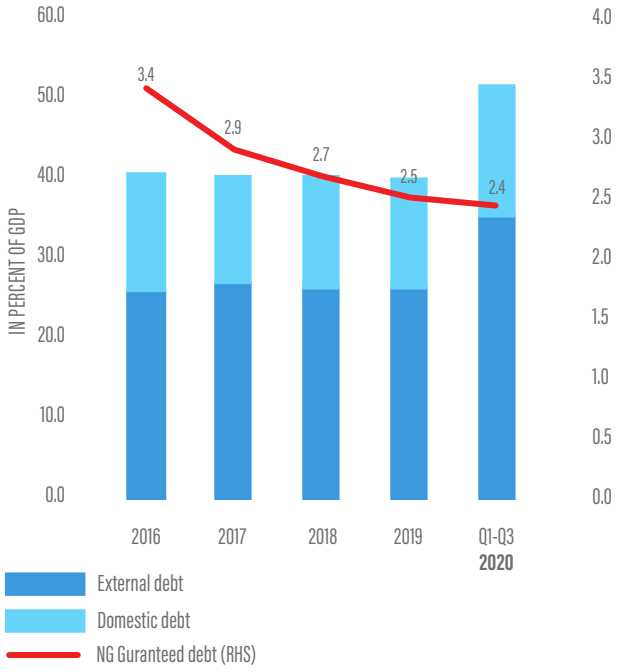
Source: DBM, PSA.

Figure 13. The government continues to finance its deficit mainly through domestic borrowing.



Source: BTr.

Figure 14. The overall debt-to-GDP ratio rose to its highest level in nearly a decade in H1 2020.



Source: BTr, PSA.

Box 2. The proposed 2021 national government budget and medium-term fiscal program


Photo: Ditsi Carolino

The proposed 2021 national budget of Php4.5 trillion (21.8 percent of GDP) supports the government's efforts to achieve a sustainable and resilient economic recovery.[18] Funding to social services, which traditionally receives the largest share of the budget, would increase by 11.3 percent, year-on-year, to Php1.7 trillion (8.1 percent of GDP) (Figure 15). The increase in the social services budget is consistent with the government's medium-term investment agenda focused on accelerating human capital investments. In addition, the budget will fund government efforts to address long-standing issues related to health and nutrition, which are at risk of worsening amid the COVID-19 pandemic. In particular, the proposed budget for the health sector is expected to increase by 14.5 percent to Php212.4 billion (1.0 percent of GDP), of which around 70 percent is earmarked for the government's health response[19,20] to the COVID-19 pandemic. With an allocation of Php754.4 billion (3.7 percent of GDP), funding to the education sector remains the largest component of the national budget. In addition, the social protection sector will receive an allocation of Php454.2 billion (2.2 percent of GDP) to help address new challenges brought by the pandemic.

The proposed budget for the economic services sector reached PhP1.4 trillion (6.5 percent of GDP), anchored on the continued push for strategic infrastructure development. The government is planning to help spur

18 It represents a 3.9 percent increase over the 2020 revised expenditure program of Php4.3 trillion (23.0 percent of GDP).

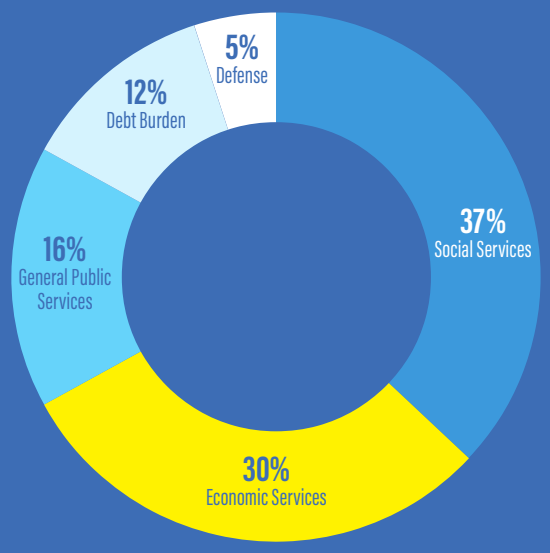
19 Php134.8 billion (0.7 percent of GDP) is earmarked for the government's COVID-19 response programs in 2021.

20 The government's COVID-19 health response budget is divided into the continued implementation of the Universal Health Care Program (Php71.4 billion) and Php63.4 billion in specific COVID-19 response programs built on the government's "Test, Trace, and Treat" strategy.

the country's medium-term recovery[21] while raising long-term productivity. This would be supported by a 41.1 percent increase in the infrastructure budget relative to the downward-revised infrastructure program of Php785.5 billion (4.1 percent of GDP) in 2020. A large share of the country's infrastructure program focuses on improving logistics connectivity by upgrading the road, air, and sea transport networks, as well as creating a more efficient public transportation system. Investments in physical infrastructure will be complemented by ramping up strategic investments in digital infrastructure and e-government service delivery,[22] which is crucial to prepare the country for the anticipated shift toward a more dynamic and resilient digital economy.

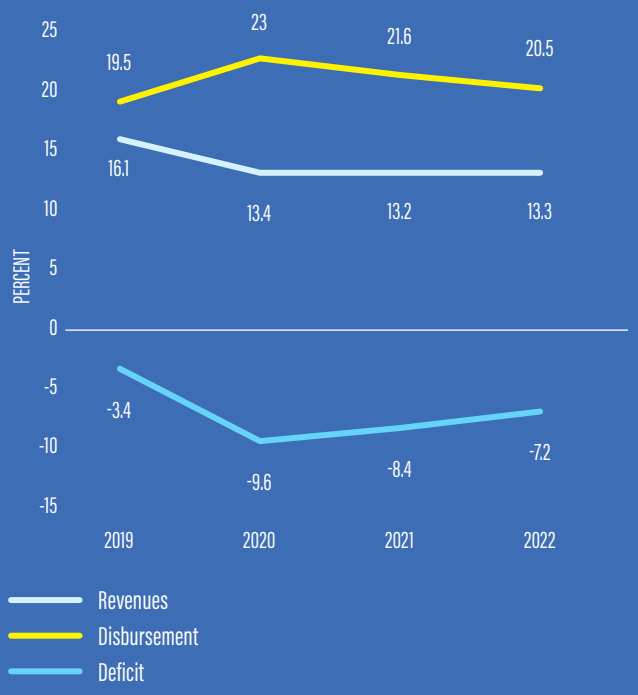
Despite a substantial rise in the fiscal deficit, the government is committed to fiscal consolidation in the medium term. The country's fiscal resilience will be put to the test in the short term amid a historic recession. As a result, the government has adjusted the medium-term fiscal program appropriately, as the disbursement program is expected to grow by an average of 3.9 percent, year-on-year, in nominal terms between 2021 and 2022, significantly slower than the 10.9 percent growth in public spending recorded prior to the COVID-19 pandemic (Figure 16). This would allow the government to contain the fiscal deficit at manageable levels and keep debt within the 60 percent debt-to-GDP threshold by end-2022 as the economy recovers in the short term. Moreover, the government remains committed to pursue key tax policy and administration reforms, which are central to the government's efforts to maintain fiscal discipline.

Figure 15. The distribution of the 2021 national government budget is similar to previous years.



Source: DBM.

Figure 16. The government remains committed to fiscal consolidation over the medium term.



Source: DBM.

21 The government expects to generate 1.1 million direct and indirect jobs from its Build, Build, Build infrastructure program.

22 A total of Php21.4 billion will be allocated towards the Medium-Term Information and Communications Technology Harmonization Initiative in 2021, focusing on improving the telecommunications infrastructure and accelerating investments in online information systems in the education, health, social protection sector.

1.4 INFLATION AND MONETARY POLICY: LOW INFLATION AMID SUBDUED DEMAND

Inflationary pressures remained weak as domestic demand was subdued due to the COVID-19 pandemic. The benign inflation environment has provided enough room for an accommodative monetary policy to mitigate the adverse impact of the pandemic on the economy. The BSP has further reduced the key policy rate to a new record low in November after a brief pause since end of June, in part due to the economy's poor performance in the third quarter of 2020 and as global economic prospects dampened with the resurgence of COVID-19 cases worldwide.

Inflation remained muted in the first three quarters of 2020 as overall demand weakened amid the pandemic. The headline consumer price index (CPI) inflation averaged 2.5 percent, lower than the 2.8 percent during the same period in 2019, and within BSP's target range of 2-4 percent (Figure 17). Harsh economic conditions such as elevated unemployment, anemic consumer confidence, and reduced remittances have contributed to lower price pressures. Although the heavily weighted food and non-alcoholic beverages inflation spiked when the ECQ was imposed in Luzon in March, it has since slowed due to the gradual reopening of the economy in May. A stable food supply, supported by unimpeded growth in the agriculture sector and a liberalized rice sector,[23] also contributed to stable food prices.

The BSP has adopted an accommodative policy stance since the onset of the crisis, and it has taken extraordinary measures to support the government's COVID-19 response. The relatively benign inflation environment has rendered the BSP ample space to implement an accommodative monetary policy to mitigate the impact of the crisis. Since the beginning of the year, the BSP has reduced the key policy rate by a cumulative 200 basis points (bps) to 2.0 percent and the reserve requirement by 200 bps to 12.0 percent, as of November 2020.[24] The BSP has also adopted other regulatory measures to minimize the economic fallout of the COVID-19 pandemic.[25] In addition, the BSP has taken unconventional measures to help the government finance its COVID-19 response program by approving a reverse repurchase agreement with the BTr worth Php300 billion[26] (1.6 percent of GDP) and the approval of a provisional advance of Php540 billion to be settled by December 29, 2020 (2.9 percent of GDP).

23 The rice tariffication law, implemented in 2019, liberalized the rice sector, removed the monopolized quota system, and allowed for the virtually unlimited importation of rice, resulting in affordable rice prices for Filipino consumers, as indicated by 17 consecutive months of negative rice inflation since May 2019.

24 The BSP further lowered the key policy rate by 25 bps on its November 20, 2020 Monetary Board meeting following a 'prudent pause' since June 2020. The rate cut was driven by the continued poor performance of the economy in Q3 and the moderation of global economic prospects following a resurgence in COVID-19 cases throughout the world.

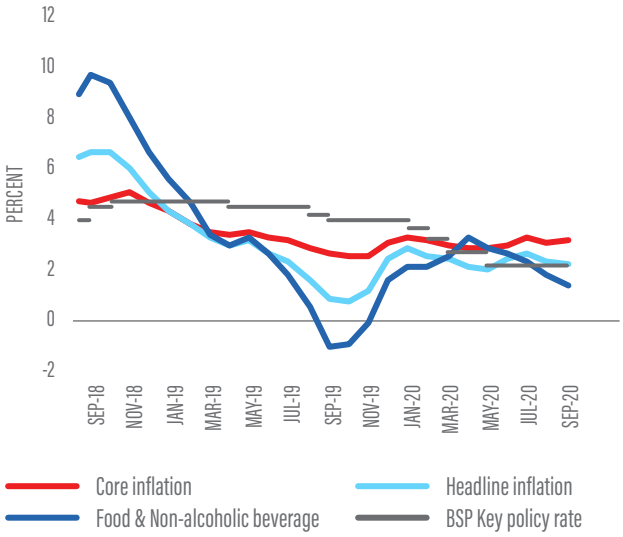
25 The BSP: (i) relaxed know-your-customer (KYC) requirements to facilitate the delivery of social protection programs; (ii) digitized some operations and waived some penalties and fees for foreign exchange transactions; (iii) suspended charges on electronic payment and financial services fees for six months; and (iv) provided relief measures to micro, small, and medium enterprises by temporary reducing the credit risks assigned to their loans and assigning a 0 percent risk weight for their guaranteed loans, among others measures.

26 The full amount has since been settled on September 29, 2020.

Photo: Ezra Acayan

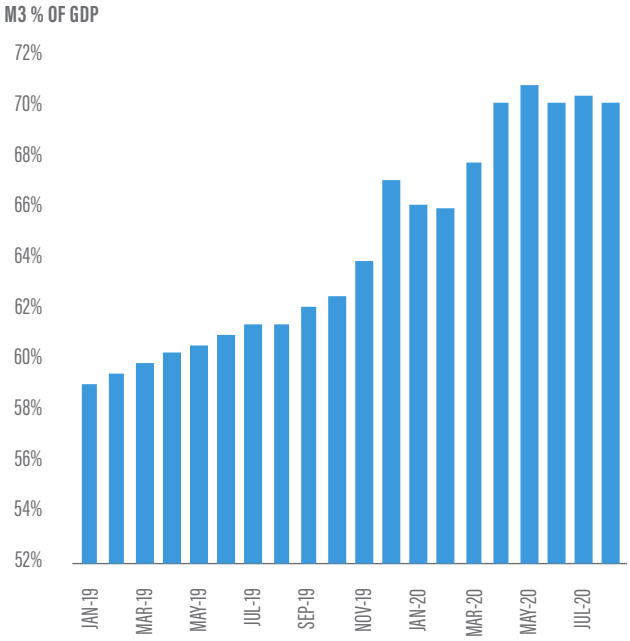
The financial system has maintained a high level of liquidity, but the impact of the pandemic has been felt on the asset quality of banks. The crisis and related lockdown measures have sharply slowed the growth of credit available for production and household consumption since March. Growth of outstanding loans to household consumption sharply declined from 23.5 percent, year-on-year, in January, to 8.7 percent in August 2020, while growth of outstanding loans to production activities declined from 7.8 percent year-on-year in January to 3.2 percent in August 2020 (Figure 19). Meanwhile, domestic liquidity (M3) reached Php13.6 trillion pesos in August, accelerating growth to 14.2 percent, year-on-year, in August 2020 from 6.3 percent in August 2019. It reached 69.5 percent of GDP in April and has remained high (Figure 18). The financial system, however, faces uncertainty, as the pandemic has affected the quality of assets in the banking system. Gross non-performing loans (NPLs) increased to 2.8 percent in August 2020, growing by 29.3 percent, year-on-year, and the past due loan ratio surpassed 5.3 percent in the same month, growing by 79.7 percent (Figure 20). Moreover, the profitability of the banking sector began to decline in the second quarter of 2020, as the return on equity fell from 9.8 percent in June 2019 to 9.0 percent in June 2020. Similarly, the return on assets fell from 1.24 percent to 1.15 percent in the same period.

Figure 17. Inflation remained subdued in Q1-Q3 2020.



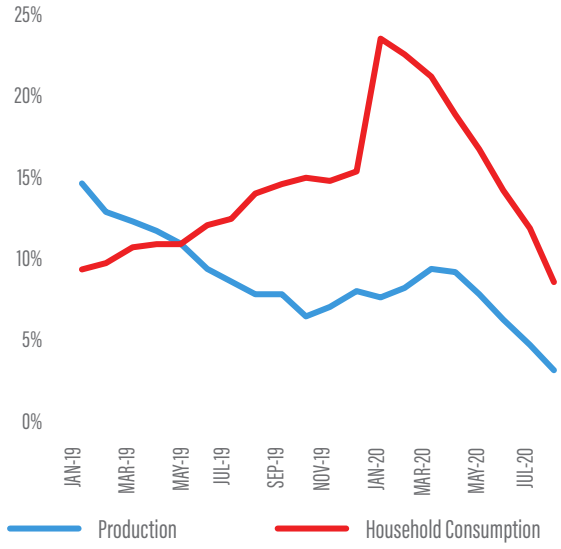
Source: PSA and BSP.

Figure 18. During the pandemic, domestic liquidity has increased rapidly...



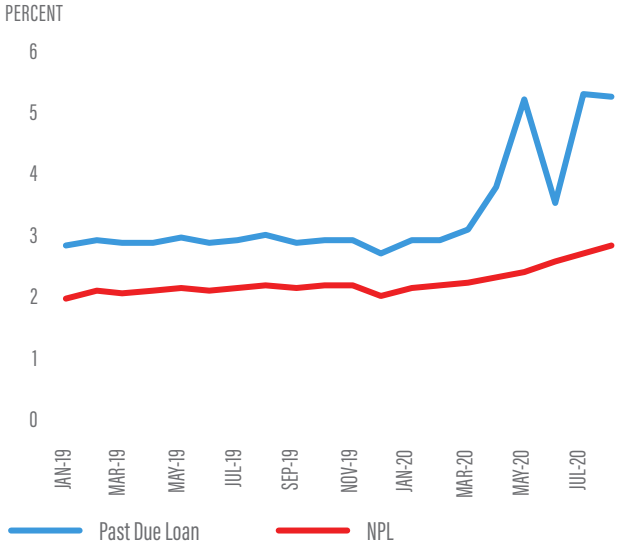
Source: BSP

Figure 19. ...while credit to production and household consumption has declined...



Source: BSP

Figure 20. ...and the past due loans ratio and the rate of non-performing loans have increased.



Source: BSP

1.5 EMPLOYMENT AND POVERTY: HOUSEHOLD INCOME LOSS RISKING REVERSALS OF GAINS

While conditions in the labor market have improved, the overall market remains bleak. As a result of containment and social distancing measures, a significant share of the population is either jobless or underemployed. Reduced labor incomes along with a drop in remittances are likely to reverse some of the gains made in poverty reduction in recent years.

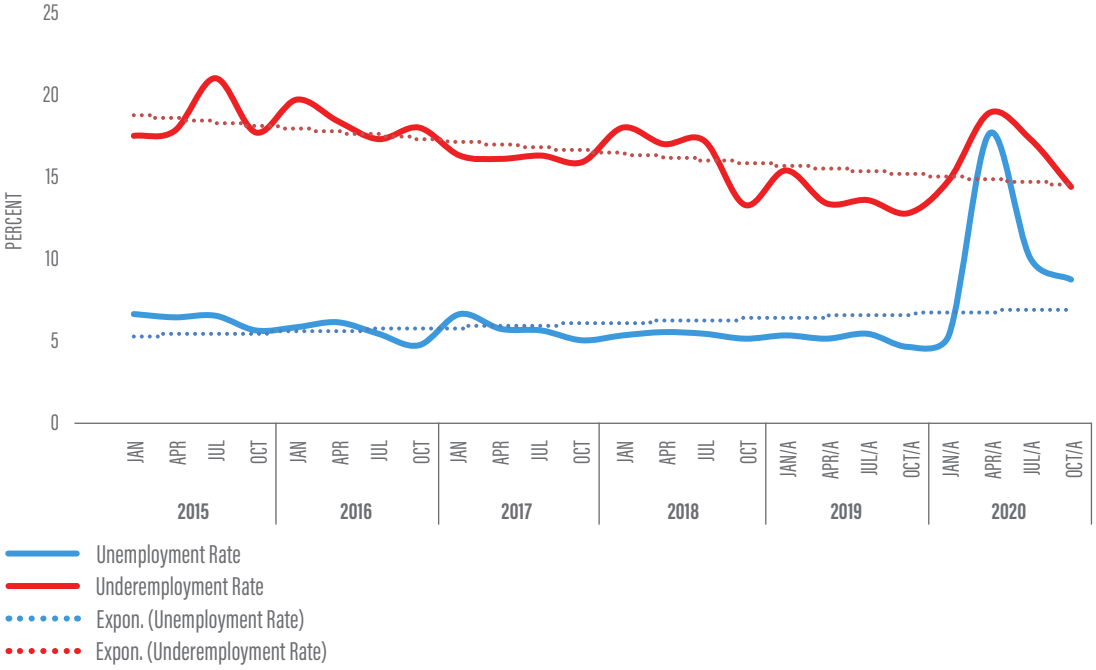
The unemployment rate declined since the peak of the pandemic, yet it remains high. As the country gradually eased community quarantines introduced in March 2020, the unemployment rate fell from 17.6 percent in April to 10.0 percent in July. The latest estimate of the unemployment rate in October 2020 suggests that it further decreased to 8.7 percent. However, it remains almost double the rate of those recorded in the same period of 2019 -- 5.4 percent in July and 4.6 percent in October (Figure 21). Joblessness is most pronounced among the youth aged 15-24, who comprise about 35 percent of the unemployed population. The youth unemployment rate surged from 12.9 percent in October 2019 to 19.4 percent in October 2020—one-fifth of the economically active youth. In October 2020, the highest unemployment rates were recorded in the National Capital Region (NCR) (12.4 percent), Ilocos (11.5 percent), and CALABARZON (11 percent), most of which have highly urbanized areas that have had to comply with more strict community quarantine.

Underemployment also declined gradually from its peak in April and continued its downward trend in July and October 2020. The number of underemployed workers who wish to work more hours or have an additional job was about 7.1 million in July 2020, equivalent to 17.3 percent of all workers, lower than 18.9 percent in April 2020. Recent estimates in October 2020 showed improvement as it further declined to 14.4 percent. Of the underemployed, half were in the services sector and nearly two thirds were working less than 40 hours a week. The most common reason for working less than 40 hours a week was variable working time/nature of work, followed by ECQ/COVID-19 pandemic. In April 2020, close to two-thirds of workers cited the ECQ/COVID-19 pandemic as the reason for working less than full time. Other labor market outcomes suggest a compositional change of the status of employment and occupations during the pandemic. Up until July 2020, the share of wage and salaried workers fell while the share of self-employed or non-paid workers increased (Figure 22). Similarly, the share of managers fell while the share of elementary workers increased (Figure 23). In October 2020, in part due to the consecutive typhoons that hit the country[27] and agricultural employment, a slight rebound in the share of wage and salaried workers and reductions in the share of unpaid workers and elementary occupations were observed compared to July 2020.

The labor force participation rate (LFPR) rebounded to its pre-pandemic level in July 2020 but reversed to a lower level in October 2020. After falling from 61.7 percent in January to 55.7 percent in April 2020, the LFPR, representing the size of the workforce engaged in or available for work, rose to 61.9 percent in July 2020, a similar level a year ago (62.1 percent recorded in July 2019) (Figure 24). Moreover, a reported 918,000 persons entered the labor market in July, tailing the pre-pandemic number of 929,000 in January 2020. However, the latest estimates in October suggest that LFPR reversed to 58.7 percent, equivalent to 2.2 million persons exiting the labor force between July and October 2020. No significant gender differences were observed in the fluctuation of LFPR (Figure 25).

27 A series of typhoons hit the Philippines in October 2020: Nika (October 11 to 12), Ofel (October 13 to 15), Pepito (October 18 to 20), and Quinta (October 24 to 27).

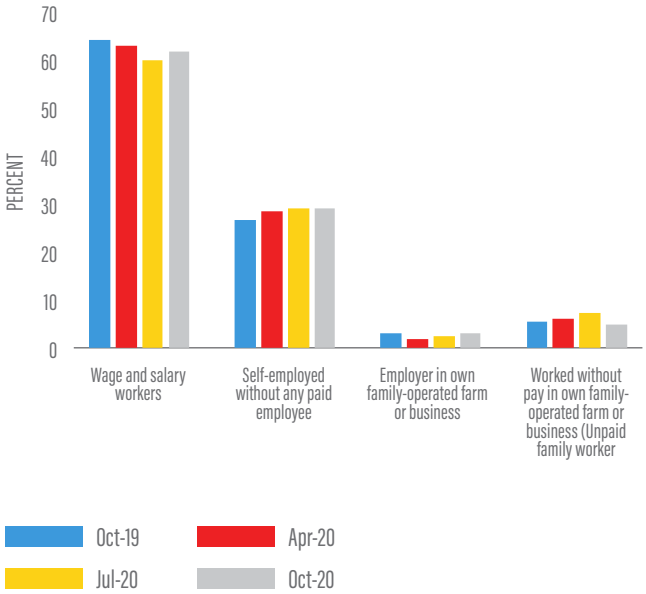
Figure 21. Unemployment and underemployment remain elevated, despite rebound in July



Source: Labor Force Survey (various rounds), PSA.
Note: Population projections based on the 2015 population census were used to generate the labor force statistics.

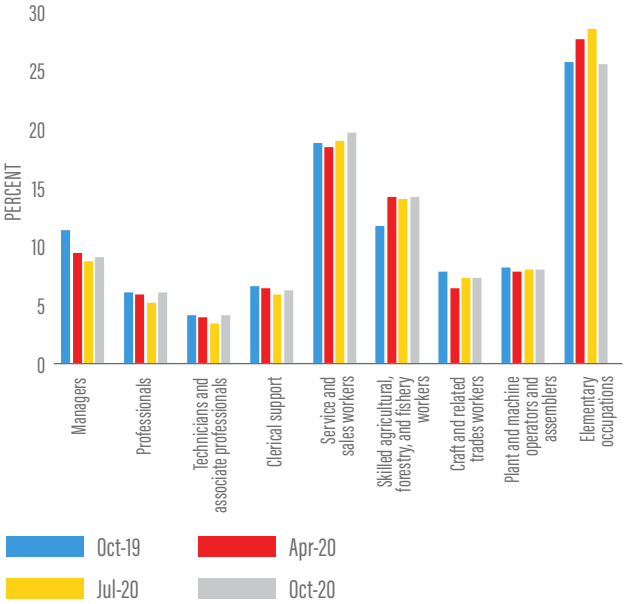
Figure 22. Wage employment has been on the decrease until its rebound in October...

SHARE OF EMPLOYMENT BY TYPE OF WORKER, APRIL-JULY 2020



Source: PSA -LFS Labor Force Survey (various rounds).

Figure 23. ...also, the share of high skilled occupations declined in recent months until bouncing back in October.



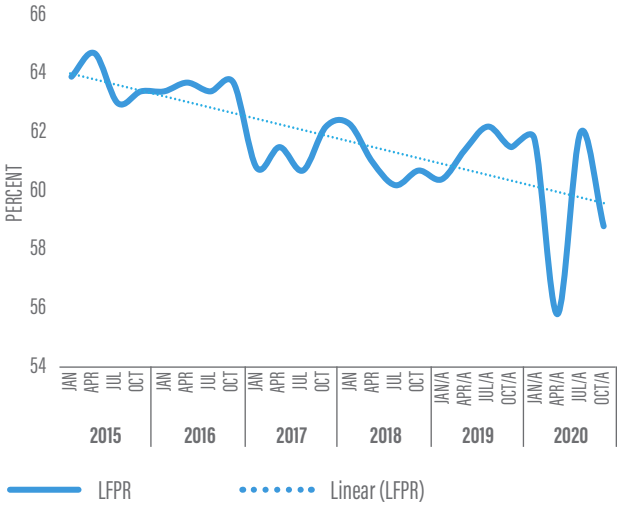
Source: PSA -LFS Labor Force Survey (various rounds).

Job losses between October 2019 and October 2020 were a staggering 2.7 million and were mostly concentrated in the services and industry sectors. The services and industry sectors shed 1.9 million and 827,000 jobs, respectively, as they were especially affected by the economic shock associated with the community quarantine as well as operational capacity requirements imposed on certain industries.[28] The subsectors that lost the most jobs in October 2020 were accommodation and food services (-667,000), transportation and storage (-657,000), and manufacturing (-618,000) (Figure 26). During the community quarantines, no hotels or accommodation establishments were allowed to operate, except under special circumstances (e.g., to host repatriated/distressed overseas Filipino workers). Compared to services and industry, the agriculture sector jobs were less affected by the pandemic, as agriculture, forestry, and fishery were some of the few industries allowed to operate at full capacity, even during the ECQ. The agriculture sector added about 70,000 jobs between October 2019 and October 2020. This was despite a 1.1 million job loss between July and October 2020, likely associated with the series of typhoons.

Overall household income has declined. Prior to the COVID-19 pandemic, there was a steady increase in household income, driven in part by the increase in real daily wages. In January 2020, the daily wage averaged Php406 (in 2012 prices), a 3.5 percent increase from the same period in 2019 (Figure 26). However, due to significant job losses, underemployment, and job changes to low paying sectors and occupations, many households have reported income losses. The results of a high-frequency monitoring survey on the impact of COVID-19, conducted in August 2020 for a nationally representative sample of households, shows a significant share (about 40 percent) of households reporting a fall in income (Figure 28). For example, entrepreneurial income reportedly fell, particularly among households engaged in non-farm business. Remittances, which have been a constant source of income for most Filipino households, were likewise affected, as two in five households that receive remittances reported a fall in the amount sent from abroad.

Figure 24. Labor force participation returned to pre-pandemic levels in July 2020 but declined in October 2020.

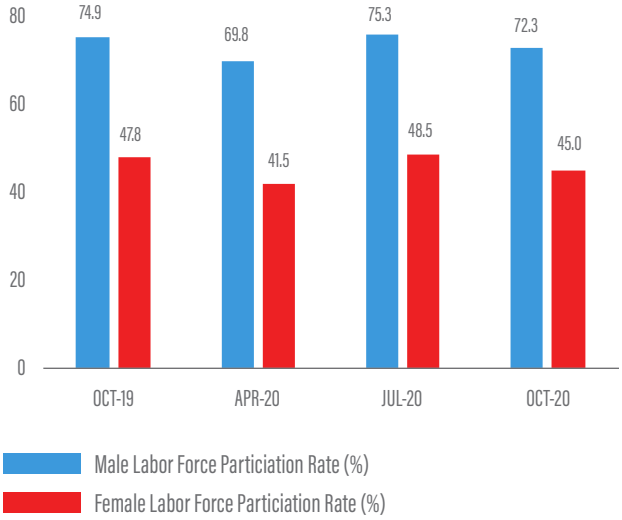
QUARTERLY LABOR FORCE PARTICIPATION RATES, JANUARY 2015- - JULY 2020



Source: PSA -LFS Labor Force Survey (various rounds).
Note: (a) The population projections based on the 2015 Population Census has been adopted to generate the labor force statistics.

Figure 25. ...similar patterns in LFPR were observed across gender.

LABOR FORCE PARTICIPATION BY GENDER

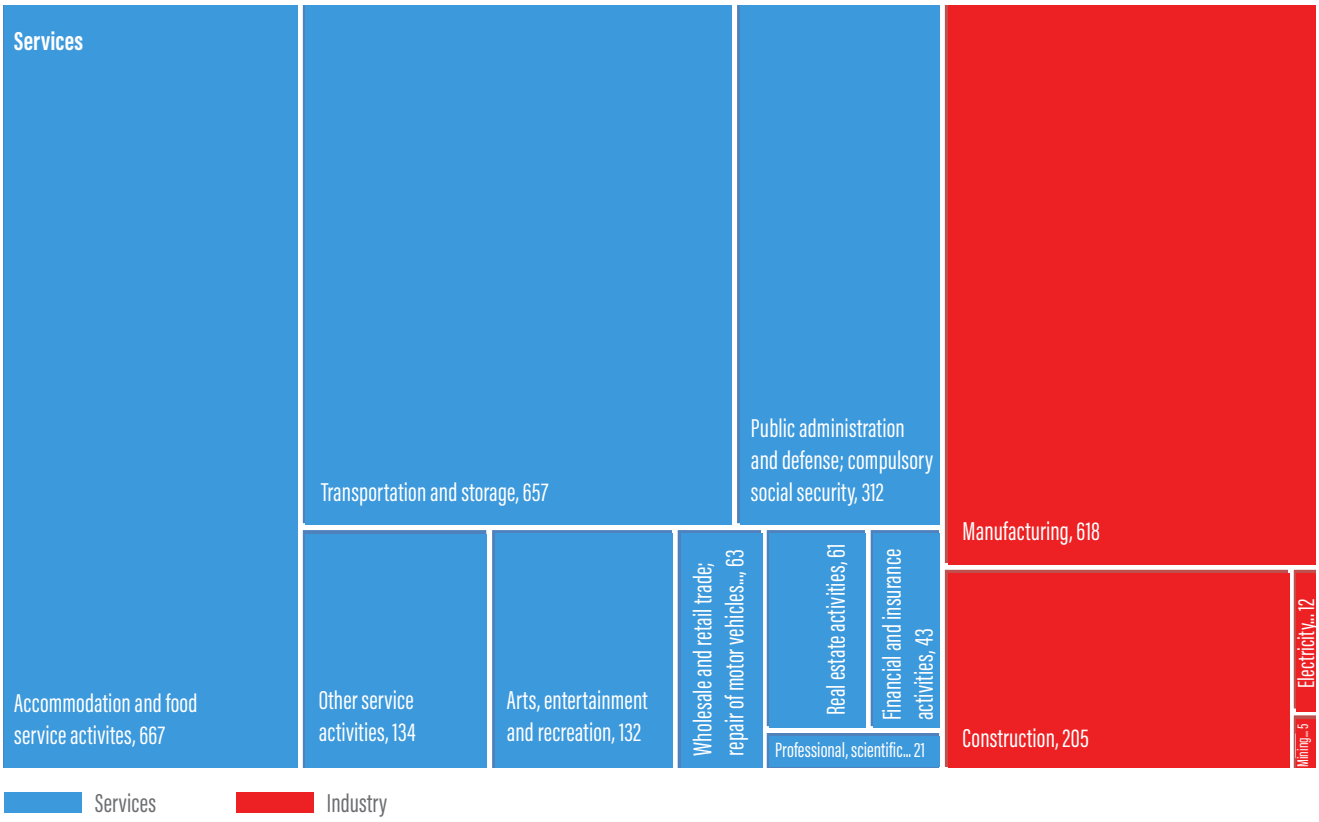


Source: PSA – LFS (various rounds).

28 Based on the Omnibus Guidelines on Community Quarantine as of June 2020, category II industries such as mining and other manufacturing, electronic commerce companies, and other delivery, repair and maintenance, and housing and office services are allowed to operate at anywhere between 50 percent to full capacity. Category III industries such as financial services, legal and accounting, and auditing services, professional, scientific, technical, and other non-leisure services, barbershops, and salons are allowed to operate with either skeletal workforce or at 50 percent capacity.

Figure 26. Job losses mounted in both industry and services.

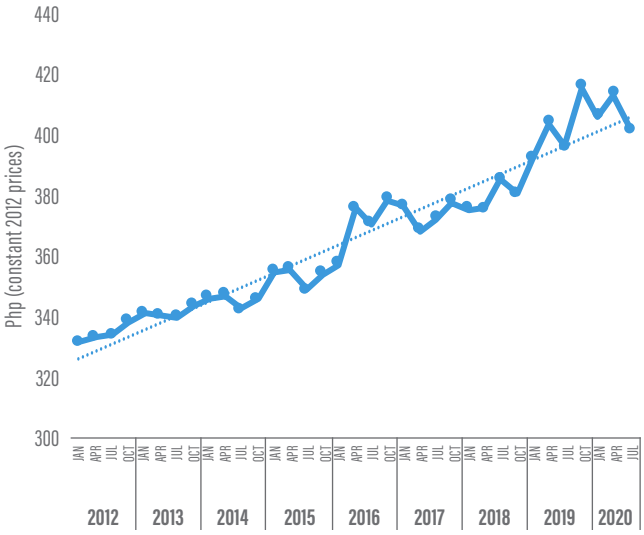
(JOB LOSSES BY SUBSECTOR, OCTOBER 2019-OCTOBER 2020, IN THOUSANDS)



Source: PSA-LFS October 2019 and October 2020 rounds.

Figure 27. Prior to the pandemic, there was a trend of increasing wages contributing to increases in household incomes...

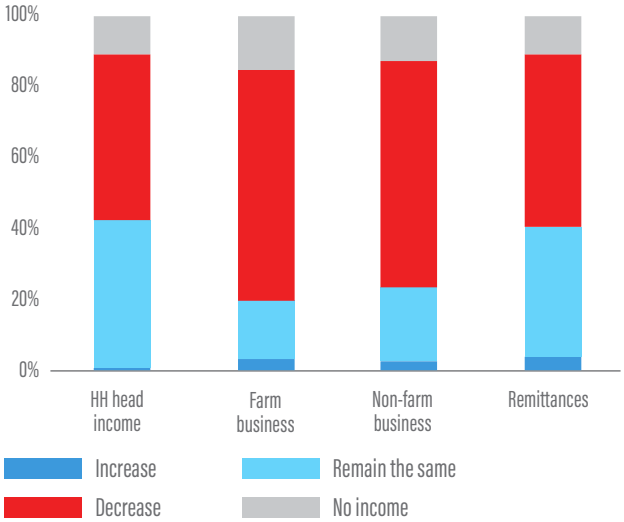
AVERAGE DAILY REAL WAGE



Source: Staff estimates using data from the Labor Force Survey (various rounds); and PSA.

Figure 28....but a large share of households experienced decreases in income.

HOUSEHOLD INCOME, AUGUST 2020



Source: Staff estimates based on data from the August round of a high-frequency monitoring survey on the impact of COVID-19, World Bank.

Photo: Ezra Acayan

The government has created an extensive package of intervention to protect households and firms from the pandemic and the short-term economic costs of mitigation measures. In March 2020, it adopted the Bayanihan to Heal as One Act (Bayanihan 1), which focuses on increasing funding for the health sector, safety nets for poor and vulnerable groups, and measures to financially support micro, small, and medium enterprises (MSMEs) and jobs. About 18 million Filipino families were supported through the first tranche of transfers from the Social Amelioration Program (SAP) for ECQ-affected workers and businesses, including top-up assistance for the beneficiaries of the country's flagship safety net program—the Pantawid Pamilyang Pilipino Program (4Ps). A survey that measured the welfare of low-income beneficiary households, conducted in April-May 2020, shows that the SAP reached 4Ps beneficiaries first, helping them to mitigate the shock in a timely manner compared to non-4Ps beneficiaries. The second tranche transfer from the SAP targeted 5 million waitlisted families and about 8 million low-income families still in ECQ in May 2020.

The adoption of the *Bayanihan to Recover as One* Act in September 2020 (Bayanihan 2) extended the national emergency. This allowed the government to continue its activities under Bayanihan 1 and introduce new measures. For example, the government has continued to provide targeted financial support to MSMEs and the agriculture and tourism sectors to protect vulnerable affected firms. It also added new supports for overseas Filipino workers and implemented other social assistance programs, although these new programs were not as extensive as the measures taken under Bayanihan 1. With the implementation of the SAP and additional measures, it is estimated that the negative impact of COVID-19 has been somewhat mitigated.

Box 3. One in four breadwinners have lost their jobs due to the pandemic.[29]

About one-quarter of household heads who worked in February prior to the COVID-19 pandemic were reported to no longer be working in August. This is not surprising given the soaring unemployment rates in April (17.7 percent) and July (10.0 percent). However, a large share of breadwinners remains jobless even after the government started easing community quarantines (CQ). The job losses among household heads were more pronounced in the National Capital Region and neighboring regions of central and southern Luzon— one-third of household heads reported job losses here—where case infections were widespread and stricter CQs were enforced. Sectors that lost the most jobs include construction (31.3 percent), food services and accommodation (25.6 percent), and trade (25.4 percent) (Figure 29). In August, about half of all households cited the forced closure of businesses as the primary reason for not working.

Many workers who were able to retain employment had to go through changes in jobs and adjustments in working conditions. About 11 percent of those working both before and during the pandemic had to change jobs, with many transitioning out of sectors severely affected by the pandemic (e.g., accommodation and food services, construction, and trade). Moreover, over half of those who were working in August were not able to work as usual, among whom two in five were working from home. Home-based work arrangements were more prevalent (60 percent) among workers involved in ICT, educational, professional, scientific, and technical activities. Close to half of all household heads reported a decline in income between February and August 2020.

Disruptions in livelihood have driven households to resort to various coping mechanisms. Fortunately, a large share of households were able to receive assistance from the government (Figure 30). Nonetheless, most households had to reduce consumption, as over three in four households reduced their food consumption or shifted to cheaper alternatives. Many households delayed their payment obligations (three in five) and resorted to borrowing, mainly from relatives and friends, and close to 60 percent of households used their savings to cope with the shock caused by the pandemic.

Figure 29. Significant job losses were reported across all sectors...

JOB LOSSES BY SECTOR

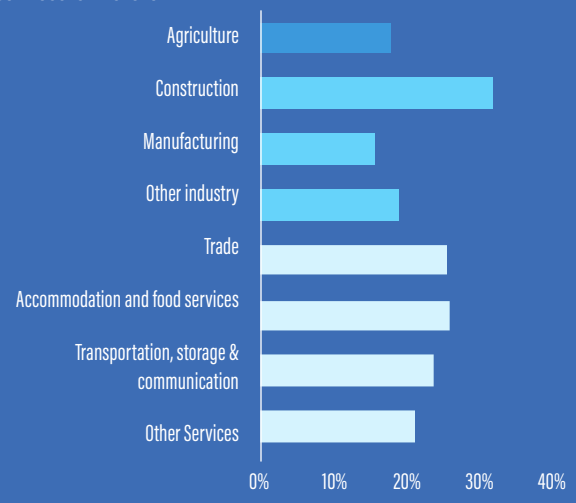
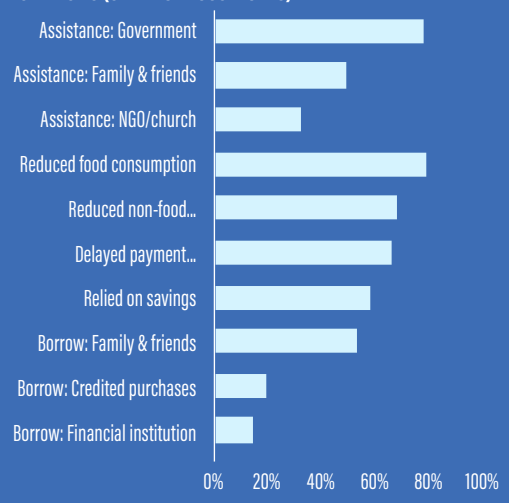


Figure 30. ...forcing households to resort to various coping mechanisms.

COPING MECHANISMS (SHARE OF HOUSEHOLDS)



29 These key findings are based on a high-frequency survey of firms, households, and communities to monitor the impact of COVID-19. This is the first of a series of surveys that were implemented in August 1-14, 2020, in close collaboration with the National Economic and Development Authority and the Department of Finance. The household survey with 26,953 respondents was implemented through self-administered web links and complemented with phone interviews to ensure households without internet access were also covered.

2

OUTLOOK AND RISKS

The Philippine economy is expected to rebound in 2021-22 assuming the infection curve is flattened in 2021. Domestic demand is expected to recover as consumer and business confidence return, supported by a moderate pick-up in public infrastructure investment. An improvement in the external environment is expected to benefit exports and remittances inflows. Monetary policy is expected to remain accommodative while the large fiscal deficit in 2020 is likely to consolidate in the medium term. The growth outlook, however, faces significant downside risks, primarily from a potential resurgence in COVID-19 cases exacerbated by the negative impact of frequent natural disasters on economic activities. In addition, COVID-19 could potentially hurt the country's productivity and long-term growth. More importantly, the country's recent gains in poverty reduction have likely been reversed, requiring intensified government efforts to support poor, unemployed, and vulnerable households.

Photo: Ditsi Carolino

2.1 GROWTH OUTLOOK: GRADUAL REBOUND IN 2021-22

Following an expected deep economic contraction in 2020, the Philippine economy is expected to rebound gradually in 2021, driven by the return to more robust economic activities assuming the infection curve flattens domestically. The authorities are likely to continue to support growth with an accommodative monetary policy and the implementation of infrastructure projects. As the external environment improves, the growth prospects of exports, remittances, and tourism will also improve.

The country's growth prospects hinge on its ability to effectively manage the COVID-19 pandemic. Consumer and business confidence levels plunged to negative territory in the third quarter of 2020 after a reversion to strict lockdown restrictions in early August, foreshadowing a difficult recovery in the remaining quarter (Figure 31). Nonetheless, there are signs that the management[30] of the pandemic is improving resulting in the decline of seven-day moving average of around 4,500 cases in mid-August to below 2,000 in mid-November. The decline is even faster for Metro Manila, from a seven-day moving average of 2,000 in mid-August to 350 in mid-November.[31] With the steady decline in daily cases despite the gradual re-opening of industries including consumer facing services sectors, the risk of reversing to stricter quarantine restrictions is likely reduced. If the positive trend persists, the infection curve is likely to flatten in the first half of 2021, which will help pave the way for a sustainable economic recovery in 2021-222.

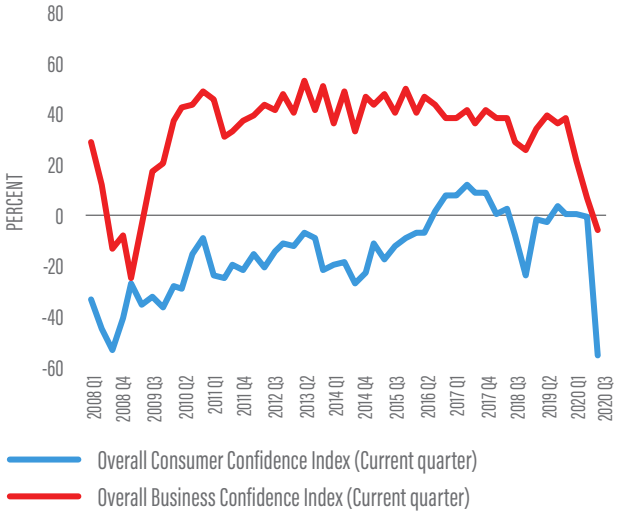
Following a deep recession in 2020, the Philippine economy is expected to rebound in 2021-22. The World Bank projects the Philippine economy to contract by 8.1 percent in 2020, before growing by 5.9 percent and 6.0 percent in 2021 and 2022, respectively (Figure 32). The downward revision compared to EAP update October edition derives from a larger than expected contraction in Q3 and the expected damages caused by a series of typhoons in November. These projections hinge on China's early recovery, among the Philippines' main export destinations, alongside the expected rebound in the global economy in 2021 (Box 4). With further relaxation of CQs,[32] more industries and services will be allowed to operate creating jobs and income, supporting private consumption growth. As the government ramps up its infrastructure spending in the fourth quarter of 2020 and even more in 2021, the construction sector will rebound contributing to job creation as well. Finally, pre-election activities in the run-up to the national election in 2022 will give an additional boost to demand as early as in the second half of 2021. Base effects will also come into play and contribute to growth in 2021 considering the deep contraction in 2020.

30 The government continues to enforce minimum health and safety standards to help contain the transmission of COVID-19. This includes mandatory use of face masks in public areas, the mandatory use of face shields in public markets, malls, public transportation, and government offices, and the limited operation of public transportation with strict guidelines on social distancing.

31 Hospital bed occupancy declined from 48.0 percent (mid-August) to 37.9 percent (mid-November). For Metro Manila, hospital bed occupancy declined from 73.7 percent to 38.1 percent over the same period. Similarly, daily positive rates (number of individuals tested positive as percent of total individuals tested) declined from 14.4 percent to 5.9 percent.

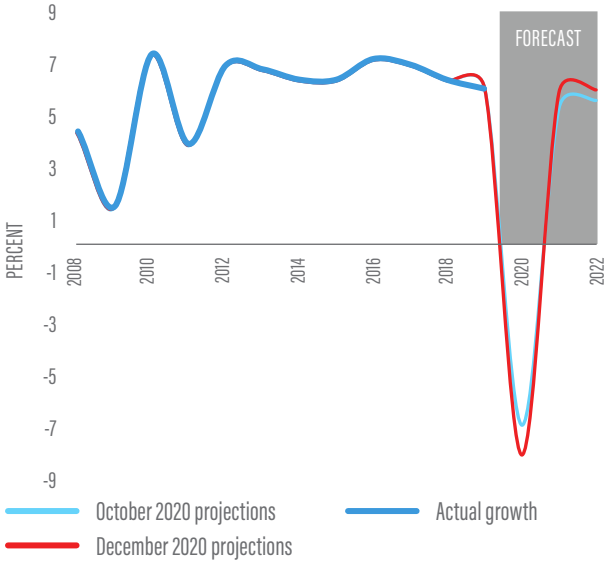
32 Nonetheless, the authorities have to be careful in further relaxing containment measures and strengthen the monitoring of cases, and continue to promote social distancing, and the use of masks and face shields.

Figure 31. Consumer and business sentiments worsened in the third quarter of 2020.



Source: BSP.

Figure 32. Economic growth is expected to rebound in 2021.



Source: PSA, World Bank staff estimates.

The fiscal deficit is expected to significantly widen in 2020 but will consolidate in the medium term as the economy recovers. The fiscal deficit is projected to widen to 8.7 percent in 2020 from 3.4 percent of GDP in 2019. The larger deficit is the result of increased public spending in response to the pandemic and lower revenue collection due to weak economic activities. In the medium term, however, the fiscal balances will likely consolidate, as public revenue is estimated to increase due to a recovering economy and the adoption of various tax policy measures, including a sin tax on alcoholic beverages and e-cigarettes that became effective in early 2020. Moreover, the government is expected to soften the pace of public expenditure growth, with the disbursement program to grow by an average of 3.9 percent in nominal terms in 2021 and 2022,[33] significantly lower than 10.9 percent prior to the pandemic.

Monetary policy is expected to be supportive of growth as inflation remains stable and within the target range. The headline inflation rate is expected to settle at 2.5 percent in 2020 as commodity prices weaken and consumption demand remains subdued. The subdued inflation outlook provides additional space for the BSP to ease rates. Furthermore, the BSP could further lower the reserve requirement ratio in response to weakened economic activity or if additional downside external risks materialize. BSP could also provide additional resources to the Treasury under the Bayanihan 2[34]. Monetary policy accommodation in advanced economies is expected to continue, especially as the U.S. Federal Reserve has indicated that interest rates will be kept near zero in the near term.

Photo: Ditsi Carolino

33 Growth rates are computed relative to the revised 2020 national budget.

34 Bayanihan 2 law raises the cap on the amount the central bank can advance to the national government from Php540 billionn to Php812 billion.

Table 3. Economic Indicators for the Baseline Projections

	2017	2018	2019	2020f	2021f	2022f
Real GDP growth, at constant market prices	**6.9**	**6.3**	**6**	**-8.1**	**5.9**	**6**
Private Consumption	6	5.8	5.9	-8	8.8	6.2
Government Consumption	6.5	13.4	9.6	12	3.1	10.5
Gross Fixed Capital Investment	10.6	12.9	3.9	-28.7	23.1	13.2
Exports, Goods and Services	17.4	11.8	2.4	-16.5	11.6	7.2
Imports, Goods and Services	15.1	14.6	1.8	-21.5	25.7	13.3
Inflation (period average)	**2.9**	**5.2**	**2.5**	**2.5**	**2.8**	**3**
National government balance (% of GDP)	**-2.1**	**-3.1**	**-3.4**	**-8.7**	**-7.2**	**-6.6**
National government debt (% of GDP)	40.2	39.9	39.6	50.3	54.3	57.1
Current account balance	**-0.7**	**-2.6**	**-0.9**	**1.4**	**-1.7**	**-1.8**

Source: PSA; and WB staff estimates.

An improvement in the external environment will make it more likely that goods and services exports recover next year. While the global economy is expected to fall into a deep recession this year, a moderate growth rebound is expected in 2021, driven by a recovery in economic activities in both advanced economies and EMDEs (Box 4). Annual growth in advanced economies is estimated to reach 3.9 percent in 2021, a significant improvement from an expected 7.0 percent contraction in 2020. This economic expansion in advanced economies would contribute to increased demand for Philippine goods exports, as roughly 70 percent of the country's exports are destined for high-income economies. Services exports would also benefit from the reopening of the tourism industry and a recovery of the BPO sector due to sustained demand.[35] Meanwhile, import growth will likely accelerate next year as the government accelerates the implementation of infrastructure projects, with renewed demand for capital goods, especially construction materials. As a result, the expected current account surplus in 2020 is likely to be followed by a current-account deficit in 2021 (Table 3).

Private consumption is expected to rebound in 2021 as economic conditions improve. Household consumption that represents more than two-thirds of GDP is projected to contract by 8.0 percent in 2020 due to income losses, a decline in foreign remittances, and depressed consumer confidence. As domestic and external economic conditions improve in 2021, consumption growth is expected to rebound to 8.8 percent and 6.2 percent in 2021 and 2022, respectively. The anticipated full opening of the economy is expected to revitalize business activities, which would help to generate jobs and mitigate the loss in income. Furthermore, a recovery in foreign markets is expected to return the demand for overseas Filipino workers, resulting in growth in remittances. Similar to past election cycles, pre-election activities will likely increase consumption starting in the second half of 2021.

Following a significant contraction in 2020, capital formation is projected to recover moderately in the next two years. Fixed capital formation, which is estimated to contract by 28.7 percent in 2020, is expected to make a modest recovery in the next two years. The expansion of private investments is likely to be dampened by weakness in the balance sheets of some large corporations that have been severely impacted by the pandemic. Moreover, the fall in foreign direct investment (10.9 percent contraction, year-on-year, in the first seven months of 2020), alongside the decline

35 In spite of the pandemic and strict CQ measures, two services subsectors—information and communication technologies and finance and insurance—continued to expand in the first half of 2020. Industry sources reveal that certain sectors such as healthcare, technology, media, and entertainment are enjoying increased demand for call center services.

Photo: Ditsi Carolino

in bank lending for production activities (average of 1.0 percent, month-on-month, contraction between April and August), preclude full access to externally sourced funds to finance investment plans. While the implementation of public infrastructure projects may have resumed in the last quarter of 2020, project delivery may face operational delays due to supply disruptions, capacity constraints, and typhoon season. Nevertheless, the government remains committed to pursuing its infrastructure investment agenda, as ramping up investment spending will contribute to an improvement in business confidence and the overall economic recovery.

The services sector is expected to drive the economic recovery in 2021. Commanding roughly 60 percent of GDP, the services sector is expected to be the main growth driver in 2021. While the services sector is anticipated to contract by 7.3 percent in 2020, the re-opening of face-to-face service sectors bodes well for tourism, the transportation industry, restaurant and food services, and wholesale and retail trade. However, as some social distancing measures will likely remain, the service sector is expected to grow by 5.8 percent in 2021—lower than pre-COVID levels. Domestic tourism is more likely to resume sooner than international tourism given constraints to international travel. In 2021, the industry sector is expected to expand, construction activities will gain momentum, and manufacturing activities will gather steam as domestic and external demand return. Agriculture is expected to be the only sector to grow in 2020, but the government needs to address unresolved productivity challenges and vulnerabilities to weather-related shocks to accelerate growth in the medium term.

Box 4. The Global Economic Outlook

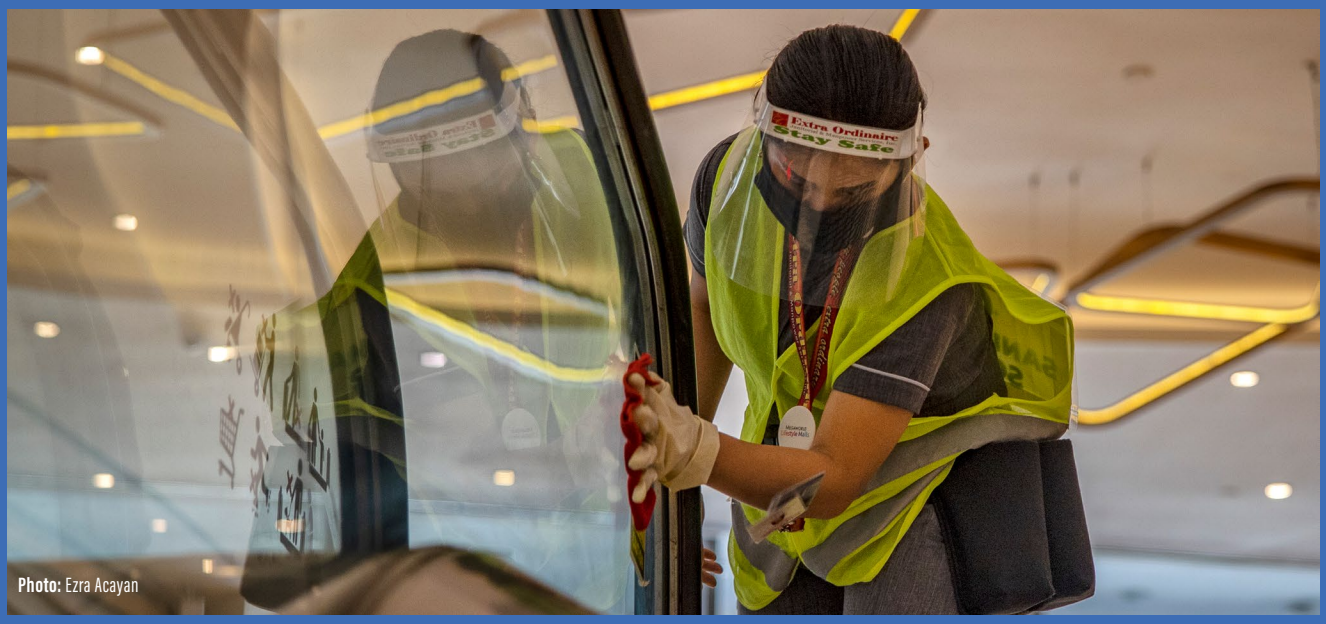


Photo: Ezra Acayan

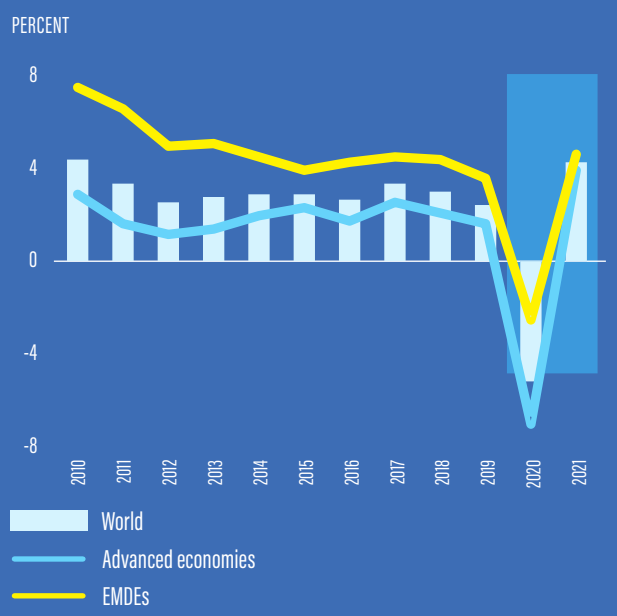
As a result of the COVID-19 pandemic, the global economy is expected to contract by 5.2 percent, year-on-year in 2020. This contraction will constitute the deepest recession in the post-war period (Figure 33). The implementation of lockdowns and social distancing measures in many countries have been accompanied by a sharp reduction in economic activities. Major advanced economies, especially in the Euro Area, are expected to contract significantly. Meanwhile, some large EMDEs, particularly China, are projected to expand but at a much slower pace than in 2019. In 2020, advanced economies are expected to contract by 7.0 percent, year-on-year, while EMDEs are expected to contract by 2.5 percent (Table 4).

Driven by an economic recovery in both advanced economies and EMDEs, moderate global growth is expected in 2021. Global economic growth is expected to recover to 4.2 percent, year-on-year, in 2021, driven by growth in both advanced economies (3.9 percent) and EMDEs (4.6 percent). Aggregate output, however, is not expected to return to its previous expected levels due to a slow rebound in economic activities as some social distancing measures remain. The large and sudden loss of household income in 2020 has increased the unemployment rate and forced many companies into bankruptcy, destroying valuable economic relationships and denting human capital that will take time to rebuild. Lower spending and continued uncertainty will likely lead to persistent weakness in investment and innovation, with potential adverse effects on growth and productivity.

In 2020, global trade is expected to suffer from one of the worst contractions in post-war history (Figure 34). Trade is typically more volatile than production and tends to fall sharply in times of crisis. The current pandemic has caused disruptions to trade logistics, international travel, and GVCs. The spread of the pandemic has disrupted the supply of key intermediate inputs and threatened the viability of many transportation companies, with potential adverse effects on the trade of goods across regions. Moreover, GVCs have come under pressure from renewed trade tensions, which could trigger a rise in uncertainty and a further fall in trade flows at a time when the global economy is already fragile.

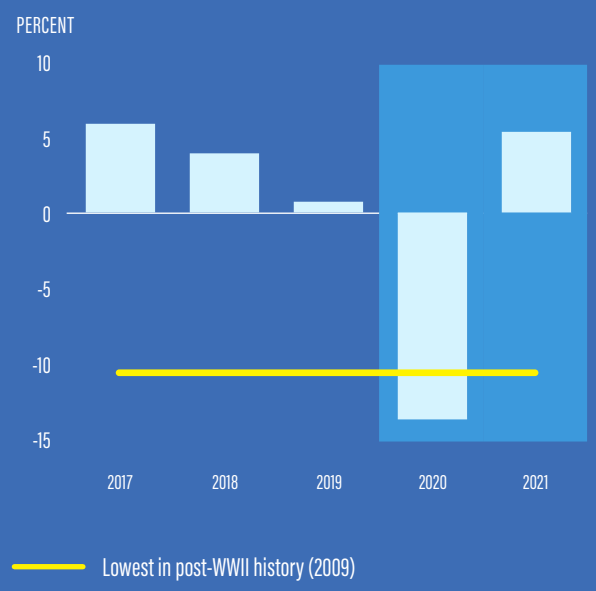
Authorities across the world continue to face the challenge of containing the pandemic while addressing the economic fallout from containment measures. Monetary authorities in advanced economies are using quantitative easing on an enormous scale and developing new tools to bolster demand and financial markets. In addition, large-scale fiscal policy responses have been implemented to support economic activity and enhance social safety nets. The strengthening of safety nets is especially pertinent to a large majority of EMDEs that are expected to suffer from an economic contraction this year, with many millions of people falling into poverty. This crisis highlights, therefore, the urgent need to protect poor households and vulnerable populations. Furthermore, countries need to improve their capacity to prevent and cope with similar events in the future. As EMDEs are particularly vulnerable, it is critical to strengthen public healthcare systems, expand social safety nets, and implement structural reforms to achieve strong, inclusive, and sustainable economic growth.

Figure 33. Global economic growth is expected to contract by 5.2 percent yoy in 2020.



Source: Global Economic Prospect June 2020.

Figure 34. Global trade is expected to register its worst contraction in post-war history.



Source: Global Economic Prospect June 2020.

Table 4. Real Growth Projections

	2017	2018	2019e	2020f	2021f
World	**3.3**	**3.0**	**2.4**	**-5.2**	**4.2**
Advanced economies	2.5	2.1	1.6	-7.0	3.9
Emerging market and developing Economies	4.5	4.3	3.5	-2.5	4.6
Developing East Asia & Pacific	6.5	6.3	5.8	0.9	7.4
Philippines	6.9	6.3	6.0	-6.9	5.3

Note: Developing East Asia & Pacific includes Cambodia, China, Fiji, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Solomon Islands, Thailand, Timor-Leste, and Vietnam.
Source: Global Economic Prospects June 2020; East Asia and Pacific Economic Update October 2020.

2.2 POVERTY AND SHARED PROSPERITY: TEMPORARY POVERTY REDUCTION TREND REVERSED

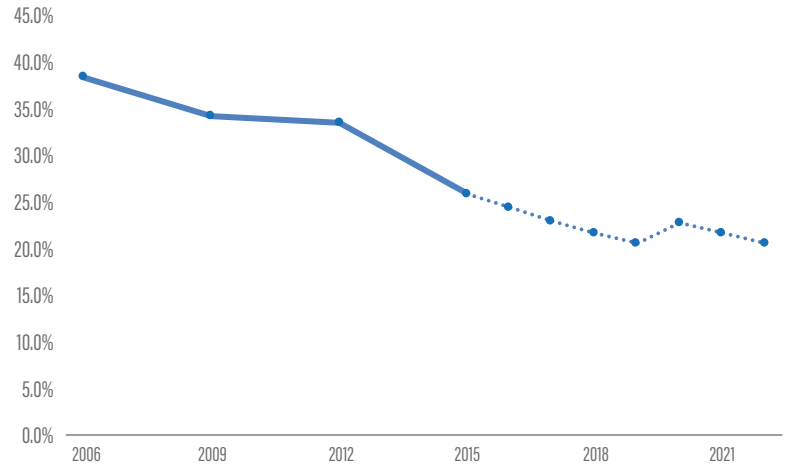
Poverty in the Philippines is likely to increase in the short term given the negative impact of the pandemic on employment and household income.

The COVID-19 pandemic threatens to partly reverse the gains made in poverty reduction and shared prosperity in recent years. The extended CQs have disrupted economic activities, resulting in job losses, a decline in wage incomes, a slowdown in entrepreneurial activities, and a fall in remittances. The poor and vulnerable, many of whom work in the informal sector, are especially likely to experience significant welfare losses, given their limited capacity to manage risks. Household perceptions regarding their finances are bleak. According to the Word Bank's household survey in August, 88.6 percent of households expressed concerns over their finances.

The expected growth contraction in 2020, along with the subsequent pressure on household income, is likely to increase poverty in the short term. With the economy contracting and household income declining, poverty is estimated to increase from 20.5 percent in 2019 to 22.6 percent in 2020 (measured against the lower middle-income poverty line of US$3.2/day), reversing the trend of a steady decline in poverty in recent years, resulting in an additional 2.7 million poor people in 2020 compared to 2019 estimates (Figure 35). As the threat of the COVID-19 pandemic dissipates and business activities gradually return to normal, the economic recovery is expected to contribute to poverty reduction. The poverty rate is projected to fall to its 2018 level in 2021 and keep falling throughout 2022.

Figure 35. Poverty is expected to rise as a result of the COVID-19 pandemic.

ACTUAL AND PROJECTED $3.20-A-DAY POVERTY RATES



Source: WB staff estimates

2.3 RISKS AND POLICY CHALLENGES

The impact of the COVID-19 pandemic remains the most significant downside risk to the growth outlook. While the pandemic could result in lower productivity growth, it could also increase the digitalization momentum. The government needs to remain committed to structural reforms that promote competition, improve the business environment, support private sector growth, and enhance resilience to natural disasters and climate change.

A potential resurgence of COVID-19 is the most significant downside risk to the country's growth outlook. The growth trajectory will be decisively influenced by the government's effectiveness in flattening the infection curve and ensuring that progress is sustained as more quarantine restrictions are relaxed. Sporadic cases of infections may lead to stricter containment measures, which could dampen economic activities, lower consumption growth, and delay the implementation of public infrastructure projects. Despite the country's recent success in flattening the infection curve, the surge of COVID-19 cases in a number of highly urbanized cities such as Baguio City, Davao City, and Makati City shows that the health situation remains fluid. Should a second wave of infections materialize and remain unchecked, a reversal to strict lockdown measures would lead to the closure of more businesses and a spike in unemployment, lowering business and consumer confidence and investment levels, which could push the economy into a deeper recession in 2020 and lead to a more protracted recovery in the medium term. On the other hand, an earlier than anticipated successful vaccine rollout in the Philippines would constitute an upward risk to the baseline growth projections as it would boost private confidence and accelerate private consumption and capital formation growth.

Additional domestic downside risks come from country's ability to respond to natural disasters in addition to the COVID-19 pandemic. The Philippines is exposed to multiple natural hazards including typhoons, earthquakes, floods, volcano eruptions, storm surges, tsunamis, and landslides.[36] In early January 2020, the eruption of Taal Volcano caused severe disruptions in tourism, agricultural, and manufacturing activities. Since May 2020, the country has experienced typhoons, floods, and earthquakes, and the pandemic has made it more difficult for the government to prepare for an effective response to these types of events. More recently, the country was hit by a series of strong typhoons in November with damages to physical infrastructure and agriculture amounted to preliminary estimates of Php24 billion[37] (0.1 percent of GDP) to agriculture and infrastructure while causing further disruptions to economic activity. The extent of the impact of these natural events on the pace of economic recovery is highly uncertain as government post-disaster response is hampered by its effort to manage the pandemic.

Subsequent waves of COVID-19 infections globally amplify the downside risks from the external environment. Social distancing and lockdown measures implemented in advanced economies have also had an adverse impact on the Philippine economy. A number of

36 GFDRR (Global Facility for Disaster Reduction and Recovery), and World Bank. 2011. "Climate Risk and Adaptation Country Profile: Philippines," World Bank, Washington DC.

37 Preliminary estimates on damages to both agriculture and infrastructure have thus far amounted to an estimated Php24 billion from typhoons Ulysses, Rolly, Quinta, and Pepito.

these economies, such as the United States, the United Kingdom, and a number of countries in the European Union, are battling new waves of the outbreak that may worsen during the winter months and cause an increase in restrictions to economic activity. In an interconnected world, the fate of the Philippine economy is tied to developments in high-income economies, many of which are major destinations for Philippine exports and a source of foreign investment, remittances, and tourism revenues. Moreover, disruptions in supply chains due to tight supply conditions, and air and sea logistics challenges, will ripple through the domestic economy, especially the electronics exports industry, if not appropriately addressed. Finally, increased international financial volatility can affect the local economy through the equity, bond, and credit markets that could lead to episodes of capital outflows or a rise in the cost of credit.

The crisis is likely to have an adverse impact on the country's productivity growth. About 15 percent of firms in the Philippines have had to close permanently because of the pandemic, and a majority of remaining firms have had to temporary suspend their operations or reduce payments to employees.[38] The exit of firms will mean the loss of intangible assets—business relationships and management practices—that are vital for productivity and difficult to rebuild. Firms that are still operating may also face prolonged uncertainty and be saddled with debt, reducing their future productivity-enhancing investments.[39] Nonetheless, the pandemic has accelerated the digitalization of some firms, which may translate to faster but likely unequal productivity growth. The challenge is for the government to support the digitalization momentum to enable greater and wider participation by the private sector, and to democratize digital access to ensure an inclusive recovery.[40]

The impact of COVID-19 on investment and productivity growth could harm the country's potential growth without mitigating measures. The World bank estimates show that before the pandemic, the Philippines potential growth would have been expected to rise in the coming decade by 0.7 percentage points. That is to increase from 5.5 percent on average during 2010-19 to an average rate of 6.2 percent during 2020-29. In this scenario, the increase would have resulted from an accelerating capital accumulation despite modest slowing of labor supply growth. However, factoring the potential negative impact of COVID-19 through its effects on investment growth, education outcomes prospects, and productivity growth, the potential growth would decline below the pre-pandemic scenario by 0.4 percentage points to 5.7 percent over the next decade (2020-29). This assumes no policy reforms would be implemented to boost investment and productivity growth post-pandemic.

Sustaining the government's infrastructure investment program will be crucial to support the economic recovery and increase growth potential. A key government priority is to boost the Philippines' growth potential by investing in human and physical capital. Before the COVID-19 outbreak, the government planned to steadily increase public infrastructure spending from 4.1 percent of GDP in 2016 to 7.3 percent of GDP by 2022. Despite the pandemic, the government remains committed to pursue the infrastructure investment agenda, with infrastructure spending representing nearly one-quarter of the proposed 2021 budget (Box 5). While the implementation of infrastructure projects has been delayed due to the pandemic and more recently consecutive episodes of strong typhoons, the government's commitment to ramping up infrastructure spending in the medium term will help accelerate the recovery through job creation. Furthermore, narrowing the country's infrastructure gap will help to boost productivity growth and expand growth potential in the long term.

To mitigate the impact of the pandemic and natural disasters on the poor and vulnerable, social protection programs can help to ensure that crises do not lead to long-term deterioration of human capital. Shocks related to the COVID-19 pandemic can have an impact on child malnutrition and stunting as well as student

38 World Bank (2020). "Impacts of COVID-19 on firms in the Philippines: Results from the Philippines COVID-19 Firm Survey conducted in July 2020."
39 World Bank (2020). "East Asia and Pacific Economic Update: From Containment to Recovery." Washington DC: The World Bank Group. October.
40 World Bank Philippines Digital Economy Report 2020 includes a list of policy recommendations.

learning, especially among poor households. If left unmitigated, these shocks may have a persistent impact on people's wellbeing and future economic opportunities. Similarly, natural disasters affect the poor and vulnerable disproportionally more as they are less resilient. Social programs, including cash transfers, can help improve food and sustenance conditions, and encourage continued participation in education. However, moving swiftly to provide transfers and other support to poor households will necessitate improvements in the government's delivery and implementation capacity. National and local government authorities need to coordinate their efforts to ensure the timely and efficient disaster response.

While there is urgency in addressing the current crisis, the government must remain focused on pursuing the medium-term structural reform agenda including the DRM agenda. Accelerating structural reforms that improve the business environment, foster competition, and strengthen resilience toward natural disasters, remains critical amid the COVID-19 pandemic. These reforms are especially important given that SMEs are being disproportionally affected by the current crisis and the increasing frequency of natural disasters. Addressing these long-standing challenges will support the economic recovery and boost productivity growth in the long term. In addition, the government needs to strengthen private sector development, which can be done by reducing regulatory restrictiveness in key markets. Reducing regulatory restrictiveness will require the authorities to, among other measures, address ownership caps on foreign investments through the passage of revisions to the Public Services Act, implementation of pro-competition reforms mandated in the National Competition Policy, minimize the scope of controlled prices, and streamline and automate administrative procedures as required by the Ease of Doing Business Act.

As one of the most disaster-prone countries in the world, the Philippines is vulnerable to the increasing impact of climate change. The 2018 World Risk Report ranks the Philippines third globally in terms of natural disaster risk. At least 60 percent of the country's land area and 74 percent of its population are vulnerable to natural hazards, such as typhoons, flooding, earthquakes, and volcanic eruptions. A higher intensity and frequency of catastrophes results in losses to both public and private assets, and it increases fiscal pressure by potentially raising the government debt-to-GDP ratio by up to 1 percentage point in the medium term.[41] Effectively addressing the increase in fiscal pressure requires an understanding of the efficiency, transparency, and inclusive use of public resources in mitigating and responding to disasters.

Disaster risk financing has become a compelling instrument for financial resilience as the COVID-19 shock is exacerbated by the country's proneness to disasters. Natural and manmade disasters can cause severe economic and fiscal shocks by generating unplanned expenditures that drain public finances and lead to budget volatility. They are contingent liabilities for the government which tend to shoulder a significant share of the cost for response and recovery. A proactive risk management approach with built-in resilience strategy will help address the risk and impact of disasters. Disaster risk financing is an important instrument to prop up financial resilience by making funding more predictable and effective for disaster-related measures, improving the financial position of national and subnational governments, and protecting the fiscal balance when disasters strike. The focus chapter of this PEU will discuss government's overall strategy on disaster risk management, progress made, remaining challenges, and policy recommendations (Table 6).

41 IMF Selected Issues: Philippines Vulnerability to Climate Change and Natural Disaster.

Box 5. Proposed 2021 National Government Infrastructure Budget

Public infrastructure development in the Philippines continues to be driven by the government's flagship *Build, Build, Build* program. The program seeks to accelerate productivity-enhancing investments logistics, agriculture, tourism development, and transport and road infrastructure to ensure long-term inclusive growth. Prior to the COVID-19 pandemic, the government ramped up its investments in infrastructure, which increased from 4.1 percent of GDP in 2016 to an expected 5.2 percent of GDP in 2020 (Table 5). The national government is expected to accelerate infrastructure investments even further in 2021, as the public infrastructure budget is set to increase by 12 percent, year-on-year, in nominal terms to Php1.1 trillion (5.4 percent of GDP) in 2021. However, the proposed infrastructure budget is lower than the projections of investment requirements prepared in 2019, as the government has had to adjust its expenditure program to pursue fiscal consolidation due to expected lower revenue collections amid the pandemic.

A large share of the infrastructure budget is allocated to investments in transportation, logistics, and flood control projects. Appropriations for the national government's (NG) and GOCC infrastructure outlays[42] and buildings and other structures[43] accounted for 77 percent of the total infrastructure budget in 2021). In particular, public investments in road networks, flood control, and railway systems account for 60 percent of the 2021 infrastructure budget (Figure 36). As a result, the Department of Public Works and Highways (DPWH) and the Department of Transportation (DOTr) received 65 percent of the total infrastructure budget between FY2019 and FY2021— despite their low budget execution.

From 2019 to 2021, 60 percent of the NG public infrastructure budget consists of centrally-managed items[44] (CMI) (CMI) or lump-sum appropriations, with nationwide and regional allocations representing 40 percent of the budget. There is a clear disparity in the

Table 5. Public Infrastructure Budget, FY2019-21

(IN PHP BILLION)

	FY2019 (Actual)	FY2020 (Program)	FY2021 (Proposed)
Total infrastructure budget (2021 National Expenditure Program)	785.6	989.3	1,107.3
% of GDP	4.0%	5.2%	5.4%
Total infrastructure budget (2019 National Expenditure Program) *	909.7	1,044.8	1,549.6
% of GDP	4.7%	5.5%	6.6%

Note: *Consistent with pre-pandemic macroeconomic assumptions and fiscal targets pre-pandemic. The infrastructure development target is to reach around Php1.8 trillion or 6.9 percent of GDP by 2022.

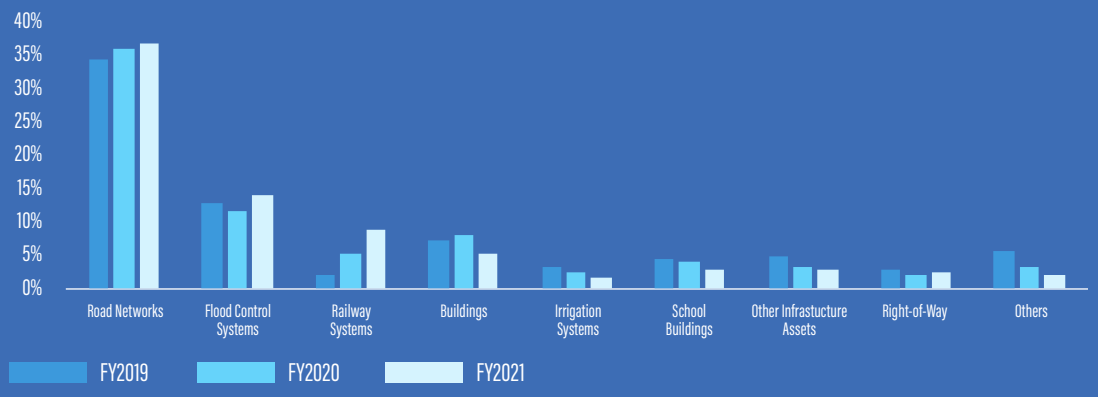
42 Includes water supply systems, sewer systems, seaport systems, road networks, right-of way, railway systems, power supply systems, other infrastructure assets, flood control systems, communication networks, airport systems, irrigation systems, housing and community, subsidy support to GOCC operations, and parks, plazas and monuments.

43 Includes school buildings, other structures, hostels and dormitories, hospitals and health centers, buildings, ground water monitoring stations, and markets.

44 Centrally-managed items are defined as items in the budget of agencies for which the operating units and the specific amounts allocated for each have not been identified in the General Appropriations Act (GAA). These are also referred to as lump-sum appropriations.

Figure 36. Infrastructure Outlays and Buildings and Other Structures, FY2019-21

INFRASTRUCTURE OUTLAYS AND BUILDINGS AND OTHER STRUCTURES, FY 2019-2021 (SHARE OF THE ANNUAL INFRASTRUCTURE BUDGET)



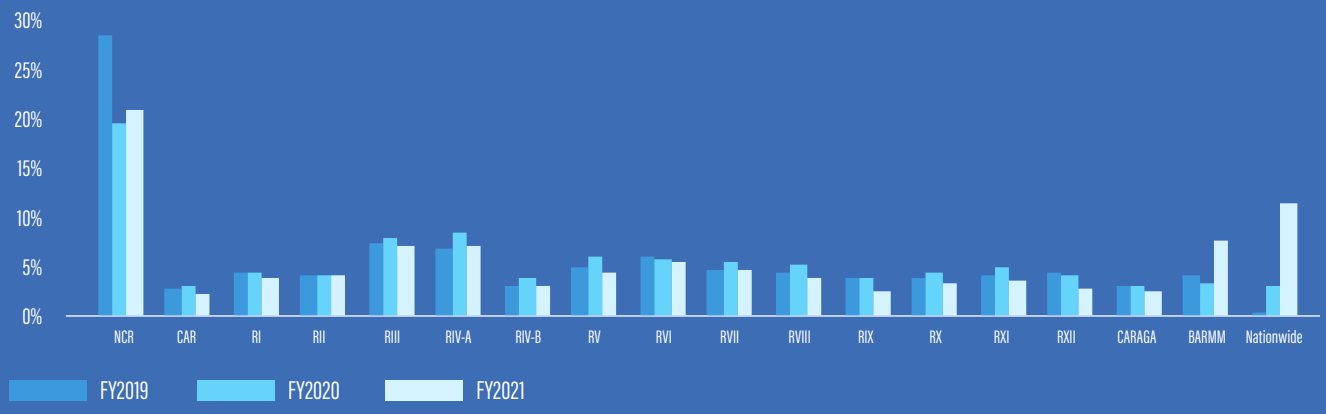
Note: Includes spending from the national government and government-owned and controlled corporations.
Source: DBM.

allocation of infrastructure outlays between the NCR and other regions, as the NCR receives a larger share of the budget for flood control systems and buildings, including NG subsidies to GOCCs, except subsidies for irrigation systems, which are regionally distributed. The NCR receives an average of 23 percent of all nationwide and regional budget allocations, much higher than 3 to 8 percent for the other regions (Figure 37). However, actual spending could vary, as CMIs related to road networks, flood control systems, and school and other buildings could subsequently be spent in the regions.

Regional allocations also include the budget for the Local Government Support Fund (LGSF), or financial assistance to local government units (except for Bangsamoro Autonomous Region in Muslim Mindanao, BARMM) intended for development and infrastructure projects, and the 20% IRA Development Fund. The increase in the budget allocation to BARMM is attributable to the Bangsamoro Government Annual Block Grant capital outlay allotment, the Special Development Fund[45], and existing internal revenue allotments for local government units within its jurisdiction.

Figure 37. There is a wide disparity in the allocation of the infrastructure budget across regions.

DISTRIBUTION OF NATIONWIDE AND REGIONAL ALLOCATIONS, FY2019-21



Note: Regions IX and CARAGA include the B/ARMM IRA 20% Development Fund, and nationwide includes NDRRMF and LGSF, or financial assistance to LGUs, in FY2021.
Source: DBM.

45 The special development fund earmarks Php5.0 billion annually for ten years for the rebuilding, rehabilitation, and development of conflict-affected communities beginning in FY2020

3

BUILDING A RESILIENT DISASTER RECOVERY

Photo: Ditsi Carolino

3.1 DISASTER RISK IN THE PHILIPPINES

The impact of COVID-19 is further exacerbating the country's risk from natural disasters. As of November 18, 2020, the Department of Health (DOH) reported over 410,000 confirmed cases of the disease, 7,861 related deaths, and 375,000 people who had recovered. The measures implemented to contain and address the pandemic have significantly impacted government overall fiscal balance, decreasing revenues and increasing expenditures. The containment measures are impacting the poor and near-poor disproportionately who have limited incomes and limited assets to buffer themselves from future events including natural disasters. As the government focuses on strengthening the capacity of the healthcare system and protecting vulnerable households, the Philippines continues to suffer from various disasters. Since May 2020, the country has experienced typhoons, floods, and earthquakes, and the pandemic has made it more difficult for the government to prepare for and effectively respond to these types of events.

Natural and manmade disasters can threaten a country's socioeconomic development and cause severe economic and fiscal shocks that often affect vulnerable households the most. Disaster events can destroy physical assets and livelihoods, adversely affect people's wellbeing, and lead to a loss in lives. Major disasters can also cause severe economic disruption and even economic contractions that threaten efforts to reduce poverty and build shared prosperity. Disasters are contingent liabilities for governments, as they tend to shoulder a significant share of the cost for response and recovery. Unexpected public spending can have severe fiscal consequences, as unplanned expenditures can drain public finances, which can lead to budget volatility and even threaten countries' fiscal position and debt sustainability, particularly in countries with limited financing options.

The Philippines is among the most disaster-prone countries in the world. At least 60 percent of its total land area and close to 74 percent of its population are exposed to multiple natural hazards, including typhoons, earthquakes, floods, storm surges, tsunamis, volcanic eruptions, and landslides.[46] In the past thirty years, 33,000 people have died and 120 million people have been adversely affected by disasters.[47] It is estimated that earthquakes and typhoons cause, on average, US$3.5 billion (over 1.0 percent of GDP) per year in direct losses to public and private assets in the Philippines.[48] Climate change is expected to increase the frequency and severity of hydrometeorological events in the country.[49] Recent estimates from climate modeling exercises show that climate change could increase emergency response costs from typhoons by over 50 percent for severe events.[50,51] Disaster-related risk is heavily concentrated in the Metro Manila Region due to population concentration.[52,53]

46 GFDRR (Global Facility for Disaster Reduction and Recovery), and World Bank. 2011. "Climate Risk and Adaptation Country Profile: Philippines," World Bank, Washington DC.

47 World Bank (2019). Country Partnership Framework for the Republic of the Philippines 2019-2023

48 In the next fifty years, the Philippines is estimated to have a 40 percent chance of experiencing losses from natural disasters that will exceed US$33 billion, and a 20 percent chance of losses that will exceed US$53 billion. Private losses are expected to account for 96 percent of annual total losses.

49 WBG. 2013. "Getting a Grip on Climate Change in the Philippines."

50 The expected cost incurred from events of various 'return periods,' such as a 1-in-100-year event, which is expected to occur, on average, once every 100 years, or with a 1 percent probability in a given year.

51 World Bank. 2019. "Impacts of Climate Change on Typhoon Risk in the Philippines."

52 World Bank, GFDRR, UK Aid, Philippines Catastrophe Risk Assessment and Modeling, January 2018.

53 With a 2 percent urbanization rate per year in 2010-19 (World Bank data), and an associated expansion of the asset base, the Philippines needs to prepare for disasters that can have an even greater adverse impact on the economy and wellbeing.

Photo credit: Ezra Acayan

The 2013 Super Typhoon Yolanda (Haiyan)—the strongest typhoon to ever make landfall in the world—was a tragic reminder of the devastating impact natural disasters can have in the Philippines. Over 6,000 people lost their lives and more than 16 million were affected, with 2.3 million people falling below the poverty line. Over 1.1 million houses were damaged or destroyed. The typhoon also had a devastating impact on public infrastructure, including roads, bridges, water and power utilities, hospitals and schools, government buildings, and agricultural and irrigation facilities. Damages were estimated at Php571.1 billion (US$12.9 billion), or 4.6 percent of GDP.[54] This event set in motion the momentum within Philippines to focus more on preparedness and financing. As of October 2020, out of a planned 135,772 houses for Western Visayas, 88,804 units have already been completed.[55] Towards the end of October to mid-November 2020, Luzon was hit by three successive destructive typhoons in a span of three weeks, Typhoons Quinta, Rolly, and Ulysses. The most recent, Typhoon Ulysses affected 3.5 million people and caused the worst flooding in Metro Manila and Cagayan Province to date. The combined cost of damage to infrastructure and agriculture of these three typhoons is estimated at Php30.76 billion.[56,57,58]

The Philippines is also exposed to multiple hazards. Besides Typhoon, the Greater Metro Manila Area Risk Assessment study[59] estimates that a magnitude 7.2 earthquake on the West Valley Fault (a probable maximum scenario called 'The Big One') would result in an estimated 48,000 fatalities and US$48 billion in economic losses, with a catastrophic impact on government continuity and service provision. The country was hit by a series of major disasters between October 2019 and January 2020, including three earthquakes, two typhoons, and the phreatic eruption of the Taal Volcano near Manila. The combined damage to infrastructure and agriculture from these events was estimated at US$245 million.

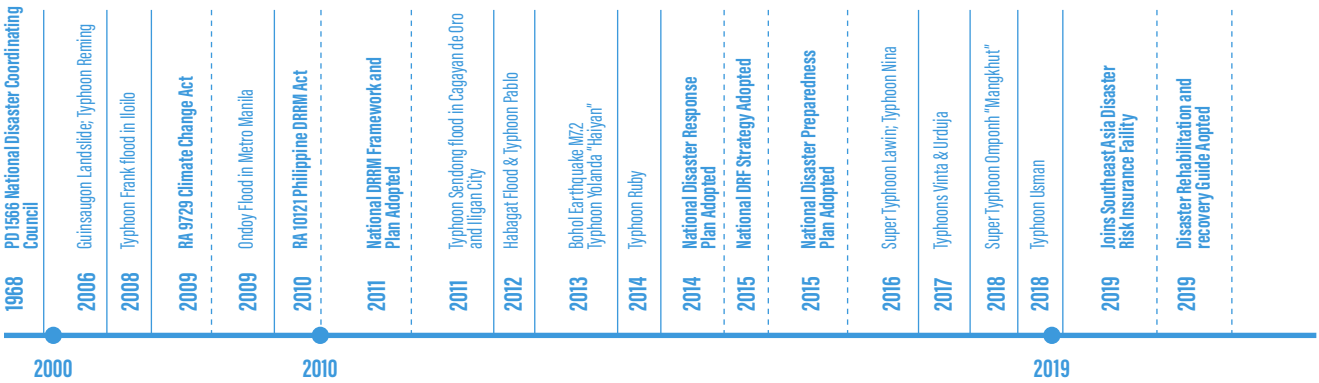
54 National Economic and Development Authority (NEDA). 2013. *Reconstruction Assistance on Yolanda (RAY): Build-Back-Better*
55 https://newsinfo.inquirer.net/1358086/govt-turns-over-2500-houses-to-yolanda-survivors
56 NDRRMC Situation Report No. 08, November 18, 2020
57 NDRRMC Situation Report No. 12, November 11, 2020
58 NDRRMC Situation Report No. 11, November 9, 2020
59 Philvolcs (Philippine Institute of Volcanology and Seismology). 2018. "The Greater Metro Manila Area Risk Assessment Program."

3.2 THE STATE OF DISASTER RISK MANAGEMENT

To address the growing risk and impact of disasters, the government is implementing policy reforms to transition from reactive to proactive risk management. Key milestones in the evolution of the Philippines' legal and institutional framework for managing disaster risk include the passage into law of the 2010 Philippines DRRM Act and the subsequent adoption of the National DRRM Framework and Plan. These policies served as the foundation for the development and approval of the country's National Disaster Response Plan in 2014,[60] a per-hazard response guide for all government agencies; the National Disaster Preparedness Plan in 2015,[61] an overall preparedness protocol for local governments; the National Disaster Risk Finance Strategy in 2015, a financial resilience strategy for the national, local, and individual level; and the Disaster Rehabilitation and Recovery Planning Guide in 2019, a guide to prepare national and local governments for rehabilitation and recovery interventions (Figure 38).

Figure 38. Overview of the Philippine Legal and Institutional DRM Framework

Key legal reforms and major disasters



Source: World Bank staff

60 The DSWD developed the response plans for hydro-meteorological hazards, terrorism-related incidents, and earthquakes and tsunamis.

61 Operation *LISTO* was developed by the DILG and is a major component of the National Disaster Preparedness Plan that provides a comprehensive preparations checklist for local governments, communities, and households.

This policy shift is taking place across financial, physical, and social resilience. These three mutually reinforcing and closely interlinked policy areas are critical to building and improving a country's financial, physical, and social resilience.[62] This is reflecting international good practice. Progress by the government in each policy area is discussed in turn in this section, followed by a discussion on where implementation of these policies needs to be strengthened.

- *Financial resilience protects the fiscal balance when disasters strike through a suite of policies and financial instruments to secure access to financing before a shock.* This approach ensures timely and sufficient access to funds and that funds are linked to pre-arranged disbursement channels to support the implementation of disaster-related measures. Financial resilience makes funding more predictable and effective, improving the financial position of national and subnational governments, households, and businesses.

- *Physical resilience avoids or reduces the underlying risk of a natural hazard becoming a disaster and improves preparedness for shocks that cannot be avoided.* The United Nations' Sendai Framework for Disaster Risk Reduction[63] calls on countries to invest in risk reduction and preparedness through structural and nonstructural measures. Structural measures, such as physical risk-reduction measures and the adoption of enhanced-engineering technologies, entail building resilient infrastructure to reduce damages and subsequent reconstruction costs, reducing disaster-related contingent liabilities. Moreover, non-structural measures, such as early-warning mechanisms and business continuity planning, can reduce the potential impact of a shock by improving a country's preparedness and resilience to disasters.

- *Social resilience helps households, especially the poor and vulnerable, mitigate the adverse effects of disasters.* In times of major disaster, affected people need access to food and non-food items, medicines, healthcare, supplies to repair damaged shelters, and general livelihood assistance. Programs aimed at building social resilience involve creating a capacity for the authorities to quickly respond to the immediate needs of the affected population and provide support for early recovery and rehabilitation in the aftermath of disasters. Cash assistance is increasingly being used to complement in-kind assistance during emergencies and can empower households to address their own needs by using available local resources.

Financial Resilience

A key milestone in the Philippines' efforts to increase financial resilience was the adoption of the National Disaster Risk Financing and Insurance (DRFI) strategy in 2015. The strategy aims to: (i) maintain the sound fiscal health of the national government; (ii) develop sustainable financing mechanisms for LGUs; and (iii) reduce the impact of disasters on poor and vulnerable households while also shielding the near-poor from falling back into poverty.

To strengthen the fiscal resilience of the national government, the Department of Finance (DOF) and the BTr are gradually building out the menu of risk financing instruments. This follows a risk-layering approach to minimize the cost and optimize the timing of the post-disaster response (Figure 39). This includes: (i) annual budget allocations to the NDRRMF, including agencies' QRFs; (ii) contingent financing from development partners as pre-arranged loans that can be accessed in times of financial crisis;[64] (iii) a catastrophe-linked bond (Cat Bond), which is a financial instrument that transfers catastrophe risk to international capital markets and provides quick funding in case of pre-determined severe

62 http://documents1.worldbank.org/curated/en/239311559902020973/pdf/Boosting-Financial-Resilience-to-Disaster-Shocks-Good-Practices-and-New-Frontiers-World-Bank-Technical-Contribution-to-the-2019-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting.pdf.

63 The Sendai Framework for Disaster Risk Reduction 2015-2030 was adopted at the Third United Nations World Conference on Disaster Risk Reduction by member states, including the Philippines, in Sendai, Japan, in March 2015. https://www.undrr.org/implementing-sf.

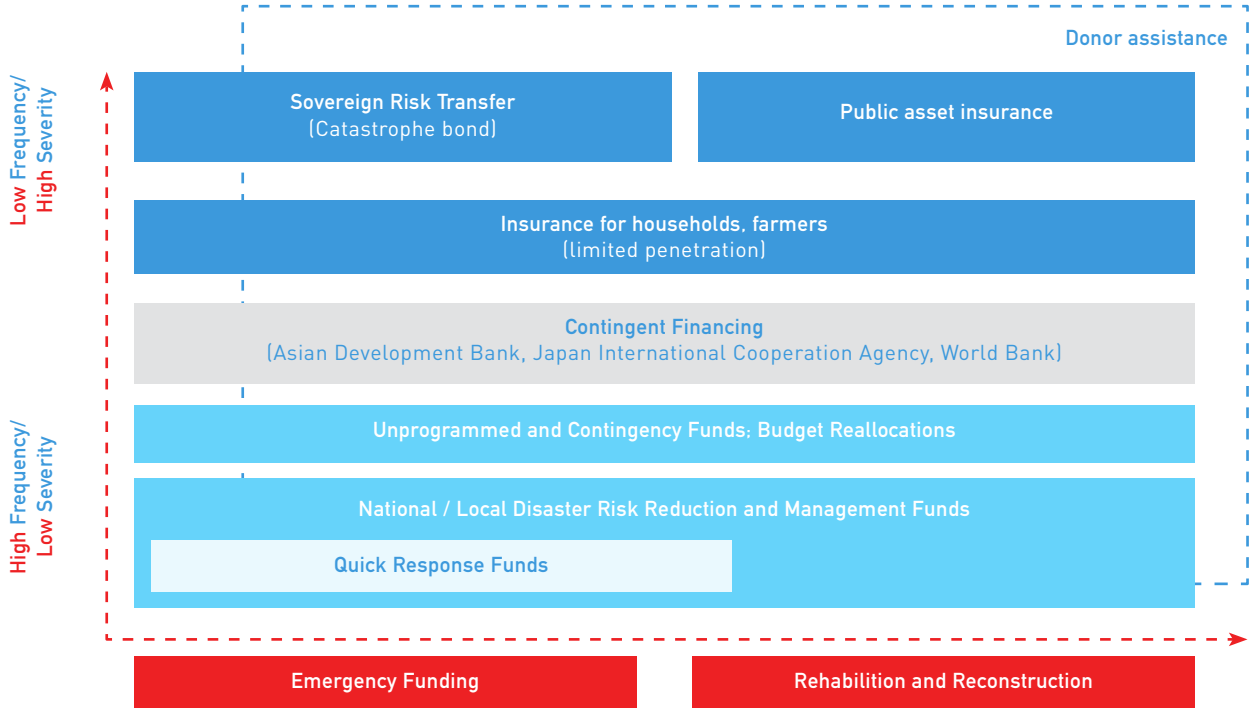
64 The government has mobilized close to US$2 billion in contingent financing from development partners (World Bank Cat DDO in 2011 and 2015; JICA SECURE in 2014; and Asian Development Bank in 2020).

disaster events occurring;[65] and (iv) a new National Indemnity Insurance Program (NIIP), which is under preparation, to improve insurance protection for strategic high-risk national government assets.

The government has embarked on an ambitious reform program to strengthen the financial risk management of public assets. The program aims to move away from ad-hoc resource mobilization for reconstruction toward pre-arranging the required funding for the rehabilitation of assets and restoration of services through the NIIP. To implement the program, the government adopted the first Philippine Government Asset Management Policy (PGAMP)[66] in September 2020 and established the first comprehensive National Asset Registry System (NARS), which has already brought together information on over 400,000 assets.[67] These efforts will not only improve financial risk management but also enhance service delivery and risk reduction for sustainable asset management in the long term.

To improve the financial resilience of LGUs, the government is investing in financial mechanisms and improved planning. The LDRRMF, established by the 2010 Philippines DRM Act, is the main source of disaster financing at the local government level. LGUs are required to set aside no less than 5 percent of their

Figure 39. The Philippines' Risk-Layering Strategy



Source: World Bank staff

65 In 2019, the Philippines worked with the World Bank to issue the first catastrophe-linked bonds (Cat Bonds) sponsored by a government in an Asian country, providing US$225 million to protect against earthquakes and typhoons. https://www.worldbank.org/en/news/feature/2020/04/09/the-philippines-transferring-the-cost-of-severe-natural-disasters-to-capital-markets and http://pubdocs.worldbank.org/en/752771575392782540/case-study-Philippines-CAT-bond-final-12-3-2019.pdf.

66 https://www.dbm.gov.ph/index.php/265-latest-issuances/joint-memorandum-circular/joint-memorandum-circular-2020/1727-joint-memorandum-circular-no-2020-001-dof-dbm-neda

67 https://www.treasury.gov.ph/?page_id=11992

estimated revenues from regular sources in the LDRRMF, and 30 percent of the LDRRMF is to be allocated as QRFs, or standby funds, for relief and recovery programs. There were a total of 43,594 LGUs and LDRRMFs (from the provincial down to the barangay level) in 2018. To complement the LDRRMF, the government, with support from the World Bank, set up a parametric catastrophe risk insurance program in 2017 and 2018 for national government agencies and twenty-five individual provinces in the Philippines. The insurance program provided financial protection against losses from major typhoon and earthquake events, with a total coverage of US$600 million for the two years.[68] A major component of the Philippine Disaster Rehabilitation and Recovery Planning Guide concerns the need for LGUs to prepare their local disaster risk financing strategy prior to a natural disaster. Integrated into the government's Local Disaster Rehabilitation and Recovery Plans, the strategy will pre-identify sources of post-disaster funding and link them to preparedness and recovery plans.

The government has significantly increased public subsidies to agricultural insurance to improve the resilience of smallholder farmers and the agricultural sector. This includes directly accessing private financial markets, for example through the Cat Bond placed in 2018, which transferred risk from the government balance sheet to international capital markets. The national indemnity insurance program for public assets under preparation will also transfer risk to international insurance markets. In addition, in the preparation of these and similar programs the government leverages private sector expertise on insurance placement, reinsurance, and financial planning. For example, the first national probabilistic earthquake and tropical cyclone risk model for the Philippines was prepared, with World Bank support, by an international risk modelling firm. This informed the design of insurance triggers and the structuring of the Cat Bond.

To improve the resilience of homeowners and small businesses to natural disasters, the government is developing a sustainable domestic insurance market. A strong domestic insurance market helps protect homeowners and small businesses by providing support if a disaster damages their home or business. This is in line with the third objective of the National DRFI strategy. It also helps to reduce the government's contingent liabilities by reducing the need for public support after disasters. The use of catastrophe risk insurance in the country however remains quite limited, facing both supply and demand challenges. The Insurance Commission is working with the insurance industry to establish the Philippines Catastrophe Insurance Facility (PCIF) by the first half of 2021.[69] This will support the growth of a sustainable domestic catastrophe risk insurance market by pooling catastrophe risk into an industry-wide aggregate portfolio to make reinsurance more efficient and ensure adequate premium rates.

The government has significantly increased public subsidies to agricultural insurance to improve the resilience of smallholder farmers and the agricultural sector. The agriculture sector is critical to the government's efforts to ensure both food-security and poverty reduction.[70] Small semi-commercial and subsistence farmers with less than 3 hectares of land account for 98 percent of the country's 5.6 million farmers. Transforming the sector will require measures to protect farmers against disasters and climate-induced income shocks. Risk financing and insurance for the agricultural sector should provide farmers with certainty that they will be reimbursed following crop losses from disasters, allowing investment in inputs and equipment and protecting their income source. On behalf of the government, the Philippines Crop Insurance Corporation (PCIC) administrates several special insurance programs that are targeted at subsistence and smallholder farmers to provide support in case of crop loss from a disaster. Due to very high public premium subsidies available

68 https://www.financialprotectionforum.org/publication/philippines-parametric-catastrophe-risk-insurance-program%C2%A0frequently-asked-questions; World Bank (2020) *Philippines Parametric Insurance Program - Lessons Learned Evaluation (forthcoming)*; http://documents1.worldbank.org/curated/en/799241548872273775/Insuring-the-Philippines-against-Natural-Disasters-Case-Study.pdf

69 https://www.nat-re.com/2020/02/24/nat-re-ic-and-pira-sign-mou-on-philippine-catastrophe-insurance-facility/

70 World Bank. 2020. "Transforming Philippine Agriculture: During COVID-19 and Beyond." https://openknowledge.worldbank.org/handle/10986/34012.

only to PCIC (90% average premium subsidy rate), it faces practically no viable competition. Very significant recent scale up of premium subsidy allowed a massive increase in policies and penetration, reaching 33 percent of all farming households. But significant challenges remain with current products offered by PCIC and consumer protection.

Physical Resilience

The 2010 Philippine Disaster Risk Reduction and Management Law was a landmark legislation that mandated a shift from disaster response to disaster risk reduction and preparedness. The law sets out multi-sectoral coordination and active participation at the local level for holistic risk management, including: (i) DRRM; (ii) good governance; (iii) risk assessment and early warning systems; (iv) knowledge and awareness raising; (v) risk-transfer instruments; and (iv) preparedness for effective response and recovery. Building on this law, the National DRRM Framework[71] and Plan[72] (2011-2028) articulated an all-hazard, multi-sectoral, inter-agency approach to DRM. Both documents span across the DRM cycle. The National Disaster Risk Reduction and Management Council (NDRRMC) has adopted the Enhanced National DRRM Framework and Plan (2020-2030)[73] to include new types of risks, global best practices in DRM, and climate change adaptation principles and lessons learned from recent natural and human-induced disasters. The adoption of these legal frameworks led to a series of DRM initiatives at the national, local, and community level.

Disaster prevention and mitigation in the Philippines has evolved from just forecasting to the development of early warning systems (EWS) that utilize technology to enhance risk identification. In 2015, the Department of Science and Technology (DOST) started providing weather-related models, multi-hazard maps, and exposure data to key agencies and LGUs. It invested in advanced technology and EWS infrastructure. To mitigate flood risks, it also developed high resolution hazard maps and installed automated rain gauges and water level measuring stations for the country's eighteen major river basins. In 2019, DOST launched geospatial tools for decision-making, development planning, and investment programming. Together with forecasting and mapping agencies, DOST also developed *GeoRiskPH*,[74] an integrated data system with an analytical interface to share multi-hazard, exposure, and risk information to assist national and local authorities accurately assess risk.

The national government has mainstreamed disaster risk reduction in key sectors, such as agriculture, housing, and public infrastructure, and for vulnerable LGUs. This means disaster risk is looked at as a core consideration in planning. For example, the government has developed tools to enhance the socioeconomic resilience of all provinces through better planning and investment programming. This includes the prioritization of more resilient infrastructure investments and adaptive social protection measures to assist vulnerable LGUs. For key sectors such as agriculture, disaster risk reduction measures are integrated into the provinces' investment plans for commodities. For housing, a policy framework was created for post-disaster shelter recovery that adopted resilient standards and designs for temporary and permanent shelters, and a multi-hazard vulnerability assessment tool for cultural heritage assets was also developed. More importantly, the DPWH has improved the country's outdated national building regulations to include disaster risk reduction and climate resilience measures, designs, and standards for public infrastructure.

To address the threat of a potentially catastrophic earthquake, the government has operationalized an earthquake resiliency program for the Greater Metro Manila Area. Through the issuance of a presidential

71 Government of the Philippines. 2011. The National Disaster Risk Reduction and Management Framework, http://www.ndrrmc.gov.ph/attachments/article/227/NDRRMFramework.pdf.

72 Government of the Philippines. National Disaster Risk Reduction and Management Plan 2011-2028, http://www.ndrrmc.gov.ph/attachments/article/41/NDRRM_Plan_2011-2028.pdf.

73 NDRRMC Full Council Meeting approved the new and enhanced National DRRM Framework and Plan (2020-2030) on October 30, 2020.

74 The integrated database system of DOST's GeoRiskPH was developed under the Geospatial Information Management and Analysis Project for Hazards and Risk Assessment in the Philippines (GeoRiskPhilippines).

executive order and the DPWH's department orders,[75] seismic resilience interventions for public infrastructure have been fast-tracked to make schools, hospitals, and other public buildings safer to earthquakes, floods, and typhoons. With World Bank financing, the government is preparing a US$300 million program[76] to invest in seismic risk reduction and resilience in Metro Manila to enhance the safety and seismic resilience of selected public buildings including schools and hospitals. The project will also strengthen the capacity of DPWH for disaster preparedness and emergency response.

To address the recurring problem of urban flooding, the government prepared the Metro Manila Flood Management Master Plan in 2012. Frequent floods in Metro Manila damage houses, properties, and businesses and prevent people from going to work or school during flood events. The poor are especially affected because they often live in high-risk locations, have lower quality houses, and are less able to prepare for floods. To reduce flooding in urban areas, the government is implementing a US$500 million Metro Manila flood project[77], with financing from the World Bank and Asian Infrastructure Investment Bank (AIIB), to construct new pumping stations and improve drainage systems and solid waste management practices in select areas in Metro Manila. Additional initiatives to address urban flooding are under preparation, including an investment project under the proposed World Bank-supported Pasig-Marikina River Basin Flood Management Project.

The government has prioritized disaster preparedness and forward planning after experiencing several large-scale typhoons, earthquakes, and human-induced disasters. In 2019, the NDRRMC adopted a Disaster Rehabilitation and Recovery Planning Guide for timely and effective disaster recovery and reconstruction. The purpose of the guide is to assist the authorities in post-disaster management and institutionalize the government's recovery policies. This is the first country-specific guide for post-disaster and post-conflict reconstruction to be used at the national, regional, and local government level, and it complements the DSWD's National Disaster Response Plan and the Department of Interior and Local Government's (DILG) National Disaster Preparedness Plan adopted by the NDRRMC. Additionally, the DILG developed an LGU preparedness manual for the management of emerging infectious diseases following the COVID-19 outbreak.[78]

The private sector and civil society are key partners in the whole-of-society approach to resilience. They have complemented government efforts by supporting disaster response, recovery, and risk reduction projects, including efforts related to: (i) improving the utility sector; (ii) introducing business continuity planning; (iii) strengthening resilience in infrastructure; (iv) bolstering the economy by supporting micro, small, and medium enterprises and industries after disasters; and (iv) generating new jobs. Box 6 outlines efforts by the private sector in DRM.

Social Resilience

The government has developed adaptive social protection programs (ASP) that are among the most advanced in Asia. The DSWD established an Emergency Cash Transfer (ECT) program in 2019, building on the 4Ps, a nationwide conditional cash-transfer program aimed at alleviating poverty. The ECT program provides post-disaster support to vulnerable households. It complements the provision of food and in-kind assistance during emergencies and empowers the affected population to decide on their own in addressing their needs using available local resources. Anchored on the DSWD's existing social registry and delivery mechanisms, the ECT can quickly provide additional assistance to affected 4Ps beneficiary households, and at the same time expand support to non-4Ps vulnerable families who may become poor due to a disaster.

75 EO No. 52 and the Two-pronged Strategy Toward an Earthquake-Resilient GMMA, the DPWH issued Department Order No. 75 series of 2019 and Special Order No. 83 s.2019.

76 Philippines Seismic Risk Reduction and Resilience Project.

77 Metro Manila Flood Management Project.

78 This supplements the *Operation LISTO*, a major component of the National Disaster Preparedness Plan that provides a comprehensive natural disaster preparations checklist for local governments, communities, and households.

Box 6. Strengthening Private Sector Engagement in DRM

In 2009, following tropical storm Ketsana (Ondoy), the Office of the President issued Executive Order No. 838 to create the Special National Public Reconstruction Commission. The commission was mandated to spearhead effective reconstruction measures that address the needs of disaster-stricken communities. It also engaged the private sector to channel more support for its reconstruction programs, resulting in the country's largest private corporations and non-government organizations (NGOs) establishing the Philippine Disaster Recovery Foundation (PDRF).

In 2013, the PDRF was reorganized as the umbrella organization of the private sector for disaster preparedness, relief, and recovery, following the civil unrest in Zamboanga, the 7.2 magnitude earthquake in Bohol and Cebu, and Typhoon Yolanda. Post-disaster recovery programs were created in five key sectors: (a) shelter, (b) livelihood, (c) education, (d) environment, and (e) water, infrastructure, sanitation, and health. In 2015, its name was formally changed to Philippine Disaster Resilience Foundation, which captures the entire disaster risk reduction and management framework. The PDRF established an emergency operations center to complement the NDRRMC's operation center. Other private sector and civil society organizations complement the government's initiatives at the national and local level.

There are currently several umbrella organizations for the private sector organized based on their sector-specific core business competency and geographic location.[79] This approach facilitates faster and more effective coordination between and among government partners, the private sector, and local communities before, during, and after disasters.

The program builds on the experience of similar support provided through ad-hoc measures during previous disasters. For example, after Typhoon Yolanda, the DSWD was able to provide immediate cash assistance (Php550.5 million, approximately US$12.5 million) to affected 4Ps families using 4Ps' system and structure of beneficiary identification and disbursement of assistance. The same modality is being used now in the government's COVID-19 response through SAP.

The DSWD is also institutionalizing the National Community Driven Development Program – Disaster Response Operation Modality (NCDDP-DROM) for disaster-affected communities. The NCDDP engages communities to work with their local governments (barangay and municipal) to choose, design, and implement development projects. It directly provides funds to community-identified service delivery and development initiatives such as small infrastructure and livelihood projects. The DROM is a built-in component of the NCDDP that already covers procedures specific to disaster response, early recovery, and rehabilitation. It was designed to simplify procedures in case of disaster, triggered by the government's declaration of a state of calamity. On October 14, 2020, the DSWD issued its updated implementation guidelines to include public health emergencies. Currently, there is a pending bill in the House of Representatives to institutionalize the NCDDP and incorporate the DROM, which would be used in times of disaster.

79 For example, the Philippine Business for Social Progress has a strong presence in Visayas and Mindanao; the League of Corporate Foundation consolidates DRM-related corporate social responsibility interventions; the National Resilience Council brings key government agencies and companies together for DRM programs; and ARISE Philippines is a member of the Private Sector Alliance for Disaster Resilient Societies, which is affiliated with the United Nations Office for Disaster Risk Reduction.

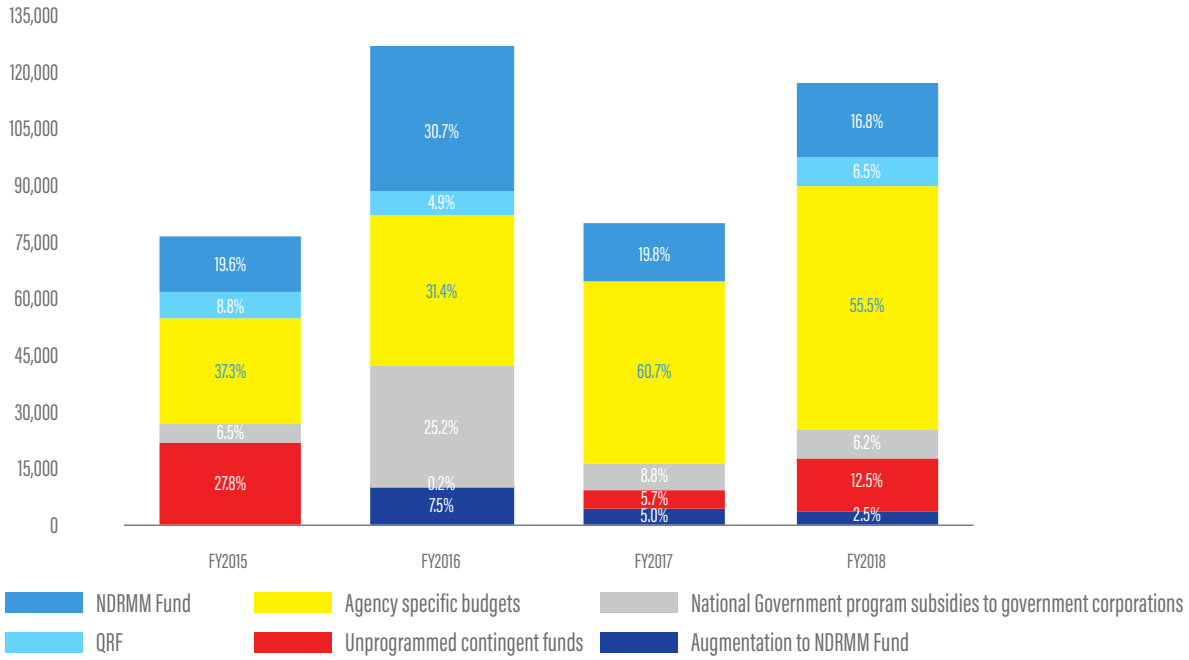
80 Bowen, T. 2014. Social Protection and Disaster Risk Management in the Philippines (The Case of Typhoon Haiyan), World Bank

3.3 PUBLIC SPENDING AFTER DISASTERS

Between 2015 and 2018, post-disaster public expenditure remained flat while overall government expenditure steadily increased.[81] In 2020, the World Bank completed its first Public Expenditure Review (PER) on Disaster Response and Rehabilitation in the Philippines. According to the findings of the PER, national government spending increased from 16.0 percent of GDP in 2015 to 18.7 percent in 2018, with the highest increase in education (from 2.7 percent of GDP in 2015 to 3.2 percent in 2018),[82] health (from 0.7 percent of GDP in 2015 to 0.9 percent of GDP in 2018), and physical infrastructure (from 3.1 percent of GDP in 2015 to 5.3 percent in 2018), which is consistent with the government's focus on ramping up public investment in physical and human capital. Yet, while the country's exposure to disasters is increasing, the national government's post-disaster spending has been relatively stable at around 0.6 percent of GDP, or 4.3 percent of the total national budget (Figure 40). Moreover, one-third of post-disaster spending comes from pre-arranged funding sources, although access to and execution of these funds is often delayed. The rest was financed through reallocation of other budget lines, causing inefficiencies and possibly delayed response.

Figure 40. Post-disaster Related Appropriations by Funding Source, FY2015-18

(PHP MILLION)



Source: Authors' calculations based on the GAA FY2015-FY2018.
Note: In FY2016, the NDRRM Fund received allocations for Yolanda Rehabilitation and Reconstruction Program (RRP) to cover remaining unfunded programs and incomplete activities.

81 Public Expenditure Review forthcoming.

82 Health, education, and infrastructure spending represented 4.5 percent, 15.4 percent, and 25.5 percent, respectively, of the total budget in 2018.

Photo credit: Ezra Acayan

Post-disaster spending is financed through several budget sources. Pre-arranged budget mechanisms include: (i) national government agencies' QRFs for immediate response activities, averaging 0.03 percent of GDP in 2015-18; and (ii) the NDRRM Fund, which is a separate budget line for risk mitigation, response, and reconstruction efforts, averaging 0.17 percent of GDP over the same period. Government agencies can also reallocate budget for response and recovery. Data on total reallocation are not recorded and generally not available. When agencies' budgets or pre-arranged funding are exhausted, the government can use unprogrammed and general contingency funds. After disasters, government agencies can request budget allocations or subsidies or use savings. For instance, Php16.4 billion in augmentation to the NDRRM Fund in FY2016-18 came from savings by the DPWH and was used by other agencies. Subsidies to government-owned and controlled corporations for disaster-related activities amounted to Php51 billion over this four-year period.

Most costs related to disaster response activities are covered by the national government. Case studies reveal that the national government contributed between 66 and 100 percent of total post-disaster expenditures in 2015-18, with the rest financed by LGUs.[83] In the same period, 37 percent of NDRRM Fund releases went to the DPWH for public infrastructure repairs and reconstruction, while 25 percent went to the DSWD to augment its QRF and provide relief assistance. This was followed by spending on agriculture and irrigation activities (11 percent) and housing and shelter projects (9 percent). In the reviewed period, no NDRRM Fund expenditures were approved for LGUs, and only negligible amounts were approved for preparedness and risk reduction activities, even though both are permissible. While the *Bayanihan* I and II laws have increased the ceiling in the use of the QRF to more than 30 percent for activities related to COVID-19 response, this flexibility has depleted the LGUs' overall LDRRM Fund. This has caused a shortfall for LGUs to respond to other disasters as in the recent cases of Typhoons Quinta and Rolly.

83 This may not account for all spending by LGUs, as this is often underreported.

3.4 CHALLENGES IN BUILDING DISASTER RESILIENCE

Despite progress in building financial, physical, and social resilience, the Philippines still faces challenges in efficiently managing the growing economic, social, and fiscal impact of disasters. The three destructive typhoons that hit Luzon recently, highlighted the coordination challenges that national and local governments continue to experience for the timely delivery of response and recovery interventions. This is on top of the ongoing coordination concerns encountered by the inter-agency task force for COVID-19. To ensure the efficient management of disaster risks, the authorities need to address key institutional and public financial management issues.

Institutional Challenges

The management and implementation of DRM policies and programs is fragmented. The NDRRMC is composed of forty-two members from different implementing agencies that develop policies and coordinate the country's overall DRM agenda. The NDRRMC is chaired by the secretary of national defense and co-chaired by the secretaries of: (i) DILG for disaster preparedness; (ii) DOST for prevention and mitigation; (iii) DSWD for disaster response; and (iv) National Economic and Development Authority (NEDA) for rehabilitation and recovery. The Office of Civil Defense (OCD) acts as the Secretariat of the NDRRMC. The NDRRMC endorses and recommends to the Office of the President key policies and access to the National DRRM Fund for the approval of the president. However, the implementation of DRM programs and projects is still the responsibility of various implementing agencies and subject to their respective mandates. As a result, response, risk reduction, and recovery projects often lack integration and cohesiveness. Several major disasters have shown that the current structure lacks the necessary authority, resources, and staff capacity to efficiently mitigate the effects of adverse events and address rapidly evolving DRM challenges. The COVID-19 inter-agency and national task forces are experiencing similar challenges.

The institutions involved in DRM have limited coordination protocols, guidelines, and mechanisms to address the increasing magnitude and frequency of disasters. Disaster response and recovery efforts are made more challenging by overlapping functions and responsibilities, duplication of interventions, and incoherent policy application, resulting in delays in reconstruction efforts. For large-scale disasters, the government usually designates task forces and special commissions to manage recovery and reconstruction efforts. These ad-hoc measures often result in confusion and delays among the institutions involved in response and recovery activities, and this was the case after Typhoon Yolanda and the Marawi Siege and has been the case during the current pandemic. With the series of destructive typhoons that recently struck Luzon, the Government through Executive has established the Build Back Better Task Force to strengthen rehabilitation and recovery efforts in areas affected by typhoons.

There are also coordination challenges between and among national and sub-national government authorities during the disaster response and recovery phases. The lack of communication between and among national government agencies and LGUs and no clear delineation of roles and responsibilities often result in delays in response interventions, overlapping interventions, and inconsistent recovery policies. Some agencies are too focused on implementing their own mandates that they forget to consult LGUs and affected

communities. This results in unresponsive interventions, conflicting issuances and orders, and duplication of assistance in some areas. This is common during disasters that involve several provinces, cities, and municipalities, such as Typhoon Yolanda and the current COVID-19 pandemic.

The recent establishment of the Bangsamoro Autonomous Region in Muslim Mindanao (BARMM) highlights challenges related to devolution, autonomy, and the institutional capacity of subnational governments. To manage disasters and crises, the regional government created the BARMM Rapid Emergency Action on Disaster Incidence (BARMM-READI). Since LGUs under BARMM are vulnerable to both natural and human-induced disasters, the NDRRMC and other national government agencies need to coordinate with BARMM and help enhance its capacity to respond to and recover from disasters. For large-scale disasters, where the national government leads response and recovery efforts, the NDRRMC needs to establish a clear coordination mechanism to ensure timely assistance while upholding the principles of autonomy.

Public procurement during emergencies has been challenging due to a lack of basic guidelines on how to apply emergency procurement procedures. Efficient and fast-tracked procurement is critical for enabling a rapid disaster response. The Philippine Procurement Act, along with its implementing rules and regulations, provides a general framework for negotiated procurement or emergency procurement in times of crisis. However, national and local government agencies have been cautious in applying this mode of procurement in the absence of specific guidelines for fear of sanctions and disallowance by the Commission on Audit (COA). On March 2020, in response to the pandemic, the Government Procurement Policy Board (GPPB) issued guidelines to simplify the government procurement process through the use of Negotiated Procurement during a state of calamity. A similar issuance is necessary for disaster-related procurement projects.

The national government usually leads the implementation of post-disaster activities, but insufficient resources limit their effectiveness. Some agencies lack sufficient capacity to implement their mandates following a disaster. For instance, national government agencies were tasked with implementing most of the recovery projects following Typhoon Yolanda and the Marawi Siege, but they had no additional staff and limited funding. Their disaster-related activities were on top of their regular mandates and deliverables, which caused implementation delays. Similar challenges are facing agencies in charge of implementation COVID-19-related programs.

Incomplete data on assets and disaster damages hinder efficient decision-making related to both financial and physical risk management. Despite the adoption of the PGAMP and the establishment of NARS, the government lacks access to complete data on all assets owned by national government agencies. Incomplete information on the location, condition, maintenance, and valuation of assets makes it harder for the authorities to effectively manage public assets to ensure efficient service delivery, create risk management plans, and perform adequate maintenance. Accurate information is also critical for financial planning, as it is important to assess contingent liabilities, make project-appropriate allocations to disaster funds, and purchase cost-efficient insurance. In times of crisis, insufficient data make it difficult to carry out rapid damage assessments and guide response and reconstruction efforts.

Public Financial Management Challenges

Contingent liabilities related to disasters, climate risks, and other shocks are currently not fully integrated in the management of fiscal risk in the Philippines. Disasters translate into contingent liabilities for the government – this means cost that may materialize in the future depending on a specific event occurring. Most of the costs related to managing national disasters are covered by the national government. The BTr, the DOF, and the DBM all play key roles in financial planning for disasters. Yet, disaster-related public spending is not integrated into comprehensive fiscal risk management. While the Development Budget Coordination Committee (DBCC) prepares an annual report on fiscal risk, the report only includes qualitative descriptions of disasters or climate risks. To inform fiscal plans, fiscal risk reports

Photo credit: Ezra Acayan

need to also quantify contingent liabilities. Disasters, climate risks, and other shocks (e.g., pandemics) could, therefore, be more systematically integrated into the government's fiscal risk planning, quantifying contingent liabilities and ensuring sufficient resources to cover disaster-related costs.

Budget allocations for pre-arranged funding mechanisms are not evidence-based and often insufficient. Budget allocations to both QRFs and the NDRRM Fund are not driven by expected needs or actual past spending. Instead, they are primarily based on the previous year's allocation or already known reconstruction costs. As a result, QRF allocations are often insufficient, relying on replenishments and delaying immediate response activities. In addition, due to its nature as a budget line, the NDRRM Fund cannot efficiently leverage its budget allocation through financial instruments to provide funding for catastrophic events through, for example, insurance or other risk-transfer mechanisms.

Complex approval processes often delay the approval and disbursement of funding, even from pre-arranged mechanisms, leading to delays in disaster response. Most funding sources require specific requests and approvals by different agencies and levels of government, delaying the release of funding and, subsequently, response and recovery. This is especially a concern for pre-arranged funds, where a streamlined approval process is critical to achieve the stated objectives. For instance, requests for funding from the NDRRM Fund require complex documentation and an evaluation by several agencies before being approved by the Office of the President. This process can be lengthy, with delays of up to one year or more (against the prescribed timeline for national government agencies of fifteen to thirty days). To cope with delays, implementing agencies have to delay projects or source funds internally and then repurpose support from the NDRRM Fund once released.

Incomplete financial data make it difficult for the government to assess the efficiency and adequacy of

public spending by comparing public expenditure with the socioeconomic impact of disasters. Estimates of disaster damages and losses are incomplete, and data on the use of different funding sources are fragmented. For example, reports from government agencies do not include detailed information on disaster-related expenditures, and the COA's annual consolidated reports on the use of disaster-related funds only cover the current year, while funds are often used across multiple years. This is made more complex by multi-year budget appropriations. There is a significant challenge with transparency on the use of the LDRRMFs, which are not strictly monitored. For example, a considerable amount of disaster-related funds at the local level seems to have been used for non-disaster-related activities, and utilization is low, although some spending may go unreported since no comprehensive information exists.

Local governments face constraints in the allocation, management, utilization, and transparency of disaster response funding. The national government finances the majority of disaster response activities, and coordination with LGUs is often inefficient. At the local level, there are currently more than 43,000 separate LDRRMFs, with total allocation equivalent to over 1 percent of the annual national budget, or more than 0.15 percent of GDP. Yet, there is limited transparency on actual allocations. COA reports show low utilization rates, utilization of funds for non-designated purposes, and a lack of transparency of unutilized funds carried over in the special trust fund. In addition, having 43,000 standalone contingency funds is financially inefficient, as it ties up unused resources.

Domestic catastrophe risk insurance penetration remains low. Strong insurance markets are critical to strengthen resilience of homeowners and SMEs. Yet less than 6 percent of total residential exposures and less than 16 percent of total commercial and industrial exposures were insured against typhoon and flood in 2018. Domestic insurance markets face challenges ahead to strengthen domestic markets for catastrophe risk. This includes demand challenges such as low awareness by the public and a weak culture of insurance. This also includes supply side challenge including data, insufficient underwriting rates which disincentivizes insurance companies from promoting catastrophe insurance, efficient access to reinsurance markets, and effective regulation and supervision.

Post-disaster financial support to the agriculture sector does not sufficiently leverage appropriate risk financing and insurance to ensure it efficiently targets the poorest subsistence farmers. The PCIC offers agricultural insurance solutions, with significant and growing government support, but these do not adequately address the needs of smallholder subsistence farmers. Micro-level indemnity-based crop insurance for individual smallholders, as currently offered by the PCIC, often cannot be cost-effectively implemented. Even when farmers are covered, current programs often face implementation challenges, including farmers not being aware that they are covered (if subsidized) and payouts not reaching covered farmers after crop losses. This means the government's premium subsidies may not translate into actual protection of farmers following a disaster shock, leaving them exposed to crop losses. Moreover, PCIC is not regulated by the Insurance Commission and are not adequately using reinsurance markets to protect against severe shocks. This means that if a severe event would require payouts to many farmers at the same time, PCIC may not be able to meet all claims, leaving farmers unsupported and requiring the government to step in.

3.5 POLICY RECOMMENDATIONS

The government has achieved remarkable progress in strengthening financial, physical, and social resilience to disasters and climate shocks, yet challenges remain. Over the past decade, the government has made strong progress in proactively manage risks and protect the population and economy. The Philippines is often looked to by other countries as a leader in building resilience to disasters. Yet, as one of the most disaster-prone countries in the world with a fast-growing population and is highly exposed to climate change, it is vital to further improve its resilience to disasters. This section provides key policy recommendations to further increase disaster resilience at both the national and local government level. The government should consider these recommendations together and work to strengthen linkages to reap the benefits and synergies from a holistic approach. For example, increased investment in prevention is critical for sustainable risk financing. At the same time, financial resilience programs can better quantify risk and drive budget allocation in risk reduction.

Institutional Strengthening:

- **Address fragmentation and capacity constraints in the implementation and oversight of DRM programs.** Fragmentation, lack of coordination, and insufficient capacity in implementing DRM programs is a challenge across all government agencies. The government's proposed national DRM agency, the Department of Disaster Resilience, could address these challenges. This would be a dedicated agency responsible for the management and implementation of DRM programs, it would mainstream disaster risk reduction in public spending, and improve disaster response and recovery at the national, regional, and local level. A single agency mandated to coordinate, plan, finance, implement, and monitor all DRM interventions should ensure that policies and programs across sectors are developed and implemented in a cohesive manner.

- **Strengthen horizontal and vertical coordination mechanisms and clarify the roles of national, regional (BARMM), and local government authorities and other stakeholders.** The roles and responsibilities of key stakeholders involved in DRM should be revisited to clearly define coordination mechanisms in advance of disasters. This should be clearly communicated through policy issuances to effectively manage the contributions and interventions of various stakeholders. For non-governmental stakeholders, pre-agreements should clearly define the roles and contributions of the private sector, academia, civil society organizations, and development partners. The government should consider defining how a whole-of-society approach to DRM can be operationalized at the national, regional, and local level. A seamless coordination mechanism would help maintain coherence across response, risk reduction, and reconstruction programs implemented by the government and non-governmental partners.

Box 7. Best Practices on Coordination across All Levels of Government and Communities in Japan

Japan's DRM system addresses all phases of disaster preparedness, emergency response, and recovery and reconstruction. Its comprehensive legal framework specifies the roles and responsibilities of national and local governments and enlists the participation of relevant stakeholders in both the public and private sector.

National and local government authorities in Japan have different but complementary roles in disaster preparedness and response. The national government oversees the definition of the overall DRM strategy and is responsible for coordination and legislation as well as budget allocations. By contrast, local governments, which have the primary responsibility for disaster management, focus on the coordination of administrative and operational functions, including preventive measures such as disaster education, execution of disaster drills, issuance and transmission of communications and early warnings, and evacuation and rescue activities, among others. Having clear roles and responsibilities assigned to each tier of government regarding preventive measures, emergency response, recovery, and reconstruction is crucial for developing countries as they strengthen their disaster preparedness.

A country needs to cultivate, reinforce, and maintain a culture of community-based organizations involved in DRM activities based on mutual assistance at the local level. Community members need to be empowered to assist each other during disaster events. For example, most people who are saved from major disasters in

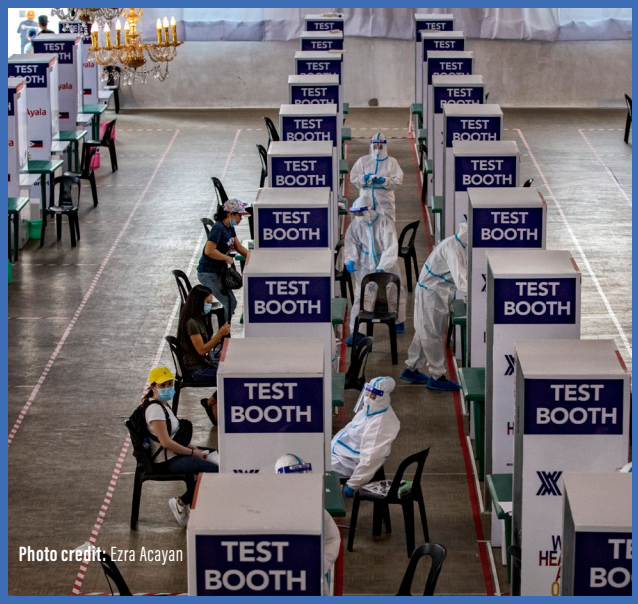


Photo credit: Ezra Acayan

Japan are rescued by relatives and neighbors within the first 24 hours—before professional responders can get to affected areas. Evidence from the aftermath of the Kobe Earthquake shows that 80 percent of those rescued were saved by their neighbors. So, while local and national authorities have key responsibilities for civil protection during disasters, communities are usually the first responders and should be empowered. The trend in Japan of legislative evolution toward decentralization demonstrates the importance of emphasizing community-based DRM. In addition to providing financial resources, local and national policymakers need to legislate and institutionalize the role of community-based organizations in emergency preparedness and response.

Source: Emergency Preparedness & Response (EP&R): Case Study of Japan. World Bank DRM Hub Technical Note (December release).

Box 8. Best Practices on Inter-Agency Coordination for Response and Recovery in Japan

In Japan, relief and rescue professionals from the national government and specialized agencies, such as police and fire departments, public works, and hospitals, prepare for the mobilization of response teams in the aftermath of disasters. For example, they clarify the chain of command, determine a roster of emergency teams—including request and dispatch mechanisms among municipalities (horizontal) and with the central government (vertical)—and conduct disaster drills to develop the local response capacity. In addition, the authorities establish intra-municipality coordination mechanisms or agreements in times of disaster among jurisdictions. Finally, information systems with complementary mechanisms that link local and national authorities help in facilitating collaboration for comprehensive DRM.

Source: Emergency Preparedness & Response (EP&R): Case Study of Japan. World Bank DRM Hub Technical Note (forthcoming).

- **Strengthen preparedness for disaster rehabilitation and recovery.** Establishing a culture of preparedness for future disasters would facilitate effective recovery. Training national government agencies and LGUs on the use of the Disaster Recovery Planning Guide will help them prepare baseline data, establish coordination mechanisms, and identify recovery interventions and financing options that could be used when a disaster happens. By simulating the recovery process, national government agencies and LGUs can pre-define commonly encountered challenges and issues and develop appropriate solutions and guidelines on working with various stakeholders in their localities. As first responders to disasters, the BARMM and LGUs need to be regularly updated on the latest DRM plans and best practices. Similarly, key government agencies can better support LGUs in implementing recovery and reconstruction projects when contingency plans and pre-disaster recovery strategies are in place.

- **Implement the PGAMP to improve asset information and drive investments in adequate maintenance and risk management for resilient assets.** Adopted in September 2020, the PGAMP is a key step to improve the management of public assets, including (financial) risk management in relation to disasters. The government should ensure that the policy is fully rolled out, including establishing implementing groups in key government agencies, enhancing capacity building, and scaling up the National Asset Registry by requiring all asset-owning agencies to regularly submit their data.

- **Include climate and disaster risk in a dedicated fiscal-risk management function and a clear mandate for risk finance management.** To further strengthen the implementation of reforms to build fiscal resilience and inform public finance decisions (e.g., the efficient allocation of resources to risk reduction and response activities), the government should consider improving the coverage of disaster-related risk in the fiscal risk statement. The fiscal risk statement, prepared under the DBCC, is mostly descriptive in its coverage of disaster and climate risks. Instead, this should quantify and include contingent liabilities from disasters, climate change, and other exogenous shocks such as pandemics to inform the implementation of the government's risk-layering strategy and support efficient allocation of resources for risk reduction. The government may want to nominate or establish a dedicated unit with a fiscal risk management function and mandate to include risks associated with disasters, climate change, and other exogenous shocks. Risk financing should also be institutionalized in the proper units in oversight agencies (e.g. with oversight under a coordinating body such as DBCC). This should

Box 9. Best Practices on Fiscal Risk Management of Disasters

A joint 2019 World Bank-OECD review of best practices in the management of fiscal risks related to disasters in both emerging markets and OECD countries recommended that fiscal risk management frameworks include an assessment of disaster-related contingent liabilities. This would raise the visibility of the fiscal risks associated with disaster-related contingent liabilities and ensure they are considered in public financial planning. It would also support a whole-of-government approach to building resilience to climate and disaster-related shocks, including efforts to reduce risks in the first place.

A growing number of countries, including Colombia, Jamaica, Peru, Serbia and the UK, have set up dedicated fiscal risk management units or mandated the creation of such dedicated functions within larger units.

Source: OECD and World Bank. 2019. Fiscal Resilience to Natural Disasters: Lessons from Country Experiences. OECD: Paris. © OECD and World Bank. https://openknowledge.worldbank.org/handle/10986/32341 License: CC BY-NC-ND 3.0 IGO.

coordinate overall risk financing activities and formulate annual risk financing plans that set out how the government will finance disaster related contingent liabilities (as identified in the fiscal risk statement).

Disaster Risk Reduction and Preparedness:

- **Mainstream the integration of risk consideration and disaster risk reduction measures in development planning, infrastructure investments, and ensure adequate budget allocation.** The Government could mandate the integration of disaster risk reduction and climate resilience in national, regional, and local development planning and investment programming through issuance of technical guidelines considering climate change forecasts. The government should increase investment in green and resilient infrastructure (i.e., schools, hospitals, bridges, transport, and public buildings) and allocate funds to risk reduction and preparedness projects. Building resilient infrastructures would help to reduce the impact and cost of future disasters and climate change.

- **Mandate the use of the government's GeoRiskPH integrated database for the national government, BARMM, and LGUs, and expand the system to include health-related information and data analytics.** All national government agencies and LGUs should be mandated to use and share information through the platform to ensure that all future plans, programs, and investments consider their exposure to risks. This would also address the limited availability and access to integrated hazard and risk assessment data. Aside from existing risks, the inclusion of health-related information in the GeoRiskPH platform could provide the government with the necessary data to anticipate, better prepare for, and respond faster to future disasters and public health emergencies.

- **The Government should promote "Green Recovery" by investing in resilience.** As part of the broader DRM reform agenda, investment in green and resilient infrastructure and communities would reduce the future contingent liability caused by disasters and climate change. The infrastructure investment to reduce existing disaster risks and to avoid the creation of new risks, would provide a double benefit. This approach would help to restart growth through the civil works and second it would reduce the damages and losses of future events. The proposed green recovery has to integrate resilience with environmental protection, promotion of renewables, access to energy, improved transport, and improved service delivery at the national, sub-national and community levels.

- **Improve the capacity to assess, record, and report the impact and damages of disasters to inform planning and fiscal assessments.** Damage reporting is essential to accurately capture the extent of the damage to public assets and other losses to inform public finance decisions and reconstruction planning. The process to record damages and losses related to disasters should include collecting and storing detailed asset loss reports and not just aggregate data, as this would provide the government with a better understanding of actual needs. To share the data with all relevant agencies, the government should develop an open and collaborative platform that is linked to existing relevant data systems such as NARS and GeoRiskPH.

- **Enhance interoperability of disaster data with the social registry to promote early warning and early action for ASP programs.** Regular social assistance programs of DSWD rely on the national household targeting system (NHTS – Listahanan or social registry) which includes socio-economic information of households covering over 70 percent of the population. However, the NHTS is not adequate to inform disaster-vulnerable or affected households for ASP programs. Disaster data such as early warning information and damage data can fill this information gap. Thus, dynamically updated NHTS made interoperable with disaster monitoring data can greatly enhance the government's ability to identify families who are vulnerable (ex-ante) as well as who are affected by a disaster (ex-post) and assess their needs. This will enable timely disbursement of cash assistance to disaster affected families in the time of crisis.

Financial Resilience:

- **Clarify cost-sharing between the national and local governments.** Currently the national government covers most disaster response costs, even though local governments have dedicated resources available which often seem not to be used. Clear and credible rules on which costs the national government will shoulder and which fall with local governments should help to improve financial planning for disaster response by making risk ownership explicit. This will also enhance incentives for risk management and financial preparedness at all levels of government.

- **Improve the process to monitor, report on, and control public disaster spending.** A uniform monitoring and reporting mechanism at the local and national level should be developed to track and capture post-disaster spending from various sources, monitor delays in the approval and release of funds, and improve controls. The use of standardized tools and templates for national and local response and recovery programs will promote transparency and accountability in the implementation of disaster response and recovery activities, especially in the allocation and use of public funds. The government could also: (i) strengthen existing audit reports to cover all funding sources, disaster events, and spending categories (response, recovery, and reconstruction); and (ii) explore an appropriate methodology for tracking disaster-related budget expenditures.

- **Strengthen pre-arranged funding by improving the NDRRM Fund and LDRRMFs.** The existing policies on the use and management of these funds should be reassessed and streamlined to make them more responsive to evolving DRM needs and compounding risks, including pandemics. This could include: (i) streamlining the procedures of the NDRRM Fund; (ii) ensuring that the QRF is available for all agencies involved in disaster response activities, including for immediate funding of smaller disasters; and (iii) improving the reporting and transparency of LDRRMFs. The authorities should also consider allocating funds based on probabilistic estimates of funding needs. Moreover, streamlined processes to minimize approval delays could be done by issuing guidelines on pre-approved expenditures and contracting; reviewing the level of reviews and approvals required to make allocations; and making decisions solely on technical considerations. Recognizing the inefficiency of having 43,000 standalone contingency funds, the government should consider creating a joint structure for LGUs

to coordinate their efforts and pool all or part of their LDRRMFs to increase the transparency and effectiveness of public resources. The national government could provide incentives for LGUs to participate in such a joint structure, for example through a reinsurance program that protects this joint fund against more severe events, by channeling additional national government support to LGUs through this arrangement more rapidly with pre-agreed technical decision protocols for approving and disbursing funds, or by systematically co-financing recovery costs through an explicit cost-sharing formula.

- **Develop emergency procurement guidelines to reduce delays.** The guidelines should simplify the procurement of essential goods and services through an umbrella framework that facilitates the quick implementation of disaster response and recovery projects. This could include provisions that allow the use of alternative procurement methods for disaster and public health emergency interventions. The guidelines would help the authorities address delays in projects delivery and allow pre-arranged agreements and framework contracts before disasters happen.

- **Link financing to pre-arranged disbursement mechanisms for more efficient disaster response and recovery.** Explicitly linking the NDRRM Fund to existing ASP and disaster response mechanisms, such as the DSWD's Emergency Cash Transfer and NCDDP-DROM programs, or the DPWH's emergency infrastructure maintenance and rehabilitation programs, could reduce delays in disaster response. This requires a clear ASP and disaster response strategy with an agreement in advance on standard operating procedures, eligible expenditures and beneficiaries, amounts to be disbursed, triggers and approval processes for additional funding, and clear pre-established fund-flow arrangements.

Box 10. Best Practices on Risk Layering and Linking Funds to Implementation in Mexico

The Government of Mexico established the Fund for Natural Disasters (Fondo de Desastres Naturales, FONDEN) to administer a comprehensive, layered approach to disaster risk financing, which includes provisions for sharing reconstruction costs across all levels of government and early recovery funding made available during national emergencies. Under Mexico's Federal Budget and the Fiscal Responsibility Law, a minimum of 0.4 percent of programmable federal spending (about US$800 million) must be available to FONDEN and its sub-programs. This is used to pay for frequently occurring losses and for the purchase of risk-financing instruments to safeguard public finances from disasters, ensuring that the government can meet its obligations. This includes sector-specific catastrophe risk indemnity insurance, an 'excess-of-loss' indemnity insurance program to protect FONDEN against large aggregate losses, and parametric catastrophe bonds against the most severe earthquakes and hurricanes.

With FONDEN, the federal government established a clear cost-sharing agreement with states to limit its obligation to provide post-disaster support. FONDEN also integrates incentives for risk reduction. It covers up to 50 percent of the reconstruction cost when a sub-nationally owned asset is damaged for the first time, which is reduced to 25 percent the second time if no insurance has been purchased, and it provides no funding for subsequent requests.

Source: OECD and World Bank. 2019. Fiscal Resilience to Natural Disasters: Lessons from Country Experiences. OECD: Paris. © OECD and World Bank. https://openknowledge.worldbank.org/handle/10986/32341.

- **Scale up the financial risk management of public assets.** The establishment of the NIIP is a key reform to ensure the effective financial risk management of critical infrastructure and public assets (e.g., roads and bridges as well as schools). The government should continue to bring strategic high-risk public assets (e.g., energy infrastructure and hospitals) under this program to ensure sufficient access to funding for asset reconstruction and reduce the government's contingent liabilities. As a further step, the program could explore ways to move beyond the insurance of physical assets to also ensure the continuity of services. For example, it could provide rapid-response financing for temporary measures to restore services, such as funding for temporary classrooms or mobile transformers. The NIIP should be closely coordinated with potential reforms to the NDRRM Fund to ensure the efficient financial protection of assets.

- **Increase financial protection of homeowners and SMEs through deepening catastrophe insurance markets and exploring new financial solutions.** This includes establishing the PCIF as well as exploring further measures to strengthen the demand for property insurance among both households and SMEs. A key step towards this will be revision of catastrophe rates and adequate supervision to ensure industry compliance. This is aligned with government efforts to revise the Insurance Code and strengthen the Insurance Commission. At the same time government should continue to invest in strengthening awareness and demand for insurance solutions, potentially exploring mandatory cover for certain risks, building on international experience. The government could further explore leveraging existing financial mechanisms, such as PhilGuarantee, to provide new financial solutions to protect SMEs against catastrophe shocks.

- **Further develop agricultural risk financing and insurance solutions, with a special focus on protecting smallholder subsistence farmers.** One key area of the National DRFI Strategy involves the protection of the poorest and most vulnerable households, including farmers. The administration's flagship economic recovery plan ("We Recover as One") includes expanding agricultural insurance in priority programs. This should include revisiting the current system of providing support and the role of the PCIC. To protect semi-commercial and subsistence farmers, the government could implement a macro-level parametric crop insurance program, co-financed by the government and LGUs on behalf of subsistence farmers, providing quick post-disaster support. This could build on international experience from countries such as India and Mexico. Insurance can leverage capital from financial markets to provide more rapid support to affected farmers than under current ex-post disaster relief programs. Investing in technologies such as tools that allow electronic payments to be transferred directly to individual farmers using mobile phones could further reduce the time and cost of distributing payments to subsistence farmers.[84]

84 *World Bank, 2020, Philippines: Options for strengthening agricultural disaster risk finance and insurance to protect subsistence farmers*, note prepared for Department of Agriculture and Bureau of Treasury

3.6 AREA FOR FURTHER STUDIES

A further analysis of key issues would help to inform future reforms aimed at strengthening resilience in the Philippines, including:

- The impact of compounding risks such as pandemics (e.g., COVID-19) interacting with typhoons, floods, earthquakes, volcanic eruptions, etc. and associated policy reforms to recalibrate the country's risk management, financial planning, preparedness, and response and recovery measures;

- Good practices and examples of coordination mechanisms and institutional arrangements from other countries that could be used in enhancing the proposed national DRM agency;

- Information on post-disaster spending, including information on budget reallocations, spending on risk reduction, and investments in preparedness to help the authorities ensure an adequate allocation of funds;

- The identification of additional measures with more systematic approach to improve ASP and disaster response interventions for poor and vulnerable households, building on initial studies on the impact of disasters on the welfare and wellbeing of the poor;


Photo credit: Ezra Acayan

- The impact of disasters on LGU finances and ways to strengthen financial planning at the provincial and municipal level to increase the efficiency of public spending; and

- The impact of the Mandanas ruling on the government's DRRM program and how this would affect the overall disaster preparedness of LGUs, considering that transfers to local governments are expected to increase following a recent Supreme Court ruling[85] that states that all national taxes will be used to compute transfers to local governments starting in 2022..

85 In the case of Mandanas vs. Ochoa, GR No. 199802 directing National Government to transfer a bigger IRA share to LGUs.

Table 6. Challenges and Policy Recommendations

#	Challenges	Policy Recommendations
1	The management and implementation of DRM policies and programs is fragmented. NDRRMC is composed of forty-two members from different government agencies that develop policies and coordinate the country's overall DRM agenda. Implementation of DRM programs and projects is still the responsibility of various implementing agencies and subject to their respective mandates.	Address fragmentation and capacity constraints in the implementation and oversight of DRM programs. The government's proposed national DRM agency, the Department of Disaster Resilience, could address these challenges. This would be a dedicated agency responsible for the management and implementation of DRM programs.
2	The institutions involved in DRM have limited coordination protocols, guidelines, and mechanisms to address the increasing magnitude and frequency of disasters.	
3	There are also coordination challenges between and among national and sub-national government authorities during the disaster response and recovery phases. The lack of communication between and among national government agencies and LGUs and no clear delineation of roles and responsibilities often result in delays in response interventions, overlapping interventions, and inconsistent recovery policies.	• Strengthen horizontal and vertical coordination mechanisms and clarify the roles of national, regional (BARMM), and local government authorities and other stakeholders. • Strengthen preparedness for disaster rehabilitation and recovery. Establishing a culture of preparedness for future disasters would facilitate effective recovery. By simulating the recovery process, national government agencies and LGUs can pre-define commonly encountered challenges and issues and develop appropriate solutions and guidelines on working with various stakeholders in their localities. • Mandate the use of the government's GeoRiskPH integrated database for the national government, BARMM, and LGUs, and expand the system to include health-related information and data analytics.
4	The recent establishment of the Bangsamoro Autonomous Region in Muslim Mindanao (BARMM) highlights challenges related to devolution, autonomy, and the institutional capacity of subnational governments.	
5	Public procurement during emergencies has been challenging due to a lack of basic guidelines on how to apply emergency procurement procedures.	Develop emergency procurement guidelines to reduce delays. The guidelines should simplify the procurement of essential goods and services through an umbrella framework that facilitates the quick implementation of disaster response and recovery projects.
6	The national government usually leads the implementation of post-disaster activities, but insufficient resources limit their effectiveness. National government agencies were tasked with implementing most of the recovery projects following Typhoon Yolanda and the Marawi Siege, but they had no additional staff and limited funding. Their disaster-related activities were on top of their regular mandates and deliverables, which caused implementation delays.	Clarify cost-sharing between the national and local governments. Currently the national government covers most disaster response costs, even though local governments have dedicated resources available which often seem not to be used. Clear and credible rules on which costs the national government will shoulder and which fall with local governments should help to improve financial planning for disaster response by making risk ownership explicit.
		Mainstream the integration of risk consideration and disaster risk reduction measures in development planning, infrastructure investments, and ensure adequate budget allocation. The Government could mandate the integration of disaster risk reduction and climate resilience in national, regional, and local development planning and investment programming through issuance of technical guidelines considering climate change forecasts. Building resilient infrastructures would help to reduce the impact and cost of future disasters and climate change.
		Link financing to pre-arranged disbursement mechanisms for more efficient disaster response and recovery. Explicitly linking the NDRRM Fund to existing ASP and disaster response mechanisms, such as the DSWD's Emergency Cash Transfer and NCDDP-DROM programs, or the DPWH's emergency infrastructure maintenance and rehabilitation programs, could reduce delays in disaster response.
		Enhance interoperability of disaster data with the social registry to promote early warning and early action for ASP programs. dynamically updated NHTS made interoperable with disaster monitoring data can greatly enhance the government's ability to identify families who are vulnerable (ex-ante) as well as who are affected by a disaster (ex-post) and assess their needs. This will enable timely disbursement of cash assistance to disaster affected families in the time of crisis.

#	Challenges	Policy Recommendations
7	Incomplete data on assets and disaster damages hinder efficient decision-making related to both financial and physical risk management. The government lacks access to complete data on all assets owned by national government agencies making it harder for the authorities to effectively manage public assets to ensure efficient service delivery, create risk management plans, and perform adequate maintenance	Implement the PGAMP to improve asset information and drive investments in adequate maintenance and risk management for resilient assets. The government should ensure that the policy is fully rolled out, including establishing implementing groups in key government agencies, enhancing capacity building, and scaling up the National Asset Registry by requiring all asset-owning agencies to regularly submit their data.
		Scale up the financial risk management of public assets. The establishment of the NIIP is a key reform to ensure the effective financial risk management of critical infrastructure and public assetstime of crisis.
8	Contingent liabilities related to disasters, climate risks, and other shocks are currently not fully integrated in the management of fiscal risk in the Philippines. Most of the costs related to managing national disasters are covered by the national government. Yet, disaster-related public spending is not integrated into comprehensive fiscal risk management.	Include climate and disaster risk in a dedicated fiscal-risk management function and a clear mandate for risk finance management. The government should consider improving the coverage of disaster-related risk in the fiscal risk statement.
		The Government should promote "Green Recovery" by investing in resilience. As part of the broader DRM reform agenda, investment in green and resilient infrastructure and communities would reduce the future contingent liability caused by disasters and climate change. The infrastructure investment to reduce existing disaster risks and to avoid the creation of new risks, would provide a double benefit.
9	Budget allocations for pre-arranged funding mechanisms are not evidence-based and often insufficient. Budget allocations to both QRFs and the NDRRM Fund are not driven by expected needs or actual past spending. Instead, they are primarily based on the previous year's allocation or already known reconstruction costs.	• Improve the capacity to assess, record, and report the impact and damages of disasters to inform planning and fiscal assessments. The process to record damages and losses related to disasters should include collecting and storing detailed asset loss reports and not just aggregate data, as this would provide the government with a better understanding of actual needs. • Strengthen pre-arranged funding by improving the NDRRM Fund and LDRRMFs. The existing policies on the use and management of these funds should be reassessed and streamlined to make them more responsive to evolving DRM needs and compounding risks, including pandemics. The authorities should also consider allocating funds based on probabilistic estimates of funding needs. Moreover, streamlined processes to minimize approval delays could be done by issuing guidelines on pre-approved expenditures and contracting; reviewing the level of reviews and approvals required to make allocations; and making decisions solely on technical considerations. • Improve the process to monitor, report on, and control public disaster spending. A uniform monitoring and reporting mechanism at the local and national level should be developed to track and capture post-disaster spending from various sources, monitor delays in the approval and release of funds, and improve controls.
10	Incomplete financial data make it difficult for the government to assess the efficiency and adequacy of public spending by comparing public expenditure with the socioeconomic impact of disasters. Estimates of disaster damages and losses are incomplete, and data on the use of different funding sources are fragmented.	
11	Complex approval processes often delay the approval and disbursement of funding, even from pre-arranged mechanisms, leading to delays in disaster response. Most funding sources require specific requests and approvals by different agencies and levels of government, delaying the release of funding and, subsequently, response and recovery.	
12	Local governments face constraints in the allocation, management, utilization, and transparency of disaster response funding.	
13	Domestic catastrophe risk insurance penetration remains low. Less than 6 percent of total residential exposures and less than 16 percent of total commercial and industrial exposures were insured against typhoon and flood in 2018.	Increase financial protection of homeowners and SMEs through deepening catastrophe insurance markets and exploring new financial solutions. This includes establishing the PCIF as well as exploring further measures to strengthen the demand for property insurance among both households and SMEs.
14	Post-disaster financial support to the agriculture sector does not sufficiently leverage appropriate risk financing and insurance to ensure it efficiently targets the poorest subsistence farmers.	Further develop agricultural risk financing and insurance solutions, with a special focus on protecting smallholder subsistence farmers. This should include revisiting the current system of providing support and the role of the PCIC. To protect semi-commercial and subsistence farmers, the government could implement a macro-level parametric crop insurance program, co-financed by the government and LGUs on behalf of subsistence farmers, providing quick post-disaster support.

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