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An Agenda for High and Inclusive Growth in the Philippines

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ISBN 978-92-9092-178-3
Publication Stock No. RPT102567

Cataloging-In-Publication Data

Habito, Cielito F.
An agenda for high and inclusive growth in the Philippines.
Mandaluyong City, Philippines: Asian Development Bank, 2010.

1. Inclusive growth. 2. Philippines. I. Asian Development Bank.

Note:
In this report, "$" refers to US dollars.

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This study was prepared by Cielito Habito, consultant, under the guidance and supervision of Joel Mangahas, country specialist, and the overall leadership of Neeraj Jain, country director of the Philippines Country Office, Southeast Asia Department, Asian Development Bank (ADB). The author wishes to thank the reviewers from ADB whose thoughtful review of earlier drafts of the manuscript led to substantial improvements in the paper. The efficient research assistance of Sandino Romero is likewise gratefully acknowledged. There are, no doubt, various shortcomings that remain in both substance and form, for which the author takes exclusive responsibility. The analyses, views, and opinions presented herein are those of the author and should not be represented as those of ADB or the institution he represents.

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Abbreviations

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
BIR	–	Bureau of Internal Revenue
BOC	–	Bureau of Customs
BOI	–	Board of Investments
BOT	–	build–operate–transfer
BPAP	–	Business Processing Association of the Philippines
BPO	–	business process outsourcing
CAB	–	Civil Aeronautics Board
CARP	–	Comprehensive Agrarian Reform Program
CDD	–	community–driven development
DA	–	Department of Agriculture
DAO	–	Department Administrative Order
DENR	–	Department of Environment and Natural Resources
DOF	–	Department of Finance
DOT	–	Department of Tourism
EPIRA	–	Electric Power Industry Reform Act
EU	–	European Union
FSM	–	Federated States of Micronesia
FTAA	–	financial and technical assistance agreement
GDP	–	gross domestic product
GVA	–	gross value added
HPI	–	Human Poverty Index
ICT	–	information and communication technology
IPA	–	investment promotion agency
IPRA	–	Indigenous People’s Rights Act
IRA	–	internal revenue allotment
km	–	kilometer
LGU	–	local government unit
LTO	–	Land Transportation Office
MPSA	–	mineral production–sharing agreement
MTPDP	–	Medium-Term Philippine Development Plan
MW	–	megawatt
NA	–	not available
NESDB	–	National Economic and Social Development Board
NFA	–	National Food Authority
NGA	–	national government agency
NSCB	–	National Statistical Coordination Board
OECD	–	Organisation for Economic Co-operation and Development
OFW	–	overseas Filipino worker
PNG	–	Papua New Guinea
PPP	–	public–private partnership
PRC	–	People’s Republic of China

R&D	–	research and development
SEC	–	Securities and Exchange Commission
SMEs	–	small and medium-sized enterprises
SMEDC	–	Small and Medium Enterprise Development Council
UDHA	–	Urban Development and Housing Act
VAT	–	value-added tax
WEF	–	World Economic Forum
WHO	–	World Health Organization

Executive Summary

Twofold Challenge

The Philippine economic growth experience has differed markedly from that of most of its Asian neighbors in two ways: One, the economy's growth over time has generally been slower and more erratic; and two, growth has failed to translate into significant poverty reduction as much as it has done elsewhere. Whereas other East Asian economies averaged annual gross domestic product (GDP) growth rates ranging from 3.6% to 6.0% from 1960 to 2008, the Philippines only managed an annual average growth of 1.4%. The Asian Development Bank (ADB) has found that for every 1% growth in GDP, poverty incidence has gone down by an average of 1.5% across the world, and even faster by an average of 2% within Asia alone. Contrary to this trend, poverty incidence in the Philippines had actually risen since 2003, a time when the economy was reported to have achieved record growth. The country thus faces a twofold challenge of accelerating and sustaining higher rates of growth, and ensuring that such growth involves and benefits a broader spectrum of the economy, both sectorally and geographically. The nascent recovery from the global financial crisis and the change in government coming out of the recent national elections provide a unique opportunity for this twin challenge of achieving both high and inclusive growth to be met with a fresh mandate and approach by the new leadership.

Key Constraints

The 2007 ADB Critical Development Constraints Study pointed to four critical factors inhibiting the Philippine economy's growth: (1) a tight fiscal situation; (2) inadequate infrastructure, particularly in electricity and transport; (3) weak investor confidence due to governance concerns; and (4) market failures leading to a small and narrow industrial base. More recent data suggest that these constraints have not eased; some have in fact even turned for the worse.

All four constraints are ultimately linked to weak governance manifested in various forms. **Tight government finances** result from poor tax administration, widespread tax evasion, and smuggling. Politicization of the budget process impairs the quality and impact of public expenditures. **Lack of infrastructure** is in turn a direct result of this. **Weak investor confidence** results from policy reversals and poor policy implementation and/or enforcement, which undermine the predictability of the policy and regulatory environment. Cumbersome government procedures and requirements significantly raise transaction costs for business, further negating the investment climate. Over-centralized decision-making leads to ill-conceived interventions, often unresponsive to actual local needs. Regulatory capture fosters monopolistic tendencies that lead to narrow benefits and higher costs in key industries, thereby undermining competitiveness in downstream economic activities and leading to the **small and narrow industrial base**. The economic reform agenda must thus be underpinned by governance and institutional reforms aimed at restoring the overall level of public trust in government, lack of which has abetted low tax compliance, inhibited investment, and ultimately stifled economic growth.

Governance Reform Imperatives

In line with the above, the new government will need to regain public trust and business confidence through decisive actions that must include:

- Ensuring **quality appointments to the Cabinet and key government posts**, via institutionalization of search committees with members who are beyond reproach.

- A convincing commitment and adherence to a policy of **zero tolerance for corruption.**
- **Strong and credible transparency and accountability mechanisms** in government, including passage of the Freedom of Information Act and designating a senior transparency and accountability officer within every government department and/or agency.
- **Intensified decentralization and devolution** of planning, program and/or project design, budget allocation, and general decision-making, with national government agencies focusing on "steering" while local government units take responsibility for "rowing."
- Strong **adherence to policy consistency and stability** within and across all branches of government to avoid policy reversals and ensure the sanctity of executed contracts.
- **Wider and deeper public participation in governance and development** through faithful implementation of mandated participatory mechanisms such as the National Anti-Poverty Commission at the national level and local development councils at the local level.
- **Intensified streamlining of government processes** to speed up service delivery and reduce the costs of doing business.

Economic Reform Imperatives

To directly address the critical constraints to growth identified by ADB, the economic growth agenda must focus on four overriding goals:

1. **Substantial boost in tax revenues**, with a short-term goal of restoring tax effort to at least 17% of GDP—already achieved in 1997—from its current level of 12%–13%;
2. **Dramatic expansion and improvement of the infrastructure base**, by programming and implementing a multi-year infrastructure catch-up program;
3. **Massive, broad-based enterprise development** highlighted by a government-wide thrust for small and medium enterprise (SME) promotion and development; and
4. **Democratization of the economy** through strengthened asset reform and competition policy.

Boosting tax revenues will necessarily entail a combination of tax policy enhancements and tax administration improvements. The new administration would be in a good position to place greater emphasis and reliance on the latter and pursue administrative solutions with unprecedented vigor, given its unique opportunity to overcome traditional political obstacles to such measures. This is important given that tax increases have time and again unfairly penalized and placed the entire burden on compliant taxpayers, while tax evaders continue to escape liability.

Improvement of tax administration should include the following initiatives:

- **Resume the effort to transform the revenue agencies into semi-autonomous revenue authorities.** The new administration needs to muster the political will to pursue what experience in other countries has shown to result in dramatic revenue improvements.
- **Optimize information and communication technology (ICT) support and capability in the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC).** A substantial boost is needed for internal capability to process and analyze the massive volume of data accumulated and made accessible to the revenue agencies from other agencies such as the Securities and Exchange Commission (SEC), Land Transportation Office (LTO), and others.
- **Institute personnel and process improvements in BIR and BOC** to minimize if not to eliminate scope for discretion and face-to-face contact between revenue officers and taxpayers.
- **Prosecute and convict high-profile tax evaders,** a long-standing recommendation that has remained unfulfilled and requires a great deal of political will to pursue effectively.

On tax enhancements, the most promising are (1) **reforming excise taxes on alcoholic beverages and tobacco products** ("sin taxes") to correct revenue-eroding features, especially in light of a World Health Organization finding that the Philippines now has among the lowest tax rates on cigarettes; and (2) **rationalizing fiscal incentives,** in light of studies pointing to substantial redundancy and inequality-preserving and inequality-reinforcing[1] features in the current incentive system.[2]

Catching up on the Philippines' huge infrastructure gap crucially hinges on success with the above revenue-raising agenda. Absent this, the logical recourse would be continued heavy reliance on public–private partnerships (PPPs), i.e., via the build–operate–transfer (BOT) scheme and its variants. It is crucial that the rules and procedures governing PPP projects be revisited, given the business and donor communities' negative reactions to recent changes introduced by the Office of the President on the implementing guidelines for the BOT Law. While purportedly meant to streamline the process, the changes have been seen by the business and donor communities as having compromised the integrity of the system.

A "big push" for enterprise development is needed through a government-wide thrust for SME development that would oblige all government agencies and units at all levels to ensure that their policies, programs, and projects contribute to enhancing the enabling environment for SMEs. In particular, efforts must help ease access by SMEs to financing, technology, raw materials, and markets. The objective is to address the "missing middle" in Philippine industry, where 92% of firms are micro-enterprises, large-scale firms comprise 0.3%, and SMEs account for less than 8%. There is a tendency for government to lump microenterprises and SMEs together ("MSMEs") in government initiatives to promote livelihood and enterprise. With SME requirements often being very different from those of microenterprises—which are mostly informal sector enterprises—lumping microenterprises and SMEs together could even compromise government support for the latter, overwhelmed by the sheer number of the former. Government institutional support for the two should thus be kept separate and distinct. The recommended SME focus must foster complementation between large-scale enterprises and SMEs, as is common in Japanese industry. By deliberately relying on SMEs as contractors and suppliers of product components as in the Japanese auto industry, large enterprises would actually help sustain, rather than supplant, smaller enterprises in a mutually beneficial synergy.

Market forces alone cannot be relied on to overcome fundamental inequities in the Philippine economy and society, given that (1) inequities stem from a historically skewed distribution of assets that has been further exacerbated through time by similarly skewed access to opportunities for advancement, and (2) markets left to themselves, especially where economies of scale prevail, tend naturally toward increased market concentration, thereby necessitating a deliberate competition policy to maintain a "level playing field." Thus, there is need to faithfully implement, sustain, and intensify the **asset reform programs** of the government in order to address the inequities that dampen the inclusiveness of growth as highlighted in Chatterjee (2005). These are embodied in the Comprehensive Agrarian Reform Program (CARP) for the agrarian and/or agricultural sector; the Indigenous People's Rights Act (IPRA) for indigenous upland communities; the Fisheries Code for coastal fisherfolk; and the Urban Development and Housing Act (UDHA) for the urban poor. At the same time, the economic policy environment must

1 This refers to inequality across sectors and across regions.

2 A current government proposal to further hike the value added tax (VAT) from 12% to 15% with a simultaneous reduction in the corporate income tax rate from 30% to 20% is likely to be highly controversial and is vulnerable to criticism as being anti-poor and pro-rich, apart from having doubtful revenue consequences. Another measure that promises to be highly controversial is a proposed increase in excise taxes on petroleum products. Due to their widespread implications, both measures require more thorough analysis, particularly on their distributional impacts in order to establish their compatibility with achieving growth that is inclusive.

continuously provide for adequate competition through both policy and regulatory instruments. The new government would do well to move toward firming up a legislated **competition policy** (i.e., similar to antitrust legislation in Western countries) that would consolidate pertinent laws governing competition in specific industries and sectors. These would include key industries and/or sectors where lack of competition (and thus higher costs) has impeded inclusive growth in the rest of the economy, such as domestic shipping, port services, air services, utilities, media, and others.

Drivers of Inclusive Growth

What industries and/or sectors would best propel growth in the economy that would at the same time be inclusive, thus poverty-reducing? On the demand side, exports and investments especially on infrastructure can provide the impetus for 7%–9% growth. On the production side, inclusive growth would best come from sectors and industries that are labor-intensive (hence job-creating) and/or possess extensive backward and forward linkages to the rest of the domestic economy. Based on these criteria, the industries and/or sectors that hold the greatest potential for inducing more inclusive economic growth are: (1) **Agriculture and Agribusiness**, (2) **Tourism**, (3) **Business Process Outsourcing**, and (4) **Food and Design-Based Manufactures** (i.e., high-end garments, and furniture and fixtures). Each one requires specific policy and program interventions in order to unleash their latent growth potentials. **Mining** has also shown strong growth potential, having grown 21% in 2009 in spite of the overall economic slowdown; however, inclusiveness of the industry's growth is open to question. However, for mining growth to be more inclusive, further policy and institutional reforms will be required, including greater democratization of the industry, increased domestic processing and greater value-adding, strengthening the fiscal regime in mining arrangements to ensure ample domestic benefits, and ensuring adherence to social and environmental responsibility.

Finally, it is well worth calling attention to the fact that budget shares for education and health have fallen behind in recent years, and this has been reflected in declining trends in education and health outcomes. Meanwhile, studies have consistently shown that the Philippines will be unable to meet all of the 2015 Millennium Development Goals. As discussed above, the Philippines needs to attain high and inclusive growth, which in the end means growth propelled by and benefiting the broad masses of its people. Investing in the country's future thus critically entails investing in its people, and in the final analysis, this is the most urgent and most important investment the country needs to restore now and in the years to come.

Introduction

Economic growth tends to be accompanied by falling poverty.[1] For Asia in particular, this association appears stronger: the empirical evidence indicates that poverty reduction accompanying economic growth has been faster than elsewhere in the world. An analysis by the Asian Development Bank (ADB) of data from 51 developing countries revealed that growth of 1% in average income is associated with a 1.5% decline in the incidence of $1-a-day poverty on average, with growth explaining 57% of the variation in changes in poverty (ADB 2004). Interestingly, when the sample is limited to countries in East Asia, Southeast Asia, and South Asia, each 1% income growth is associated with 2% decline in poverty incidence, with 65% explanatory power. Ferreira and Ravallion (2008), in reviewing the evidence on levels and recent trends in global poverty and income inequality, similarly point to the dominant role of Asia in accounting for the bulk of global poverty reduction since 1981.

These observations suggest that growth has served the poor better in Asia than elsewhere in the developing world. Taken against this backdrop, the Philippines' contradictory experience—especially in recent years—stands out starkly. Official data indicate a perverse growth–poverty reduction experience: headcount poverty incidence actually rose 3 percentage points from 2003 to 2006, a period when the economy was reported to have enjoyed historically high rates of growth (NSO 2006, 2008). In general, the economy's growth has translated into much slower poverty reduction over the years compared to its Asian neighbors.

The Philippine Challenge: Slow and Non-Inclusive Growth

Looking further back, the development performance of the Philippines over the past 3 decades, both in terms of poverty reduction and economic growth, has lagged behind that of most of its comparable regional neighbors. Its gross domestic product (GDP) per capita is now the lowest among the five members of the Association of Southeast Asian Nations (ASEAN-5) (Indonesia, Malaysia, the Philippines, Singapore, and Thailand), having been overtaken by Indonesia during 1990–2008 (Table 1). This is ironic given that the country possessed one of the most advanced and dynamic economies in Asia in the 1950s and 1960s. At that time, it enjoyed one of the highest levels of per capita GDP in Asia—higher than that of the People's Republic of China (PRC), the Republic of Korea, and Thailand. But within 3 decades, the Philippines had moved from near the top of the list in Asia to near the bottom. Whereas other East Asian economies averaged annual GDP growth rates of 3.6% to 6.0% from 1960 to 2008, the Philippines only managed annual average growth of 1.4%. Consequently, per capita GDP has grown 19 times in the PRC, 8 times in Thailand, 6 times in Malaysia and Indonesia, but only 2 times in the Philippines (World Bank 2009a). The *2009–2010 Global Competitiveness Report* ranked the Philippines at 87th out of 133 countries, having fallen 16 places from the previous year's ranking of 71st. As such, it ranked behind its Southeast Asian neighbors such as Singapore in 3rd, Malaysia in 24th, Thailand in 36th, Indonesia in 54th, and Viet Nam in 75th.

The economic growth performance of the Philippines had been relatively slow and highly erratic—spurts of growth have typically been followed by bust and stagnation. Its more recent economic growth, while appearing respectable in the aggregate, has been characterized as narrow, shallow, and hollow (Habito 2005; Aldaba et al. 2005). Narrowness is manifested in how capital formation achieved over the last 20 years has been largely concentrated in a small number of industries and

[1] Dollar and Kraay (2001) is probably the most widely cited empirical analysis on this issue.

Table 1 Gross Domestic Product per Capita, ASEAN-5 Countries, 1990–2008 ($)

Year	Indonesia	Malaysia	Philippines	Singapore	Thailand
1990	645	2,432	710	12,091	1,506
1995	1,056	4,314	1,059	23,916	2,794
2000	804	4,030	977	23,019	1,968
Average 1990–1999	839	3,574	920	19,571	2,175
2005	1,304	5,382	1,156	28,352	2,674
2008	2,246	8,209	1,847	37,597	4,043
Average 2000–2008	1,323	5,347	1,201	27,533	2,666

ASEAN = Association of Southeast Asian Nations.

Note: GDP per capita expressed in current US dollars for specified years.

Source: World Bank Annual Development Reports.

regions, and failed to generate overall gains that can permeate through a broader spectrum of the economy. Shallow growth is manifested in the way the bulk (over 70%) of its export earnings come from two industries—electronics and garments—both of which are essentially import–export operations with a thin layer of domestic value added, mainly in the form of assembly labor. Thus, backward linkages to the rest of the economy are absent. Hollow growth is seen in how output growth is accompanied by persistently high and occasionally rising unemployment—and in recent years, rising poverty as well—exemplifying what has become commonly described as "jobless growth."

The major challenge for the Philippines is to accelerate and sustain a more rapid rate of growth that also allows a wider range of sectors and geographic areas to participate in and benefit from the growth process. The 2007 ADB Critical Development Constraints Study on the Philippines identifies four critical factors that constrain growth: (i) tight fiscal situation; (ii) inadequate infrastructure, particularly for electricity and transport; (iii) weak investor confidence due to governance concerns; and (iv) inability to address market failures leading to a small and narrow industrial base. It is expected, then, that addressing these critical constraints can bring the country to a higher level of sustainable growth. But accelerating growth by overcoming these constraints is only half the challenge; ensuring inclusiveness of growth will require deliberate measures to broaden the base of economic growth and widen the benefits it brings, both geographically and in terms of economic sectors. ADB's operational definition of inclusive growth cites "equal opportunities" as the key element to accompany growth (Ali and Zhuang 2007).[2] What the country needs, then, is an inclusive growth strategy hinged on high and sustainable growth based on maximizing and guaranteeing equal access to economic opportunities, thereby promoting maximum well-being for all Filipinos.

Inclusive Growth in Asia: The Recent Record

Even as economic growth in the 1990s and since 2000 has translated into faster poverty reduction in Asia than elsewhere, the experience has varied across the region. In the 1990s prior to the East Asian financial crisis, income growth was accompanied by the strongest reductions in rural poverty (measured as headcount poverty incidence) in Bangladesh, Indonesia, and the Republic of Korea (Table 2). During 2000–2006, the strongest performers appeared to be Indonesia, Pakistan, and the PRC (Table 3), along with Malaysia, Thailand,

[2] In seeking an operational definition for inclusive growth for use by ADB, Ali and Zhuang (2007) have suggested "growth with equal opportunities," pointing out that inequalities may arise due to inequality of opportunities ("bad inequalities") and inequality of outcomes ("good inequalities").

and Viet Nam.[3] Sri Lanka, Nepal, and Bangladesh had moderate reductions in income-based poverty with economic growth. Cambodia, India, the Philippines, and Mongolia had the weakest performance, with the last two actually seeing an increase in poverty even as their economies grew.

In Table 4, poverty reduction is measured using the multi-dimensional Human Poverty Index (HPI) developed by the United Nations. Within the region, the strongest reductions in HPI accompanying economic growth in recent years have been achieved in Malaysia, Singapore, Thailand, and Viet Nam. These countries had elastic responses indicating a more than proportionate reduction in the multi-dimensional HPI for every 1% rise in real GDP. Nepal had a near-unitary elasticity, while Mongolia, the PRC, Cambodia, and Pakistan also had poverty elasticity of growth (PEG) with absolute values exceeding 0.5. Poverty reduction accompanying economic growth was relatively weak in the Philippines, Bangladesh, and India, and was weakest in Myanmar, Indonesia, and Sri Lanka. Between 2000 and 2005, the Philippines and Sri Lanka actually saw a rise in poverty as measured by HPI.

In the case of Thailand, deliberate efforts to prioritize social development starting in the late 1990s, as embodied in its Ninth and Tenth Five-Year National Economic and Social Development Plans (NESDB 2001, 2006), appear to have paid off. Meanwhile, Malaysia has devoted a relatively larger portion of public expenditures to education and health since 2000. Together with efforts to strengthen social safety nets, this clearly yielded positive results for Malaysia (Shari 2003). Experience in these two countries suggests that inclusive growth does not happen by itself, but takes deliberate efforts on the part of government to ensure the quality of the economic growth that is achieved.

Table 2 Average Annual Gross Domestic Product Growth and Reduction in Poverty Incidence in Selected Asian Countries, 1990–1996 (Pre-Asian Financial Crisis)

Country	Ave GDP Growth 1990–1996	Poverty, Rural			Poverty, Urban			Elasticity	
		1990	1996	% Red.	1990	1996	% Red.	Rural	Urban
Bangladesh	**4.6**	86	51	(40.7)	86	56	(34.9)	**(1.47)**	(1.26)
China, People's Republic of	**10.7**	10	12	20.0	NA	NA	NA	**(0.31)**	NA
India	**5.6**	51	49	(3.9)	40	38	(5.0)	**(0.12)**	(0.15)
Indonesia	**8.0**	44	16	(63.6)	26	20	(23.1)	**(1.33)**	(0.48)
Korea, Republic of	**7.9**	11	4	(63.6)	18	5	(72.2)	**(1.34)**	(1.52)
Malaysia	**9.5**	38	23	(39.5)	13	8	(38.5)	**(0.69)**	(0.67)
Nepal	**5.2**	61	43	(29.5)	55	19	(65.5)	**(0.95)**	(2.10)
Pakistan	**5.1**	29	31	6.9	32	20	(37.5)	**(0.23)**	(1.23)
Philippines	**2.8**	64	54	(15.6)	50	40	(20.0)	**(0.93)**	(1.19)
Thailand	**8.6**	34	29	(14.7)	15	7	(53.3)	**(0.28)**	(1.03)

( ) = negative, GDP = gross domestic product, NA = not available, Red. = reduction.

Sources: UNDP. *Human Development Report*; ADB. *Key Indicators of Developing Asian and Pacific Countries*.

[3] Table 2 for the pre-Asian crisis period uses poverty incidence measures based on nationally defined poverty thresholds, while Table 3 uses poverty incidence based on the standard $1.25 per day threshold, for which cross-country was not available for the 1990–1996 period covered in Table 2. Inasmuch as the interest in both tables is on rate of reduction in poverty incidence rather than the levels of poverty incidence, the difference in bases for the poverty incidence measure need not be of great consequence.

Table 3 Poverty Elasticity of Growth Based on Income Poverty Headcount and Average Annual Gross Domestic Product Growth, 2000–2006

Country	Pop Below $1.25 a Day (%), Before	Pop Below $1.25 a Day (%), After	Period	GDP Growth in Period	PEG
Indonesia	29.3	21.4	2002–2005	16.32	(1.652)
Pakistan	35.9	22.6	2002–2005	22.65	(1.636)
China, People's Republic of	28.4	15.9	2002–2005	33.70	(1.306)
Malaysia	1.9	1.5	1997–2004	26.12	(0.806)
Thailand	1.9	1.7	2002–2004	13.94	(0.755)
Viet Nam	24.2	21.5	2002–2006	17.37	(0.643)
Sri Lanka	16.3	14.0	1996–2002	24.10	(0.586)
Nepal	68.4	55.1	1996–2004	37.78	(0.515)
Bangladesh	57.8	49.6	2000–2005	30.27	(0.469)
Cambodia	48.6	40.2	1994–2004	109.48	(0.158)
India	49.4	41.6	1994–2005	100.67	(0.157)
Philippines	22.0	22.6	2003–2006	17.68	0.154
Mongolia	15.5	22.4	2002–2005	24.00	1.855
Singapore	NA	NA	2000–2006	33.08	NA
Myanmar	NA	NA	2001–2006	85.55	NA

( ) = negative, GDP = gross domestic product, PEG = poverty elasticity of growth, Pop = population.

Sources: World Bank. *World Development Indicators 2008 Poverty Supplement*; ADB. *Key Indicators of Developing Asian and Pacific Countries*.

Table 4 Poverty Elasticity of Growth Based on Human Poverty Index and Average Annual Gross Domestic Product Growth, 2000–2006

	Human Poverty Index (HPI-1)		Reduction		Average Annual GDP	Elasticity (PEG)
Country	2000	2006	2000–2006	% Change	Growth (%)	2000–2006
Malaysia	12.6	6.4	6.2	(49.2)	5.6	(1.46)
Singapore	6.5	4.1	2.4	(36.9)	5.0	(1.23)
Thailand	14.0	9.0	5.0	(35.7)	5.0	(1.19)
Viet Nam	27.1	12.5	14.6	(53.9)	7.6	(1.18)
Nepal	43.4	33.3	10.1	(23.3)	3.8	(1.02)
Mongolia	19.4	13.0	6.4	(33.0)	6.1	(0.90)
China, People's Republic of	14.9	7.9	7.0	(47.0)	9.9	(0.79)
Cambodia	43.3	28.9	14.4	(33.3)	9.5	(0.58)
Pakistan	41.0	33.6	7.4	(18.0)	5.5	(0.55)
Philippines	14.6	12.5	2.1	(14.4)	4.9	(0.49)
Bangladesh	42.4	36.9	5.5	(13.0)	5.8	(0.37)
India	33.1	28.5	4.6	(13.9)	7.2	(0.32)
Myanmar	27.2	21.0	6.2	(22.8)	13.0	(0.29)
Indonesia	18.8	17.2	1.6	(8.5)	5.0	(0.28)
Sri Lanka	17.6	16.9	0.7	(4.0)	5.1	(0.13)

( ) = negative, HPI-1 = human poverty index for developing countries, PEG = poverty elasticity of growth.

Sources: UNDP. *Human Development Report*; ADB. *Key Indicators of Developing Asian and Pacific Countries*.

Rationale and Objectives of the Study

The recent change in national leadership in the Philippines and the new round of development planning it will usher in provide a fresh opportunity to address what have so far appeared to be intractable constraints to achieving high and inclusive growth in the Philippines. Based on the above discussions, the main challenge for the country is to identify and implement concrete actions that will put its economy on a sustained broad-based growth path. Key questions that need to be addressed include the following:

- What are the most critical binding constraints to growth? What are their root causes? What interventions are needed to ease these constraints?
- How can the country accelerate and sustain annual GDP growth of at least 8%? How can it achieve macroeconomic stability? How can the volatility of growth be reduced?
- How can the country best promote capital accumulation, efficient use of resources, technological progress, and a socially acceptable distribution of income? What measures or actions are needed to improve trade and facilitate investment?
- What are the key drivers of growth and how can they be harnessed? What goods and services can the country become competitive in providing, which will generate greater opportunities for employment and income growth? How can the country expand and diversify its industrial base to generate high value-added products and maximize multiplier effects?
- What level of social service delivery is needed to support optimal economic growth? How should human resource planning and development be strengthened to support growth?

This study seeks to address the above questions, and thereby offer some recommendation to policy makers in defining appropriate courses of action needed to bring about high and inclusive growth in the years ahead.

Trends and Patterns of Growth in the Philippine Economy

Since at least the 1990s, the services sector has consistently been the most reliable source of growth in both output and employment. But even within this sector, output growth appears relatively concentrated in a few industries, most notably finance, business services, and communication—although growth in the communications industry appears to have tapered off from previous periods. On the other hand, recent data show employment growth being dominated by retail trade, private household employment, and transport.

Agriculture, a key sector for achieving broad-based economic growth, has seen highly erratic growth across quarters, and is a primary source of the variability in the overall GDP growth rate (Figure 1). The sector's growth rate has varied widely from a high of 8.1% in the first quarter (Q1) of 2004 to a low of –3.8% in Q4 2009. Industry growth has likewise been highly variable (ranging from –5.0% to 10.1% over the period), with its most dominant subsector—manufacturing—seeing a general decline in the past year, together with utilities. On the other hand, mining has exhibited double-digit growth rates in recent quarters despite the global downturn, but remains a relatively small part (1.8%) of overall GDP and employment (<0.5%).

On the demand side, there is a glaring lack of investment, with overall capital formation virtually at a standstill (i.e., averaging zero growth) since 2000. Overall private investment has seen

Figure 1 Sectoral Growth Rates, Q1 2004–Q4 2009 (%)

AFF = Agriculture, fishery, and forestry; GDP = gross domestic product.

Source: National Statistical Coordination Board (NSCB).

Table 5 Growth Rates of Expenditures for Gross Domestic Product, 2008–2009 (%)

	2008	2009				
Indicator	FY	Q1	Q2	Q3	Q4	FY
Personal consumption expenditure	4.5	1.3	5.4	3.2	5.1	3.8
Government consumption	4.3	4.5	9.7	8.1	12.1	8.5
Capital formation	4.2	(15.1)	(10.3)	(12.1)	(0.8)	(9.9)
Fixed capital	3.7	(7.2)	(3.9)	(0.9)	(1.6)	(3.5)
Of which:						
Construction	6.3	6.7	8.9	1.7	(2.9)	5.8
Public	(0.7)	11.5	27.7	21.8	(7.2)	15.7
Private	11.4	4.3	(10.1)	(9.4)	(0.1)	(4.2)
Durable equipment	1.7	(18.5)	(19.7)	(4.2)	(0.1)	(11.4)
Breeding stock and orchard development	(1.6)	1.0	(5.6)	1.5	(2.0)	(1.4)
Exports	0.0	(14.7)	(18.1)	(13.0)	(10.0)	(14.2)
Merchandise exports	(1.7)	(24.6)	(22.4)	(14.6)	(9.1)	(17.8)
Non-factor services	7.7	21.1	3.0	(4.1)	(13.9)	2.3
Imports	(1.1)	(20.6)	(2.2)	0.1	(2.5)	(5.8)

( ) = negative, FY = fiscal year.

Source: NSCB.

a general decline (Table 5), with public investment—particularly public construction—helping to fill, but not quite overcome, the gap.

Private consumption, propelled by overseas remittances, has provided the primary impetus for growth. But with the consumption slowdown brought about by the global financial crisis and economic downturn, and with the significant contraction in exports, government spending for consumption and construction has lately been the main driver of growth in demand (Table 5). However, even this had reversed in Q4 2009 with the government's finances already reaching precarious levels and the government deficit reaching an unprecedented high of P298.5 billion.

The general picture that emerges is that output growth in the Philippine domestic economy has primarily not come from industries that generate large numbers of quality jobs. Growth in employment has come primarily from the informal sector, particularly in services. Thus the pressing challenge is to achieve more formal and durable bases for growth in both output and employment in the years ahead.

Lessons from Neighbors: What Makes Growth More Inclusive?

In a survey of the literature on inclusive development in Asia, Chatterjee (2005) affirmed that economic growth has had the most significant impact on reducing poverty. However, he noted that promoting growth alone as a policy measure will not suffice, particularly as there are signs that growing inequalities are beginning to reduce the impact of growth. Among the conclusions drawn by Chatterjee are the following:

- Economic growth that worsens income inequalities must be avoided.
- The institutional and policy framework must continue to support financing of domestic investment through savings rather than debt, strengthening human development, raising factor productivities, and reducing population growth.
- The sectoral composition of growth is important, and requirements vary according to country situations: where rural poverty remains high and structural transformation possibilities are low, agricultural growth remains important; otherwise, secondary sector growth may be more inclusive.
- Labor-absorbing growth is crucial and requires policies that reduce rigidities in labor absorption, including dualistic structures, and promote rapid structural transformation.
- Land reform is instrumental to achieving inclusive development where agriculture is important and contains a sizable proportion of the poor.
- There remains wide scope for broader application of microfinance for poverty reduction in Asia and the Pacific, but reforms are required to provide the economic and institutional environment necessary for its success.[4]
- Human capital development must be intensified, including increased resource support from the private sector, reform of delivery institutions, and building capacity for more efficient services targeted to the poor.
- Rural infrastructure has a strong role in directly reducing poverty in both its income and non-income dimensions.
- Participatory governance and decentralization are important, but beset with a host of challenges including lack of capacity at the local levels.

Consistent with these conclusions, Habito (2009) found in a cross-country analysis using data from 15 Asian countries that quality of governance, public expenditures in social services, and sectoral composition of GDP growth had significant relationships with the inclusiveness of economic growth:

- Quality of governance measured via the World Bank's World Governance Indicators is significantly correlated to the poverty elasticity of growth. These observations imply that initiatives and investments toward strengthening the quality of governance could be the most crucial measures a country can take toward attaining

[4] While this observation was made by Chaterjee for Asia in general, it may be pointed out that microfinance has found much more application and success in the Philippines relative to most of its Asian neighbors.

inclusive growth, as governance is critical to all government initiatives to reduce poverty and promote broad based growth and development. Apart from enhancing the inclusiveness of economic growth, there is evidence that good governance itself tends to be associated with higher economic growth.[5]

- Public expenditures on education, health, and housing are important to the attainment of inclusive growth. Economic growth by itself, especially when driven by economic sectors with low employment potential, will not guarantee poverty reduction, as borne out by the experience of the PRC and Pakistan in the 1990s, and Mongolia, the Philippines, and Sri Lanka since 2000. In the face of the recent global economic downturn, when fiscal stimulus has been the common prescription for reinvigorating economies, such stimulus spending would be best directed towards improving the health, education, and housing status of poor citizens. However, it is equally important to ensure that stimulus spending is not undertaken at the expense of fiscal sustainability, as experience has shown (e.g., in Indonesia and the Philippines) that a heavy debt service burden will crowd out such crucial public investments in the future.
- A stronger contribution by agriculture to overall economic growth enhances the inclusiveness of growth, particularly in reducing rural poverty. The obvious key to the role of agriculture is the employment it generates in rural areas. But this suggests that promotion of rural enterprises in general, including in agro-based manufacturing and services including tourism, would be instrumental in the attainment of more inclusive, broad-based growth. Promotion and development of small and medium-sized enterprises (SMEs) would thus be a complementary thrust that would help achieve such expansion of rural enterprise and employment. Governments would do well to address the traditional obstacles to access by SMEs to finance, technology, raw materials, and markets.

[5] See, for example, Kaufmann, Kraay, and Mastruzzi (2009); Quibria (2006); and World Bank (1992).

High and Inclusive Growth in the Philippines: The Impediments

There appears to be wide agreement on the four critical factors constraining growth cited by the 2007 ADB Critical Development Constraints Study: (i) tight fiscal situation; (ii) inadequate infrastructure, particularly in electricity and transport; (iii) weak investor confidence due to governance concerns; and (iv) market failures leading to a small and narrow industrial base.[6] While this was the result of analysis of data up to 2006, there is little to suggest that these constraints have eased in subsequent years. Some of these constraints have even worsened (e.g., power supply capacity, fiscal balances, governance performance in voice and accountability, political stability, and rule of law)[7] and are thus likely to have become even more binding to growth (Table 6). More recent analyses by the World Bank (2009) affirm these same constraints to Philippine economic growth.

An informal survey of some 60 economic experts undertaken for this study[8] further affirmed the primary importance of these constraints to growth. Survey respondents were asked to identify the three most prominent impediments to both high and inclusive growth, defined as growth with broad sectoral and geographical participation and benefits. The results of the informal survey were largely consistent with the ADB (2007) and World Bank (2009) analyses: respondents pointed to corruption and weak governance, including weak institutions, as the most commonly perceived critical and underlying impediment to high and inclusive growth in the Philippines (Table 7). The four constraints identified by the ADB study are clearly ultimately linked to weak governance manifested in various forms, as discussed below.

Weak governance is reflected in a tax effort ratio—currently just over 12% of GDP—that is low by both regional and historical standards, which in turn leads to the tight fiscal constraints seen as a major growth constraint by the ADB study and by survey respondents. The problem is apparently not so much due to lower statutory tax rates, which are considered comparable to those of Asian neighbors (Aldaba 2006). Rather, it is attributable to poor tax administration and collection efficiency amid widespread tax evasion and smuggling, with the latter reflecting weak customs enforcement. Politicization of the allocation of public funds—or their outright diversion—further reduces not only the quantity, but also the quality and impact of public expenditures. That GDP growth accelerated after the implementation of the expanded value-added tax (EVAT) in 2006 attests to the critical role of the government's fiscal position in spurring economic growth, and the binding effect of tight revenue constraints.

Lack of infrastructure, which was also affirmed in the informal survey to be among the perceived key impediments to high and inclusive growth, is in turn a direct result of tight fiscal constraints, and thus again stems from weak governance. The inadequacy of infrastructure is manifested in both the quantity and quality of key facilities,

6 More recent analyses by the World Bank (2009) largely affirm these constraints.
7 As measured by the World Governance Indicators reported in Kaufmann and Kraay (2009).
8 Appendix 2 describes the nature and conduct of the informal survey.

Table 6 Fiscal, Infrastructure, and Governance Indicators, 2006–2009

Indicator	Year			
	2006	2007	2008	2009
Fiscal (P billion)				
Revenues	978.7	1,134.63	1,202.90	1,123.21
Expenditures	1040.9	1,144.06	1,271.02	1,421.74
Surplus (Deficit)	(62.2)	(9.4)	(68.1)	(298.5)
Infrastructure				
Electric power capacity (MW)	15,803	15,937	15,681	NA
Road length (km)	28,978	29,370	29,709	NA
Gross Fixed Capital Formation (% growth)	**2.1**	**11.2**	**1.7**	**(9.9)**
Private construction	(2.9)	15.9	11.4	(4.2)
Durable equipment	(1.4)	4.5	1.7	(11.4)
Breeding stock and orchard development	0.0	4.5	(1.6)	(1.4)
Industry Performance (% growth)				
Gross value added (%)	4.5	7.1	5.0	(2.0)
Employment (%)	0.03	3.63	(0.16)	1.32
Governance Indicators (% growth)				
Voice and accountability	(0.08)	(0.16)	(0.20)	NA
Political stability and absence of violence/terrorism	(1.30)	(1.31)	(1.41)	NA
Government effectiveness	(0.09)	(0.04)	0.00	NA
Regulatory quality	(0.12)	(0.13)	(0.05)	NA
Rule of law	(0.44)	(0.54)	(0.49)	NA
Overall Governance (Average)	**(0.41)**	**(0.44)**	**(0.43)**	**NA**

( ) = deficit or negative growth rate, GVA = gross value added, km = kilometer, MW = megawatt, NA = not available, P = peso.
Sources: National Economic Development Authority; NSCB; Kaufmann, Kraay, and Mastruzzi (2009).

and in their high cost (e.g., of energy and power, and of inter-island shipping), thereby undermining the competitiveness of domestic producers. In electric power, capacity expansion and cost reduction has been hampered by slow implementation of, and internal contradictions in, the Electric Power Industry Reform Act (EPIRA) which aims for eventual attainment of a competitive and efficient market for power. The latest *Global Competitiveness Report* (WEF 2010) puts the Philippines behind most of its ASEAN neighbors, including Cambodia and Viet Nam, in infrastructure competitiveness (Table 8).

Weak investor confidence is a direct consequence of policy reversals, and poor policy implementation and enforcement, which are yet further manifestations of weak governance. These undermine the predictability of the policy and regulatory environment, impairing overall business confidence and the general investment climate. De Dios (2010) explains how instances of massive corruption of economic or political processes have led to political instability that has in turn depressed levels of investment. Furthermore, cumbersome government procedures and requirements significantly raise transaction costs for business, further negating the investment climate. Overly centralized decision making is yet another governance weakness that leads to ill-conceived interventions often unresponsive to actual local needs, and a propensity for "one-size-fits-all" approaches involving large-scale procurement prone to graft.

Table 7 Quick Survey Responses: Impediments to High and Inclusive Growth

Reasons Cited	Count	Reasons Cited	Count
GOVERNMENT FAILURES	68	Poor business climate	2
Corruption	21	High barriers to entry	1
Bad Governance	19	Labor rigidities	1
Weak institutions	8	HUMAN DEVELOPMENT WEAKNESSES	30
Inequality/Elite control	6	Poor human capital/Formation	16
Lack of proper planning	5	High population/Growth	5
Corrupt legal system	4	Weak social capital	4
Constitutional rigidities	2	Widespread poverty	3
Lack of insight	2	Brain drain	2
High cost of doing business	1	FISCAL/FINANCIAL CONSTRAINTS	10
ECONOMIC IMPEDIMENTS	39	Poor tax effort/Collection	5
Inadequate Infrastructure	20	Lack of credit for SMEs	2
Neglect of rural development	6	Poor spending practices	2
Macroeconomic problems	3	Low savings rates	1
High cost of doing business	3	EXTERNAL INFLUENCES	3
Lack of investments	3	External shocks	1
Lack of integration	2	Unfair trade	1
Market failure	2	Weak export industry	1

SMEs = small and medium-sized enterprises.

Source: Author's Informal Survey (see footnote 8 and Appendix 2).

Finally, weak governance manifested in regulatory capture fosters monopolistic tendencies, contributing to persistent market failures that have in turn led to a high degree of inequality by perpetuating the historically oligarchic structure of the Philippine economy and society (World Bank 2010; Aldaba et al 2005). The informal survey also commonly cited this oligarchic structure as a key impediment to high and inclusive growth. Inclusiveness is undermined by the traditional dominant control by the ruling political and economic elite, seen to result in persistent capture of opportunities for advancement, while narrowing access to the same for the larger majority who are less endowed. Apart from narrowing benefits from economic growth, the same monopolistic tendencies raise costs in downstream industries, undermining their competitiveness and ultimately leading to the small and narrow industrial base cited as the fourth major constraint to growth in the ADB study (2007).

A common thread linking these difficulties is a low level of public trust in the national government leadership, a sentiment that has consistently been affirmed in respected opinion surveys in recent years.[9] This has hampered the capacity of the economy to deliver inclusive growth, in more ways than one. First, it has constrained government's revenue-raising capacity, having promoted an atmosphere in which tax evasion and tax avoidance are rationalized as justifiable in the face of perceived wide misuse of taxpayer money. Second, and as an offshoot of the first, it has severely limited the capacity of the government to finance the infrastructure needed to support higher levels of private

[9] Social Weather Stations (www.sws.org.ph) and Pulse Asia (www.pulseasia.com.ph) are most commonly cited and considered the most reliable.

Table 8 Infrastructure Competitiveness, Selected Asian Countries, 2009

Country	Score	Rank
Singapore	6.35	4
Malaysia	5.05	26
Thailand	4.57	40
Sri Lanka	3.88	64
India	3.47	76
Indonesia	3.20	84
Viet Nam	3.00	94
Cambodia	2.94	95
Philippines	2.91	98

Source: World Economic Forum. *Global Competitiveness Report 2009–2010*.

investment and thus output growth. Third, it has also hampered the government's ability to provide quality social services, particularly health, education, and housing. And fourth, it has dampened private investment because of the generally negative effect on overall business confidence.

While not seen by the ADB (2007) study as a current binding constraint to growth in itself,[10] weak human capital, and particularly inadequate education and health, was prominently identified by informal survey respondents as an impediment to high and inclusive growth. Nonetheless, the ADB study identified inequitable access to education and health (along with infrastructure and productive assets) as among the critical constraints to poverty reduction. It is thus on inclusiveness of growth that the constraining effect of this factor is seen to impinge more prominently and directly. This is because inadequacies in health and education—some indicators of which show a deterioration since 2000 (Table 9)—have the effect of narrowing access to opportunities by ordinary Filipinos, thereby directly undermining inclusiveness of growth. At the same time, it could well be argued that the same health and education inadequacies impinge on growth itself, through their negative impact on productivity.[11]

Table 9 Selected Health and Education Indicators, 2000–2008

Year	Child Mortality <1 Year Per 1,000 Live Births	Maternal Deaths Per 1,000 Live Births	Life Expectancy (Years)		Net School Participation Rate (%)	
			Male	Female	Elementary	Secondary
2000	15.7	0.96	66.3	71.6	–	–
2001	15.2	1.03	66.6	71.9	96.8	66.1
2002	14.3	1.08	66.9	72.2	97.0	73.4
2003	13.7	1.08	67.2	72.5	90.3	58.3
2004	13.2	1.07	67.5	72.8	81.7	47.0
2005	12.8	1.03	67.8	73.1	76.1	42.5
2006	–	–	–	–	73.5	44.5
2007	–	–	–	–	83.2	58.6
2008	–	–	–	–	84.8	61.9

– = No data available.

Source: NSCB.

[10] This is based on the argument that high rates of unemployment and underemployment suggest that human resources are not a limiting factor to achieving faster growth in economic activity in the country.

[11] The informal survey also commonly cited neglect for rural development as an impediment to high and inclusive growth, which will be addressed below in a discussion of the agriculture sector as a driver for inclusive growth.

Imperatives for High and Inclusive Growth in the Philippines

The above discussions imply that to be effective, economic measures to pursue high and inclusive growth must be underpinned by governance and institutional reforms aimed at restoring the overall level of public trust in government. As pointed out above, a lack of such trust has abetted low tax compliance, inhibited investment, and ultimately stifled the growth of the economy. Indeed, in the informal survey governance reforms (control of corruption, reform and strengthening of institutions, improving the country's leadership, and improved law enforcement) were the most dominant answers when respondents were asked to identify the most critical interventions needed to attain high and inclusive growth (Table 10). Thus, the road map to high and inclusive growth in the Philippines must consist of an economic reform agenda that is underpinned by a governance and institutional reform agenda. Elements of both are outlined and discussed below.

Economic Reform Agenda

Unleashing Growth

The Philippine economy needs to break out of its historically low growth performance relative to its East Asian neighbors to make more significant headway in reducing poverty. Various analyses point to the need to achieve a sustained growth rate in the range of 7%–9%, or about 5%–7% per capita income growth (Balisacan 2007; World Bank 2009a). There is wide agreement that achieving higher rates of growth is a necessary condition for a significant and sustained reduction in poverty, but it is not a sufficient condition, as indicated by the recent rise in poverty in spite of record growth.

As discussed earlier, the constraints to higher economic growth identified by the Critical Constraints Study (ADB 2007) have remained binding. Hence, achieving accelerated growth of the Philippine economy under a regime of macroeconomic stability hinges on economic measures that directly and deliberately address these growth constraints. The added goal of inclusiveness of growth further qualifies the need for the growth agenda to ensure a broadening of the base of economic growth. Given this, the thrust for inclusive economic growth must necessarily focus on four primary goals:

- achieve a substantial boost in tax revenues;
- dramatically expand and improve the infrastructure base;
- attain massive, broad-based enterprise development; and
- democratize the economy through strengthened asset reform and competition policy.

While the government's tight fiscal constraints can and should be addressed from both the revenue and expenditure sides, the more binding constraint in recent years has been revenues, especially as expenditure compression had caused concern in past years. Thus, a substantial boost in tax revenues is of highest priority in the economic agenda, even as efforts to enhance the quality of public expenditures must continue. The country's inferior infrastructure relative to its ASEAN neighbors has impaired its attractiveness to both domestic and foreign investors. A deliberate and extraordinary infrastructure catch-up program is thus called for to close the gap. Apart from filling the infrastructure gap, addressing the constraint of low investments

Table 10 Quick Survey Responses: Interventions for High and Inclusive Growth

Reasons Cited	Count	Reasons Cited	Count
GOVERNANCE REFORMS	72	FISCAL/FINANCIAL REFORMS	23
Combat Corruption/Provide Transparency and Accountability	19	Improve Tax Administration	15
Reform/Strengthen Institutions	16	Provide affordable credit and support to SMEs	3
Improve Leadership; Better Appointments	14	Better public expenditure management	2
Improve Law Enforcement	5	Improve savings and investments	2
Electoral reform	4	Channel OFW remittances to infra and human capital	1
Better strategic planning	4	ECONOMIC MANAGEMENT	14
Legal/Regulatory reform	3	Open Economy Further/Increase Competition	7
Decentralization/Empower LGUs	2		
Policy continuity and consistency	2	Improve business climate	3
Reduce size of bureaucracy	1	Develop key sectors	2
Constitutional reform	1	Stabilize prices	1
Strengthen judiciary, media	1	Create more jobs	1
DEVELOPMENT INTERVENTIONS	42	OTHER	6
Improve Human Capital Formation thru Health and Education	16	Environmental protection measures	3
Increase Infrastructure Investments	13	Separate church from state	1
Invest in Agricultural/Rural Development	6	Strengthen family and communities	1
Population control	3	Inspire the people	1
Better poverty intervention strategies	3		
Food sufficiency	1		

LGU = local government unit, OFW = overseas Filipino worker, SMEs = small and medium-sized enterprises.

will require interventions in the nature of both governance and institutional reforms, and economic reforms. The governance and institutional component must include bureaucratic improvements to reduce the cost of doing business, and ensuring policy consistency to improve investment security. The economic component must also aim at massive enterprise development across all scale levels, with particular attention to the development of SMEs as a tool for more inclusive growth. Finally, addressing the market failures that have narrowed the economy's industrial base will require sustained asset reform to broaden access to productive assets and the economic opportunities they provide. It will also require economic and governance reforms to strengthen competition policy that levels the playing field for all economic actors, and move away from the traditionally oligarchic nature of the Philippine economy and Philippine society.

Restore Tax Effort to at Least 17% of Gross Domestic Product

The weakest link in the country's economic management has been revenue performance. The critical importance of restoring wide trust and confidence in the national government and its ability to spend public resources responsibly for maximum public benefit cannot be overemphasized. As indicated earlier, the lack of such trust and confidence has made it difficult to improve tax compliance over the years. Further exacerbating this is poor collection performance and corruption in the key revenue agencies, namely the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC). Unsurprisingly, improved tax administration was a prominent prescription emerging from the informal survey.

A tax-to-GDP ratio of 17% had already been achieved in 1997; hence this is not an unrealistic target. The implied 4–5 percentage point boost in tax effort, if achieved in 2009, would have translated to additional revenues of up to P385 billion—more than enough to eliminate the entire government deficit. Apart from the necessary measures to address the governance and institutional agenda discussed above, raising the tax effort requires a combination of tax administration improvements and tax policy enhancements, with greater emphasis and reliance on the former. It is important that government address the long-standing injustice inherent in resorting to tax increases whenever revenues need to be further raised. In the absence of achieving significant improvement tax collection efficiency, or even allowing it to worsen, this approach perennially and unfairly penalizes and places the burden on compliant taxpayers while effectively tolerating rampant tax evasion and fraud. It is thus incumbent on the government to pursue administrative solutions with unprecedented vigor.

Based on the above, the following tax administration reforms merit serious attention and renewed efforts from the government:

- **Resume the effort to transform the revenue agencies into semi-autonomous revenue authorities.** There is much empirical evidence showing that under the right circumstances, corporatizing revenue agencies has led to significant increases in tax collection elsewhere (Manasan 2003). This proposal is not new; it was pushed in the early years of the Arroyo administration, but was later abandoned in the face of strong resistance from the agencies concerned. As Manasan's study concluded, the key is in sustaining the autonomy of the revenue authority once it is established, to avoid erosion of the revenue gains achieved.
- **Optimize information and communication technology (ICT) support and capability in BIR and BOC.** Computerization at the revenue agencies, along with improved access to third-party information—such as that from the Securities and Exchange Commission (SEC), the Land Transportation Office (LTO), and local government units (LGUs)—has vastly increased the potential for these agencies to detect and curb tax evasion. However, their internal capability to process and analyze data has apparently not kept pace with the massive volume of data accumulated and made available to the agencies. A thorough management audit must be conducted, in particular to determine the human and physical resource requirements for optimizing the usefulness of the available information base toward boosting tax collection. BIR must also be open to more active partnerships with civil society organizations, academe, and local governments in improving its tax collection capability. Such partnerships must include better access by civil society partners to nonconfidential tax data (i.e., excluding individual tax records) for the purpose of improving tax enforcement. Data sharing between BIR and LGUs must also be maximized to improve revenue collection capabilities on both sides.
- **Institute personnel and process improvements in the revenue agencies that will minimize (if not eliminate) scope for discretion by revenue officers and avoid face-to-face contact between revenue officers and taxpayers.** Such discretion and face-to-face contacts provide opportunities for corruption (via extortion and bribery) that have historically been the main source of revenue leakages. Various ICT-based solutions now eliminate the need for face to face contact. BIR also needs to strengthen its capability to follow up nonresponses to the letter notices that are automatically sent to taxpayers found to have dubious tax declarations. In general, BIR and BOC need considerable upgrading of their tax enforcement capabilities through improved human and

physical resource support to send a clear message to taxpayers that tax evasion and tax fraud will not pay.

- **Prosecute and convict high-profile tax evaders.** This has been a long-standing recommendation widely acknowledged to be an effective tool for boosting tax compliance, as it represents a clear demonstration of the government's seriousness in enforcing proper tax compliance. That it has remained an unfulfilled recommendation over the years, notwithstanding the existence of a number of well-publicized tax evasion cases, reflects the degree of political will and statesmanship that must be mustered by the government to truly make a difference and bring government revenue performance to a new and higher level.

Some tax policy enhancements are also both inevitable and desirable. Two merit immediate attention by the government:

- **Reform excise taxes on alcoholic beverages and tobacco products ("sin taxes") to correct revenue-eroding features.** The current law on sin taxes is considered by many, including the Department of Finance (DOF), to have been "watered down" from the original proposal made by DOF. The result has been a dramatic reduction in the measure's revenue-raising potential from what was originally envisaged. Among other things, the price basis to determine the base of the tax on cigarettes (pegged then to 1997 price levels for older brands) needs to be improved to reflect current realities and permit a much stronger revenue yield from the tax. There is also a need to simplify the four-bracket structure of the tax into a uniform rate, which will correct the discriminatory treatment of imported products that has attracted complaints from foreign governments. In light of the World Health Organization (WHO) finding that identified the Philippines as having among the lowest tax rates on cigarettes (WHO 2010), there is clearly much scope for further raising the "sin taxes."
- **Rationalize fiscal incentives.** DOF estimates up to P300 billion revenues foregone per year due to various fiscal incentives (Senate Economic Planning Office 2005; Briones 2008). However, a substantial portion of such incentives are deemed to be redundant, hence an unnecessary loss of revenue to the government. Reside (2006) further observed that the "redundancy-ridden incentives system of incentives provision has therefore tended to be inequality-preserving and inequality-reinforcing" across both regions and social classes, in direct violation of the equity principle of a good tax system. He recommended the granting of incentives only to exporters, elimination of the fiscal incentives-granting function of the Board of Investments (BOI), streamlining of other incentives, stricter screening and monitoring procedures at other investment promotion agencies (IPAs) to prevent leakages, greater coordination between the IPAs and BIR in monitoring IPA-registered firms, and the consolidation of all incentives into a single law that recognizes the potential negative fiscal and economic externalities of redundant incentives provision.

Two other tax enhancements that could potentially raise significant additional revenues, but are likely to be highly controversial and meet with strong public resistance are: (i) a further increase in the rate of value-added tax (VAT) from the current 12% to 15%, coupled with a reduction in the corporate income tax rate from 30% to 20%; and (ii) increased excise taxes on petroleum products.

The first of these measures is likely to be perceived as anti-poor and pro-rich—hence running counter to inclusiveness—and thus merits thorough empirical analysis to establish its revenue and incidence effects.[12] Results of analyses of the previous VAT rate increase from 10% to

[12] Such an analysis is beyond the scope of this paper, and would best be conducted as a general equilibrium analysis that assesses the full range of impacts of the simultaneous measures across industries and across income groups.

12% by Newhouse and Zakharova (2007) on incidence and by Manasan (2008) on revenue effects are indicative. Manasan estimated that the VAT expansion contributed 0.53 percentage points out of BIR's total 1.12 percentage point improvement in tax effort (tax-to-GDP ratio) in 2004–2007, thus affirming a significant revenue yield. But this was only second to (and just a little over half of) the revenue yield of the temporary increase in the corporate income tax from 32% to 35%, which led to a 0.93 percentage point improvement in tax effort.[13] Meanwhile, Newhouse and Zakharova determined that the VAT rate increase was borne more heavily by higher income groups in terms of both proportionate share in generated revenues, and percentage reduction in expenditures induced. They nonetheless recognized that (i) the VAT increase imposed a significant burden on the poor, which the government attempted to mitigate with certain measures, and (ii) the mitigating measures undertaken by the government significantly benefited the rich along with the poor. It is also implicitly acknowledged that the expanded VAT took a relatively larger slice from the incomes of the poor relative to the rich, due to the capability of the latter to save part of their incomes (and in so doing avoid the tax). In other words, the expanded VAT was considered progressive on the basis of relative impact on expenditures, but regressive on the basis of incomes, as is the tendency with indirect taxes. Manasan (2008) also noted that a significant decline in tax collection efficiency (a 0.8 percentage point reduction in tax effort) accompanied the various tax enhancements. These findings taken together suggest the following likely effects of the proposed further VAT increase from 12% to 15% coupled with a reduction of corporate income tax to 20%:

- VAT compliance is likely to deteriorate further (i.e., the evasion rate will rise further) with the even larger increase being contemplated, in the absence of substantial improvements in collection efficiency. There is even the possibility of a Laffer curve effect,[14] inducing reduced overall VAT revenue collection.
- Revenue reduction from the proposed 10 percentage point cut in corporate income taxes is likely to more than offset the revenue gains from the 3 percentage point VAT increase.[15]
- Without extraordinary efforts to improve tax administration, overall tax compliance and collection efficiency is likely to decline further with the proposed twin measure.

The findings cited above, plus the strong political resistance and social implications likely to ensue, thus provide a compelling argument for extreme caution toward the twin measure currently being contemplated. At the same time, one is led to the conclusion that intensified efforts to improve tax administration are essential, whether or not additional tax measures are introduced.

The second potentially controversial measure is an increase in the excise taxes levied on petroleum products, justified on the basis that the rate of petroleum taxation in the Philippines has fallen behind historical levels and in relation to other countries. Due to its widespread implications, such a measure should likewise be subjected to thorough incidence analysis, particularly to ascertain its compatibility with ensuring inclusiveness of growth. In any case, and as argued above, strong and determined efforts toward dramatic improvements in tax administration should take precedence over controversial tax enhancement measures such as these.

Program and Implement a Massive Multi-Year Infrastructure Catch-Up Program

The Philippines has much catching up to do in infrastructure development relative to its more dynamic ASEAN neighbors (Table 8) and relative to its own requirements. Within ASEAN,

[13] Note that the two do not add up to the total because of the negative impact of other tax measures on overall tax effort.

[14] The effect described by Arthur Laffer wherein tax revenues as a function of tax rates follow an inverted U shape; that is, beyond a certain "optimum" tax rate, revenues are expected to decline. See Laffer (2004)

[15] Given the experience with the temporary increase in the corporate tax rate from 33% to 35% that led to a substantial increase in the tax effort (Manasan 2008), a Laffer curve effect of higher revenues from lowering the tax rate cannot be expected here.

its infrastructure has fallen behind even that of Cambodia and Viet Nam. Hence, increasing infrastructure investments was another prominent prescription in the informal survey. While public infrastructure provision will have to be the main responsibility of the government through its public investment program, fulfilling this role crucially hinges on success with the above revenue-raising agenda.

At the local level, there remains wide scope for improving rural infrastructure provision by LGUs through improved local development planning and public investment programming. Improved implementing mechanisms among LGUs, including resource pooling arrangements, also provide scope for increased efficiency in public infrastructure delivery at the local levels. Appendix 1 provides a discussion of rural infrastructure (Section I–C; Box A1.2).

If substantial improvements in revenue collection are not forthcoming, the logical recourse will be continued heavy reliance on private sector resources to finance infrastructure development via public–private partnerships (PPPs), i.e., via the build–operate–transfer (BOT) scheme and its variants. However, previous changes in project evaluation and approval procedures for such projects from the Office of the President, while ostensibly aimed at streamlining the process, had been viewed with concern by the business and donor communities, which saw them as having compromised the integrity of the system.

It is thus crucial that these rules governing PPPs be revisited to ensure that both ends are served.[16] The imperative is to address bottlenecks in government approval processes that will provide an attractive investment environment, while ensuring transparency and appropriate competition to uphold the public interest in the selection of projects and providers.

Adopt a Government-Wide Thrust for the Development of Small and Medium-Sized Enterprises

The Philippine economy needs job-creating growth with broad sector and geographic reach. Such broad-based growth would best come from the widespread development of SMEs nationwide, especially in the rural areas where the bulk of the country's poor reside. Consistent with this, the informal survey also identified investment in agricultural and rural development as a common prescription for high and inclusive growth.

The country needs a "big push" for enterprise development that would have all government agencies and instrumentalities contributing to the thrust. Promotion and development of SMEs should be declared as the centerpiece of the government's economic program, wherein all government agencies and units at all levels are obliged to ensure that their policies, programs, and projects contribute to a generally favorable enabling environment for SMEs. In particular, efforts must contribute to the easing and widening of access by SMEs to financing, technology, raw materials, and markets.[17] What is needed is substantial upscaling of efforts and a government-wide commitment to the development of SMEs, given the magnitude of the challenge.

The enterprise sector of the Philippines is often cited as having a particularly glaring feature described as the "missing middle." In 2002, more than 91.9% of enterprises were microenterprises (the bulk of which were in the informal sector), while 0.3% were large. SMEs thus accounted for a mere 7.8%. In relation to this, analysts have stressed the importance of making a distinction between microenterprises and SMEs (Box 1, Tan 1997).

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[16] A set of widely consulted revised guidelines (Revised Implementing Rules and Regulations) for the BOT Law had already been formulated by the BOT Center and had been endorsed by the business community after 2 years of wide consultations. However, this was summarily set aside when the Office of the President issued its own version. No major BOT project has been approved since.

[17] This has been the subject of numerous studies. See, for example, Tan (1997), Habito and Bautista (2005), and Madarang and Habito (2006) for discussions on past and present government programs in support of SME promotion and development in the country.

Box 1 Defining Small and Medium-Sized Enterprises

The Philippines employs two criteria in operationally defining SMEs, namely employment and asset size (see table below). The National Statistics Office classifies an enterprise as a microenterprise if it has less than 10 employees, small if it has 10–99 employees, medium with 100–199 employees, and large if it has 200 or more employees. This criterion lends itself readily to international comparisons.

Definition of Small and Medium-Sized Enterprises by Employment and by Asset Size

Size	By Employment	By Asset Size
Micro	1–9 employees	Up to P3,000,000
Small	10–99 employees	P3,000,001–P15,000,001
Medium	100–199 employees	P15,000,001–P100,000,000
Large	200 and above employees	P100,000,001 and above

Sources: National Statistics Office; Small and Medium Enterprise Development Council (SMEDC) Resolution No. 1, Series 2003.

On the other hand, the Small and Medium Enterprise Development Council (SMEDC) uses asset size as its basis for classification. A drawback with this criterion is that periodic adjustment of the definition may be necessary because of changes in the price level through time. In addition, comparison across economies is difficult, or would be questionable at best even if asset values were to be converted into a common currency like the US dollar.

There is a tendency within government circles to lump microenterprises and SMEs together and treat them as one, hence, the common reference to "MSMEs" in government initiatives to promote livelihood and enterprise. However, the requirements of SMEs are very different from those of microenterprises—most of which tend to be informal sector enterprises—and programs to assist the latter may not be very helpful to the former, and vice versa. For this reason, it is argued that government institutional support for the two should be kept distinct and separate, and handled by distinct government bodies and agencies.[18] It is even likely that this tendency to lump microenterprises and SMEs together could compromise government support—especially for the latter, if it was to become overwhelmed by the sheer number of the former.

This recommended focus on SMEs need not imply a bias against large enterprise; indeed, a key element of the strategy for SMEs would be to foster closer synergy between large-scale enterprises and SMEs, as is common among Japanese enterprises. By deliberately relying on SMEs as contractors and suppliers of product components as in the Japanese auto industry, large enterprises would actually help sustain, rather than supplant, smaller enterprises.

Asset Reform and Competition Policy

Even as the above three thrusts are employed in pursuit of rapid and broad-based growth, market forces alone cannot be relied on to overcome fundamental inequities in the Philippine economy and Philippine society. First, inequities stem from a historically skewed distribution of assets that has been further exacerbated through time by similarly skewed access to opportunities for advancement. Second, markets left to themselves—especially where economies of scale prevail—tend naturally toward increased market concentration, thereby necessitating a deliberate competition policy to maintain a level playing field. Thus, the asset reform programs of the

[18] Personal communication, Prof. Quintin Tan, circa 2005.

government—embodied in the Comprehensive Agrarian Reform Program (CARP) for the agrarian/agriculture sector; the Indigenous People's Rights Act (IPRA) for indigenous upland communities; the Fisheries Code for coastal fishers; and the Urban Development and Housing Act (UDHA) for the urban poor—need to be faithfully implemented, sustained, and intensified to address the inequities that dampen the inclusiveness of growth as highlighted in Chatterjee (2005). At the same time, the economic policy environment must continuously provide for adequate competition through both policy and regulatory instruments.

A recent Asset Reform National Report Card study initiated and undertaken by civil society organizations and coordinated by this author (PhilDHRRA 2008) found that the government has been deficient in delivering asset reform and its associated services, meriting a rating of "poor" from a multi-stakeholder panel that included candid representatives from the government itself. CARP, the most prominent among the government's asset reform programs, has been extended another 5 years by recent legislation. The continuing challenge is the provision of responsive and timely support services to agrarian reform beneficiaries. Governance weaknesses including weak coordination, overlapping mandates, conflicting laws, lack of clear accountabilities, and poor inter-agency communication have been the typical hurdles to more expeditious conduct of the various processes and delivery of services under the asset reform programs. The assessment concluded that (i) asset reform in its various forms has been positive and beneficial steps taken by government deserve to be continued, intensified and implemented more efficiently and expeditiously, but that (ii) effective asset reform ultimately hinges on good governance and political will, which have so far been the primary constraints to better performance and achievement.

The government would do well to move toward firming up a legislated competition policy (i.e., similar to anti-trust legislation in Western countries) that would consolidate laws governing competition in specific industries and sectors. These would include key industries and sectors in which a lack of competition (and thus higher costs) has impeded inclusive growth in the rest of the economy, such as domestic shipping, port services, air services, utilities, and media. These industries are critical elements in the value chain, in particular for agriculture and manufacturing, which are critical sectors for the achievement of broad-based growth in the economy, as further discussed below.

Pushing Production: Drivers for Inclusive Growth

Where would the targeted annual GDP growth of 7%–9% come from? The policy agenda discussed above identifies imperatives for facilitating investment and promoting capital accumulation that would provide the underlying basis for sustained growth. The question remains of what specifically would drive the desired 7%–9% growth on the demand and supply sides.

On the demand side, the growth push may come from any of the four major categories of expenditures in the economy: personal consumption expenditures, government expenditures, capital formation and its various components, or net exports. Their growth rates over the past 10 years are shown in Table 11 and in Figures 2 and 3. Recent historical experience shows that exports and capital formation, particularly in public and private construction, have demonstrated capacity to grow well beyond 8%, and would therefore be the most promising growth drivers on the demand side. Exports, in particular, will have continued wide scope for further growth, given the country's still relatively lower exports-to-GDP ratio compared to its East Asian neighbors (Table 12). Public construction would likewise pick up if the government was to embark on the massive infrastructure catch-up program recommended above. Growth in public construction reached 8.5% in 2003, but has stayed within and below 8% in most years since 2000. Along with private construction, there is wide scope for accelerated growth in durable equipment investments beyond 8% in the years ahead, given the new opportunity to overcome governance concerns that have dampened private investment since 2000. In sum, the likely demand-side growth drivers will be exports, construction (both public and private), and durable equipment investments. Meanwhile, continued growth in overseas remittances will

Table 11 Sectoral Growth Performance, 2000–2009

Indicator	Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross National Product	4.8	3.4	4.5	5.6	6.2	5.6	6.1	8.0	6.2	3.0
Net Factor Income from Abroad	12.8	7.2	5.0	17.9	8.5	13.5	13.3	16.5	30.8	20.1
Gross Domestic Product	4.4	3.2	4.4	4.7	6.0	5.0	5.4	7.2	3.8	0.9
BY EXPENDITURES										
Personal Consumption Expenditure	3.5	3.6	4.1	5.3	5.8	4.9	5.5	5.8	4.7	3.8
Government Consumption	6.1	0.3	2.4	0.5	0.0	4.0	6.1	8.3	3.2	8.5
Capital Formation	5.5	1.3	(3.5)	0.1	9.5	(6.0)	2.7	11.2	1.7	(9.9)
Fixed Capital	3.1	(2.2)	2.4	2.9	4.2	(3.9)	1.4	11.8	2.9	(3.5)
Of which:										
Construction	2.6	(3.0)	0.3	(2.9)	3.0	(0.9)	5.5	21.3	4.6	3.9
Public	6.6	(6.1)	(1.8)	(15.5)	0.0	(4.6)	24.7	29.6	(0.4)	15.7
Private	(1.5)	0.3	6.6	6.8	4.8	1.2	(3.7)	15.9	8.2	(4.2)
Durable Equipment	3.6	(2.7)	4.8	8.5	5.8	(7.1)	(1.8)	4.5	1.9	(11.4)
Breeding Stock and Orchard Development	3.7	5.8	3.3	2.4	0.8	0.8	(0.4)	4.5	(1.5)	(1.4)
Exports	17.7	(5.2)	3.6	4.4	14.1	4.2	11.2	5.6	(1.9)	(14.2)
Imports	4.0	(0.8)	4.7	10.2	5.9	2.4	1.9	(4.5)	2.4	(5.8)
BY OUTPUT SECTOR/INDUSTRY										
Agriculture, Fishery, and Forestry	3.4	3.7	3.3	3.8	4.9	1.8	3.8	4.9	3.2	0.1
Agriculture	4.3	3.5	3.5	2.7	4.0	0.9	3.1	4.5	2.5	(0.7)
Fishery	10.6	5.5	6.1	6.9	8.2	5.6	5.6	6.4	5.2	2.4
Forestry	(19.5)	(33.5)	(66.4)	23.2	29.8	(31.3)	(4.0)	(10.5)	1.7	(1.1)
Industry	4.9	1.3	3.7	3.8	5.2	4.9	4.5	7.1	5.0	(2.0)
Mining/Quarrying	10.0	(6.6)	51.0	16.8	2.6	9.3	(6.1)	25.9	1.9	21.1
Manufacturing	5.6	2.9	3.5	4.2	5.1	5.6	4.6	3.4	4.3	(5.1)

continued on next page

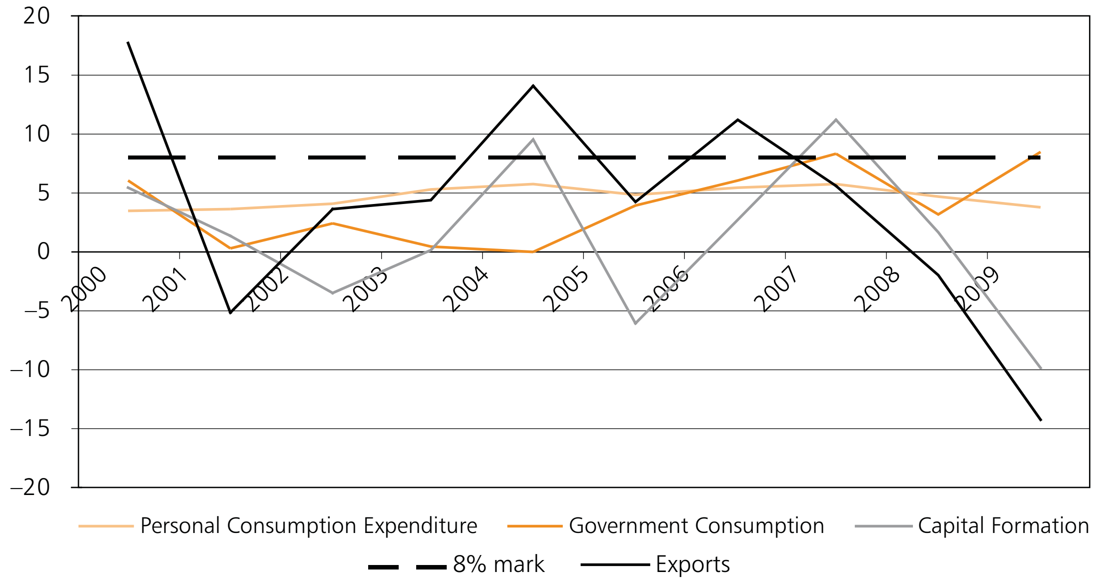
Table 11 *continued*

Indicator	Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Construction	1.4	(3.6)	(3.3)	(2.6)	7.4	0.9	7.3	23.1	7.8	5.8
Utilities	4.2	0.7	4.3	3.2	4.2	2.5	6.4	6.7	7.3	(2.8)
Services	4.4	4.4	5.4	5.8	7.1	6.4	6.7	8.1	3.3	3.2
Transport, Communications, and Storage	10.4	8.8	8.9	8.6	11.2	7.2	6.3	8.3	4.2	1.8
Trade	5.2	5.6	5.8	5.7	6.8	5.6	6.1	8.2	1.2	2.9
Finance	0.9	1.2	3.4	7.1	8.4	13.6	11.4	13.1	2.5	7.1
Own Dwelling and Real Estate	0.0	(0.5)	1.7	4.0	5.3	5.4	5.7	5.9	5.7	(1.0)
Real Estate	(6.4)	(10.7)	(0.7)	9.9	16.1	15.4	17.1	18.1	14.8	(10.5)
Private Services	4.8	4.4	5.5	5.1	6.7	5.5	6.9	8.4	4.9	3.8
Government Services	1.7	2.7	4.7	2.9	2.2	1.9	4.7	2.6	5.5	5.0

( ) = negative.

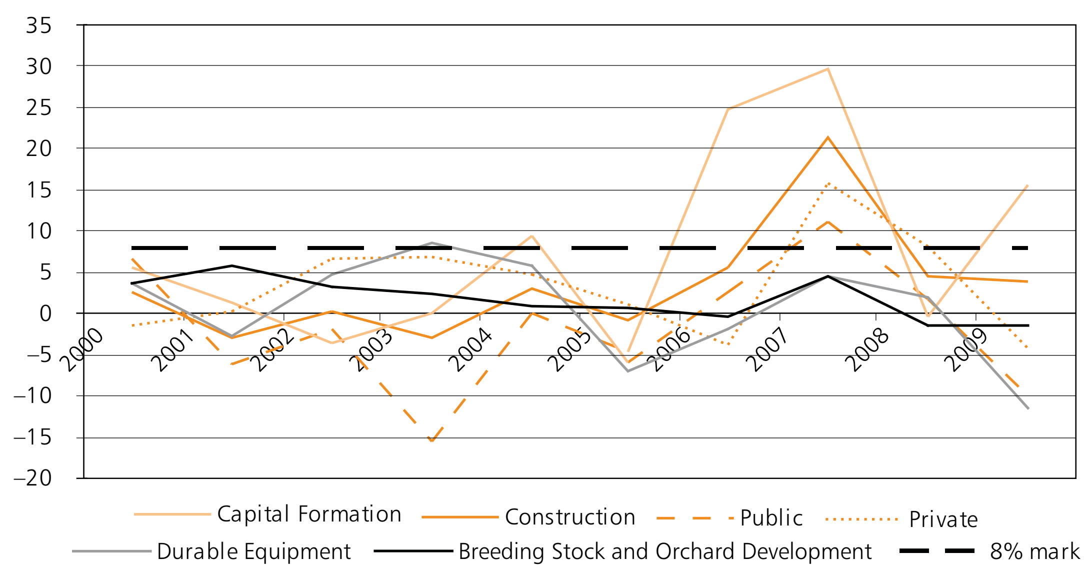
Source: NSCB.

Figure 2 Gross Domestic Product Expenditure Categories, Growth Rates, 2000–2009



Source: NSCB.

Figure 3 Capital Formation and Components, Growth Rates, 2000–2009



Source: NSCB.

continue fueling private consumption growth within the historical range of 4%–6%, while similar moderate growth is expected in government consumption expenditures as the government seeks to achieve fiscal consolidation in the wake of record current deficits.

On the production side, fishery and forestry have demonstrated the capacity to grow beyond 8%; however, growth rates are highly erratic (Table 11 and Figure 4). In industry, mining and quarrying, and construction have posted double-digit growth in recent years (Figure 5). A number of manufacturing industries including food, furniture and fixtures, electrical and non-electrical machinery, and publishing and printing have also achieved growth rates beyond 8%. In services, the most rapid growth has been in finance, (tele)communications, real estate, and business services, especially business process outsourcing (BPO).

In the drive to boost productive investments—which will require a big push for enterprise development at the large, medium, small, and micro scales—the above sectors and industries will thus merit special attention to help propel the 7%–9% GDP growth necessary for sustained poverty reduction. Inclusiveness will be further served if growth is driven by sectors and industries that (i) are labor intensive (hence job-creating), and/or (ii) possess extensive backward and forward linkages to the rest of the domestic economy. Based on these criteria, it is possible to determine the sectors and industries that hold the greatest potential for inducing more inclusive economic growth using the economy's input–output table produced by the National Statistical Coordination Board (NSCB).[19] The derivation of the forward and backward linkage indexes from the input–output table is explained in Appendix 3. The sectors and industries identified to have relatively high labor content and strong backward and forward linkages are appropriate objects for enterprise development initiatives from government.

Table 13 presents the labor coefficients and the backward and forward linkages indexes of the economy's production sectors based on the 11-sector input–output table for 2000 from NSCB. Applying the above criteria, the following sectors and industries emerge as good potential drivers of high and inclusive growth:

- agriculture and agribusiness;
- tourism;
- BPO;
- food and design-based manufactures; and
- mining.

Each of these is discussed briefly below.

Agriculture and Agribusiness

Taken together, agriculture and food manufacturing possess strong interindustry linkages and relatively high labor coefficients, indicating wide scope for benefits arising from growth in the sectors. With 70% of the country's poor and the bulk of the underemployed situated in rural areas, it stands to reason that agriculture and its allied industries remain the focus for pursuing improvement in the standards of living of the rural population. The opportunities in, and potential of, high-value horticultural crops in particular are very promising, as demand in developed countries and in the rest of Asia has grown briskly and is projected to sustain rapid growth in the years ahead. The reforms persistently needed in agriculture are a mix of technical and institutional, with challenges in the latter becoming more prominent in recent years. The following recommendations are borne out by various analyses of the sector:[20]

- reform the agricultural bureaucracy and budget toward greater decentralization, depoliticization, elimination of overlaps, and stronger roles for local governments in program and project design, among other things;
- boost rural public infrastructure investments under a holistic value chain approach, with strong roles for LGUs in programming and provision coupled with transparency mechanisms done in partnership with civil society;
- promote and facilitate clustering of small and medium producers to gain benefits

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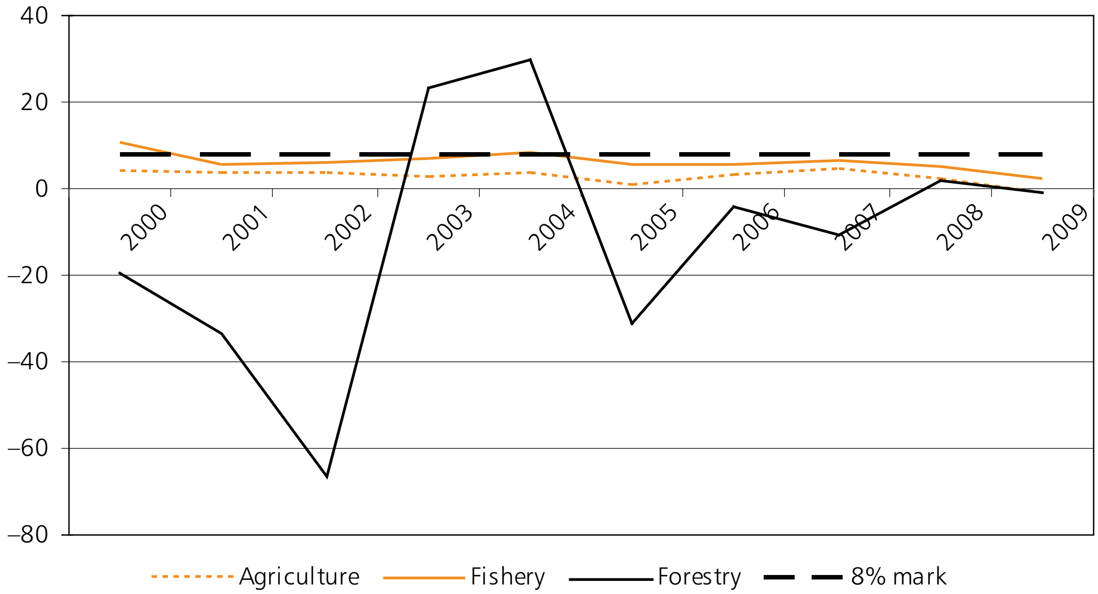
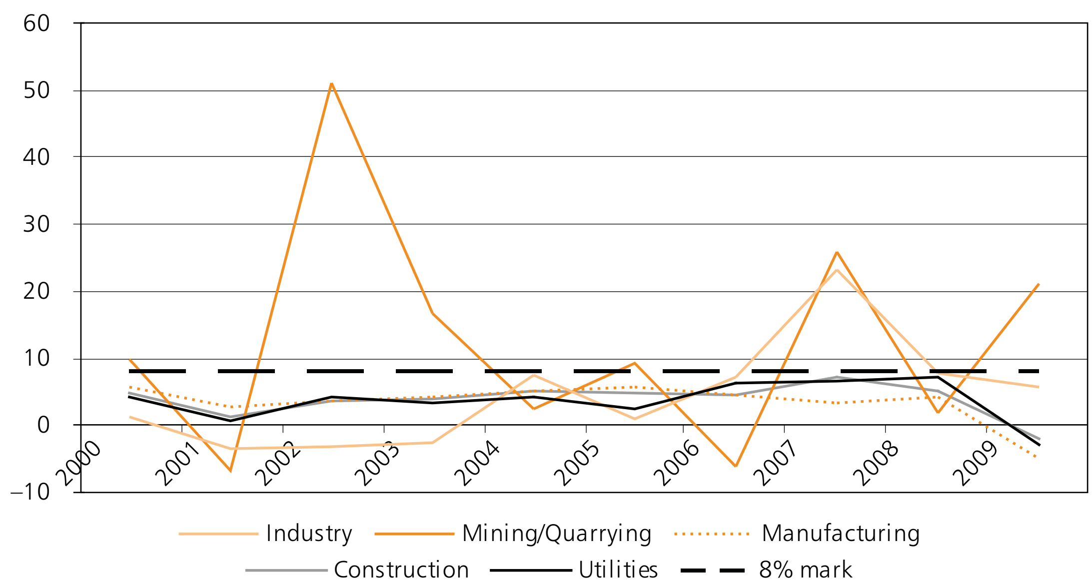
19 Available from NSCB on CD.
20 See, for example, Balisacan (2007), Dy (2006), and World Bank (2007).

Figure 4 Agriculture Sector/Subsector Growth Rates, 2000–2009



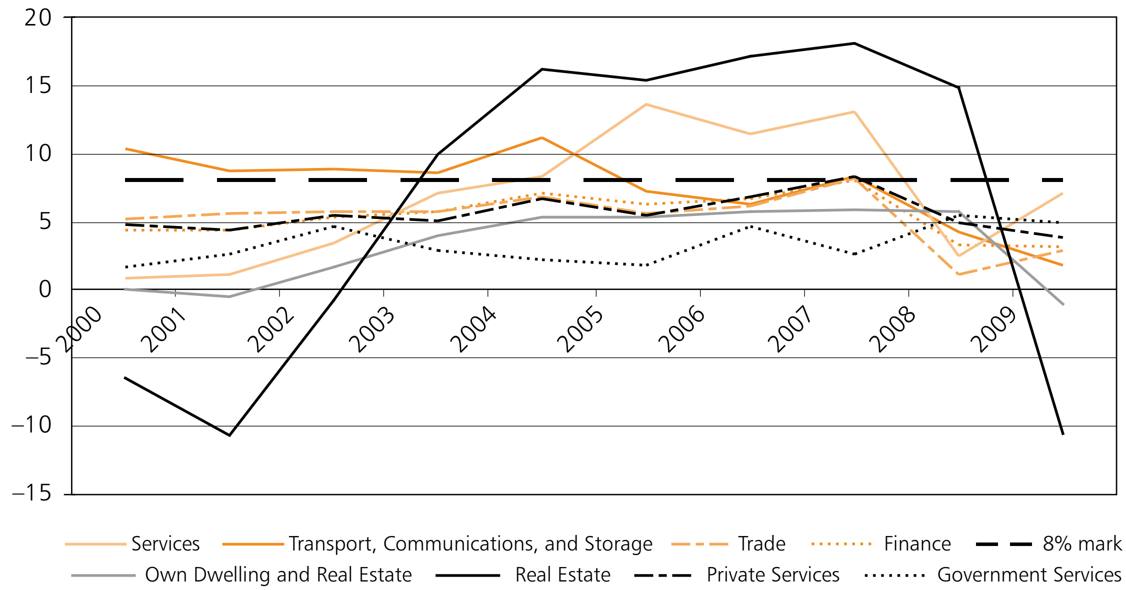
Source: NSCB.

Figure 5 Industry Sector/Subsector Growth Rates, 2000–2009



Source: NSCB.

Figure 6 Services Sector/Subsector Growth Rates, 2000–2009



Source: NSCB.

Table 12 Exports-to-Gross Domestic Product Ratio, ASEAN-5 Countries

Country	Ratio (%)
Singapore	234.3
Malaysia	118.4
Thailand	76.4
Indonesia	49.6
Philippines	46.7

ASEAN = Association of Southeast Asian Nations.

Source: ADB. *Key Indicators of Developing Asian and Pacific Countries*.

of economies of scale and better access to markets;

- foster small and medium-scale agricultural processing enterprises to widen rural non-farm livelihood and employment, while avoiding monopsonistic tendencies in primary product markets; and
- address bottlenecks in CARP implementation and accelerate completion of agrarian reform, along with ample provision of agriculture support services for beneficiaries and farming communities in general.

Tourism

From Table 13, tourism emerges as having the strongest interindustry linkages among the sectors of the economy. Apart from having great potential for wide internal linkages to the domestic economy, tourism also paves the way for wider foreign investment into the country, inasmuch as every foreign investor entering the country first visits as a tourist. The potential for both domestic and foreign tourism remains vast, with the latter fueled especially by rapid growth in the giant economies of the PRC and India, providing new tourism markets beyond the more traditional ones of Japan, the Republic of Korea, Europe, and North America. There is acknowledged to be a wide potential for tourism in the country in various specific niches such as ecotourism, historical and cultural tourism, and medical tourism. Aging populations in developed countries propel continued growth in demand for aging-related industries such as medical tourism and retirement estates, as well as export of caregiving services.

A key policy impediment has been the continued restrictiveness of civil aviation policies that

Table 13 Backward and Forward Linkage Indexes and Labor Coefficients

Sector	Backward Linkage Index	Forward Linkage Index	Sum	Labor Coefficient
Tourism	12.3031	8.2372	20.5403	0.0987
Food Manufacturing	4.5966	13.2302	17.8268	0.2577
Manufacturing	2.5625	2.8780	5.4405	0.1319
Footwear, Wearing Apparel	1.8807	1.3536	3.2344	0.1755
Private Services	1.2953	1.0581	2.3534	0.2432
Transport, Communications, and Storage	1.2998	0.8859	2.1857	0.2644
Trade	1.0840	0.8800	1.9640	0.6873
Construction	1.1852	0.6292	1.8145	0.1397
Agriculture, Fishery, and Forestry	0.6616	1.0307	1.6923	0.1211
Government Services	0.8937	0.5875	1.4812	0.1333
Finance	0.6813	0.7624	1.4437	0.0249
Electricity, Gas, and Water	0.4787	0.8237	1.3024	0.0734
Mining and Quarrying	0.4570	0.8162	1.2732	0.1339
Real Estate and Ownership of Dwellings	0.4009	0.6482	1.0491	0.1549
Business Process Outsourcing	0.4479	0.0399	0.4878	0.3075

Source: Computations by author from the NSCB 2000 Input–Output Table.

effectively limit the availability of seats on flights into the country, and raise travel costs relative to other Southeast Asian destinations. An open-skies policy for secondary airports needs to be pursued to reap similar gains to those achieved by ASEAN neighbors like Cambodia and Viet Nam in terms of massive tourism earnings and employment opportunities. There is also the need to upgrade airport terminals and domestic air links to bring them up to world class standards.

Meanwhile, the new Tourism Act addresses the policy and institutional environment to facilitate increased public and private investments in support of tourism development. Such investments need to be strategic and planned under a systems approach that considers the entire value chain of tourism products and services.

Business Process Outsourcing

While having relatively weak interindustry linkages, BPO is a relatively employment-intensive industry (Magtibay-Ramos, Estrada, and Felipe 2007). Now acknowledged to be the fastest-growing services export of the country, BPO has been projected to provide close to a million jobs for Filipinos by 2010. The worldwide trend toward outsourcing is projected to sustain its growth as industrialized countries continue to feel the pressures of tight labor markets arising from long term demographic trends. The current challenge facing the industry is the need to ensure an adequate supply and pipeline of qualified human resources for the industry, through expansion of appropriate courses and training programs to meet the industry's skill requirements. Imperatives for sustaining the growth in the BPO industry, as identified by the Business Processing Association of the Philippines (BPAP), are the following:

- address the growing gap in qualified personnel relative to industry needs;
- expand facilities outside of Metro Manila to take advantage of yet untapped workers therein; and
- further improve the business environment for BPO firms.

Food and Design-Based Manufacturing

With very high interindustry linkages and a relatively high labor coefficient, growth in food manufacturing promises wide benefits across the economy. Growth in food demand will continue indefinitely with the expanding population, and will be further boosted by the expansion of tourism. As average incomes rise, food tastes also move toward more processed forms of food products, suggesting that this largest subsector in the manufacturing sector will continue to be an important growth driver in the future. The imperative is to provide a climate conducive to processing by SMEs, especially in the countryside, close to or within the primary agricultural production areas. This includes appropriate standards and testing facilities, apart from the usual need for support in access to financing, technology support, raw materials, and markets.

Notwithstanding the emergence of the PRC as "factory to the world," the Philippines maintains a comparative advantage in manufacturing where design is a key element, such as high-end garments, furniture, and housewares. Filipino designs are highly sought after in Western markets as Filipino designers are known to be well-attuned to Western tastes (compared to other Asian counterparts). The imperative is for government to facilitate access to financing, technology support, raw materials, and markets for SMEs; and to foster clustering and cooperation to allow response to volume demands.

In this regard, the following are needed:

- widen availability of financing for SMEs;
- strengthen technology support for SMEs, including maintenance and testing of quality standards;
- facilitate establishment of processing SMEs in primary production areas;
- encourage and facilitate clustering to expand and sustain market access; and
- assist in gaining market access through proactive development diplomacy.

Mining

While mining continues to be mired in continuing controversies due to environmental and social issues, the country's unusually rich endowment of mineral resources makes it logical for the country to find the appropriate approach to derive maximum benefits from the industry. The imperative is to continue confidence-building initiatives to satisfactorily address widely held apprehensions and concerns about the adverse environmental and social impacts of mining.

There is no doubt that mining promises to be a driver for rapid economic growth. What is debatable is whether the industry will promote inclusive growth, particularly under the current circumstances. At present, it ranks relatively low on backward and forward linkages (Table 13). The latter indicates a lack of value adding and processing within the domestic economy, with the bulk of the industry's output exported in primary form. It is thus important that mining development be pursued democratically, i.e., by providing equitable opportunities for small, medium, and large-scale mining enterprises alike, in a way that upholds social and environmental responsibility. This is a major challenge given that small-scale mining in the country has a history of negative environmental effects, while large-scale mining has also been beset by high-profile environmental accidents. A good governance environment marked by trust and confidence in government among the various industry stakeholders is a key prerequisite for mining development to proceed in a way that provides the broadest benefits for the Filipino people.

For mining to become a driver of both high and inclusive growth, the following are imperative:

- capacitate provincial governments to accredit and regulate small and medium mining enterprises;
- establish and develop partnerships with civil society in the promotion and assurance of responsible mining;
- foster investments in domestic processing of minerals and greater value-adding;
- move toward banning the export of raw mineral ores;
- address and settle conflicts over mineral-rich ancestral lands; and
- amend the Mining Act to incorporate the fiscal regime governing financial and technical assistance agreements (FTAAs), while revising the fiscal regime for mineral production-sharing agreements (MPSAs) to provide for the rightful share of the state in the value of mineral products extracted.

A fuller discussion of each of the above measures is provided in Appendix 1.

In addition to the above, infrastructure development itself will be a potent growth driver, to the extent that the government can pursue the massive infrastructure catch-up program discussed earlier. Real estate, which grew briskly even at the onset of the global economic crisis, likewise continues to possess latent growth potential, especially because there remains a large unmet demand for housing particularly in the low- to medium-income category. Surging demand for office space for BPO firms has likewise driven the rapid growth in the real estate industry since 2000. These all imply that construction—in itself a major generator of employment in the economy—will also be an important driver for inclusive growth in the years ahead.

Governance and Institutional Reform Agenda

As discussed earlier, weaknesses in governance have had a pervasive effect on the overall economic and social environment, from which stem the critical constraints to the economy's growth, as well as its translation into social outcomes that affects its inclusiveness. There is widespread expectation that the recent change in government will provide a fresh opportunity to address policy constraints as well as governance and institutional impediments more definitively and convincingly, and thereby provide a more hospitable business environment and a more attractive investment climate.

The overarching imperative for the institutional reform agenda confronting the new government leadership is the restoration of wide public trust and confidence in the government. As argued above, this lack of trust and confidence has contributed to low tax compliance, has severely affected levels of domestic and foreign investment (especially the former), and has in turn constrained the growth of the economy over the past 6 years. It has also severely impaired government's capability to deliver quality basic social services amid evidence of increased poverty in recent years. Thus, fundamental governance reforms must underpin the government's social and economic reform agenda toward achieving high and inclusive growth in the years ahead. In this regard, decisive and convincing actions will be required from the government, including the following:

Ensure Quality Appointments to Key Government Posts, from the Cabinet to Key Regulatory Bodies

Demonstrated character and competence must be upheld as the key criteria for selecting appointees to the Cabinet and other key government positions, with independence as a key additional criterion in appointments to regulatory agencies. The latter is crucial in addressing the fourth critical constraint to growth identified by the ADB study (2007), as government regulation is the appropriate response to market failures which have led to monopolistic tendencies in certain production sectors of the economy. In the search for officials with appropriate competence and qualities to fill key government positions, it would be best to institutionalize the use of search committees with members who are beyond reproach.

Adopt an Unequivocal Policy of Zero Tolerance for Corruption and Demonstrate Commitment by the Top Leadership to this Policy

The mere perception of top-level corruption is enough to undermine the entire government's effectiveness in curbing it. Any perception that top leaders engage in graft and corrupt practices, whether or not true, leads government workers to rationalize such behavior as tolerable or acceptable. It also undermines the moral authority of leaders, and therefore their effectiveness in curbing corruption. Thus, it is crucial that the top leadership, from the President to the Cabinet members, along with senior legislative and judicial officials, are perceived to be sincere and determined to curb corruption by their own example. Otherwise, it will be impossible to make significant headway towards its reduction and elimination.

Operationally, effective control of corruption will require further strengthening of the Office of the Ombudsman with increased human and physical resources, and the appointment of officials therein with recognized integrity and independence. It will also require management audits (with appropriate dismissals of erring officials) and procurement process improvements in the most graft-prone departments and agencies, particularly (i) revenue collection agencies, especially BIR and BOC (see further below); and (ii) line departments and agencies with large program budgets, including the Department of Agriculture (DA), Department of Public Works and Highways, Department of Transportation and Communication, Department of Environment and Natural Resources (DENR), and Department of Education. Improvements in the procurement process should include the institutionalization of citizen or civil society participation in agency Bids and Awards Committees.

Install Stronger and More Credible Transparency and Accountability Mechanisms in Government, Starting with Enactment of the Freedom of Information Act

Concrete mechanisms must be instituted within each government department and agency to demonstrate sincerity in enforcing transparency and accountability, including designation of a transparency and accountability officer among its senior officials (at the level of at least Assistant Secretary).

Uphold Subsidiarity through Intensified Decentralization and Devolution of Planning, Program Design, Budget Allocation, and General Decision Making

Decision-making authority within government departments and agencies needs to be reviewed with a view toward empowering lower-level officials to become more responsive to challenges and problems where they arise. This includes expanding the scope of decision-making powers and raising approval authorities on budget disbursement of officials at the subnational and local levels. This will also help diminish the concentration, and thereby the likelihood for politicization, of decision making in government agencies. At the same time, the role of LGUs in planning, designing, and implementing development initiatives must be strengthened, with national government agencies (NGAs) to focus on "steering" while the former carry out the "rowing" functions. Thus, NGAs must henceforth focus on standard setting and regulation, technical guidance and capacity building for LGUs, and initiatives among LGUs, rather than engage in direct implementation of programs and projects better left in the hands of LGUs. Such devolution must involve the corresponding transfer of appropriate budgetary resources from the NGAs to LGUs beyond the latter's internal revenue allotments (IRAs), but with appropriate transparency and accountability mechanisms in place.

Consciously Adhere to Policy Consistency and Stability

Policy instability and policy reversals are among the biggest deterrents to investment, as they raise the level of uncertainty in the outlook for business. Policy reversals—whether within the executive branch or through judicial actions that run counter to stated policy—must be studiously avoided to minimize this form of uncertainty in the country's business environment.

Widen and Deepen Public Participation in Governance and Development

Broad-based or inclusive development is participatory development. It is thus important for government at all levels to faithfully activate the mechanisms provided by law for meaningful public participation in governance and development management. These include the National Anti-Poverty Commission and Philippine Council for Sustainable Development at the national level, and the Local Development Councils at the provincial, city, municipal, and barangay[21] levels. Opening local school boards to wider participation has also been proven to yield significant benefits in such places as Naga City, for example.

[21] Village.

Intensify Streamlining of Frontline Government Processes and Procedures

Lengthy and cumbersome bureaucratic procedures raise the cost of doing business and dampen investment. Hence, there must be deliberate and continuing management audits of such procedures, especially frontline government services at both national and local government levels, with an eye for eliminating superfluous or redundant requirements that only serve to unduly raise transaction costs.

Conclusion

The Philippines possesses the requisite ingredients for rapid economic growth: rich endowments of natural resources, an ample and resilient human resource pool, and an adequate knowledge base. But given the country's recent history, weak governance and corruption are widely perceived to be at the root of the most critical impediments to its attainment of high and inclusive growth. There is wide agreement on four major constraints to growth as identified by the 2007 ADB Critical Development Constraints study, all of which are linked to weak governance: (i) tight fiscal situation; (ii) inadequate infrastructure, particularly for electricity and transport; (iii) weak investor confidence due to governance concerns; and (iv) market failures leading to a small and narrow industrial base. These growth constraints need to be addressed directly if high and inclusive growth is to be attained in the midst of current challenges. But while these are necessary conditions, the roadmap for economic reform must additionally ensure that the growth that results is broad based in its participation and benefits.

Based on the above constraints, unleashing the economy's growth potential would require the following economic management agenda:

- **Address tight fiscal constraints by restoring tax effort to at least 17% of GDP.** This would require a combination of tax administration improvements and tax policy enhancements. It is important, however, that the former takes precedence.
- **Program and implement a massive multi-year infrastructure catch-up program.** The ability of the government to finance this hinges crucially on its success in dramatically raising revenue effort. Without this, there will need to be continuing reliance on PPPs in infrastructure provision. Government procedures governing PPPs need to be revisited to address the concerns of the business and donor communities about the current guidelines.
- **Undertake a government-wide thrust for the promotion and development of SMEs.** A big push for enterprise development is needed to raise domestic investment levels substantially and in a way that provides broad benefits. This requires concerted effort from all units and instruments of government to provide the necessary environment for addressing traditional constraints to access by SMEs to financing, technology, raw materials, and markets.
- **Democratize the economy through sustained asset reform and strengthened competition policy.** Deliberate measures are needed from government to ensure equitable access to productive assets, and therefore to economic opportunities. The government's asset reform programs, led by the CARP need to be sustained and more faithfully and expeditiously implemented. At the same time, competition policy needs to be strengthened to address traditional market failures that have perpetuated a high degree of concentration of wealth and economic opportunities.

In light of past Philippine economic performance, the 7%–9% GDP growth required for sustained poverty reduction would most likely be driven on the demand side by exports and investments, particularly in construction and durable equipment. Thus, maintaining a governance, institutional, and policy environment conducive to reducing the costs of doing business and attaining international competitiveness among domestic producers remains crucial. On the production side, the following sectors and industries are poised to provide the push for high and inclusive growth, by virtue of their employment potential and/or backward–forward linkages: (i) agriculture and agribusiness, (ii) tourism, (iii) BPO, and (iv) food and design-based manufacturing.

While mining promises to be a strong driver of growth in the economy, much still needs to be done to make the growth coming out of the industry inclusive, including greater domestic processing and value-adding.

In addition, construction (both private and public) will be an important driver for inclusive growth inasmuch as infrastructure development will need to be aggressively pursued by the government. At the same time, growth in real estate, an industry also heavily reliant on construction, is expected to resume in the face of large unmet needs for housing, and continuing rapid growth in demand for office space for BPO firms.

Critically underpinning all of these is the urgent imperative to restore public trust in government, and generally improve the quality of governance in the country at all levels. The entry of the Aquino government through the national elections in 2010 has provided a fresh opportunity for the country to overcome this persistent drag on its ability to match the rates of growth and poverty reduction experienced by its Southeast Asian neighbors since 1990. Government must be deliberate and convincing in addressing the following key concerns:

- Ensure quality appointments to key government posts, from the Cabinet to key regulatory bodies;
- Adopt an unequivocal policy of zero tolerance for corruption and demonstrate commitment by the top leadership to this policy;
- Install stronger and more credible transparency and accountability mechanisms in government, starting with enactment of the Freedom of Information Act;
- Uphold subsidiarity through intensified decentralization and devolution of planning, program design, budget allocation, and general decision making;
- Consciously adhere to policy consistency and stability;
- Widen and deepen public participation in governance and development; and
- Intensify streamlining of frontline government processes and procedures.

Finally, it is important to note that education and health have fallen behind in budget allocations in recent years, which has translated in no uncertain terms into declining trends in education and health outcomes. Studies have also consistently shown that the Philippines will be unable to meet all of the 2015 Millennium Development Goals.[22] What the Philippines needs at this time is to attain high and inclusive growth, which in the end implies growth propelled by and benefiting its people. Investing in the country's future thus critically requires investing in its people—and in the final analysis, this is the most urgent and most important investment the country needs to restore now and in the years to come.

[22] See, for example, Manasan (2007), and NEDA (2010).

Appendix 1

Sector Drivers: Pillars for High and Inclusive Growth

Agriculture and Agribusiness

The critical role of agriculture in a country's overall economic development—as stylized in the economic development literature—is well known. First, it provides food and vital raw materials for the rest of the economy. Second, it provides a market for the products of the nonagricultural economy, as a buyer of farm inputs and consumer goods and services. And third, as the sector grows and modernizes in the face of limited agricultural land, it releases surplus labor to the industry and services sectors. With 70% of the country's poor coming from the rural areas where agriculture is the dominant source of livelihood and employment, the importance of agriculture to the Philippine economy is obvious. Thus, the Medium-Term Philippine Development Plans (MTPDPs) of successive administrations have consistently recognized the critical importance of energizing and modernizing the agriculture sector in the overall pursuit of vigorous and broad-based economic growth and development. Unfortunately, success in this goal has remained elusive.

Where Are We Now?

Agriculture, fishery, and forestry directly account for around 15% of the economy's aggregate domestic output. The sector's average growth over the years has been relatively anemic, averaging 1.7% per annum during the period 1981–2003, compared to the average overall GDP growth of 2.6% over the same period. Agriculture's importance looms larger when it comes to employment, with nearly two-fifths (40%) of jobs currently coming from the sector. If one includes agro-processing and the manufacturing and trading of agricultural inputs (i.e. the agribusiness sector) as well as basic agricultural production, agriculture accounts for about 40% of GDP and two-thirds of jobs in the economy (World Bank 2005; Tolentino et al. 2001). Thus, the sector continues to be the most important vehicle for broad-based economic growth, and will remain so for some time to come. Unfortunately, agriculture has traditionally displayed the most erratic growth among the economy's major sectors, with growth rates tending to fluctuate widely from quarter to quarter. This volatility continues to be manifested in most recent periods even as industry has recently displayed more volatility since 2006 (Figure 1).

It is commonly observed that the poor performance of the Philippine agriculture sector in recent decades resulted from failures and shortcomings in the policy and institutional environment within which the sector operates. This environment has been shaped through the years by misdirected price intervention policies (including trade policies), inadequate and inappropriate public expenditure allocations, and institutional and governance weaknesses (Table A1.1). Relative to neighboring countries, the adverse domestic policy, institutional, and governance environment has hampered investments and severely constrained growth in the sector, of both small farms and commercial farms. David (2003) argues that the policy regime has not established an appropriate incentive structure for the rapid development of agriculture. With the reversion of price policies toward agricultural protection in the 1990s, protection favored import competing rather than export-oriented sectors, thus continuing the regime of distortions, while further eroding the competitiveness of labor-intensive industries (because of artificially high food prices that raise the cost of wage goods).

Table A1.1 Impediments to Investments in Agriculture and Agribusiness

Factor	Details	Nature
Lack of access to public lands	• 60:40 domestic ownership (Section 2, Chapter XII of the Constitution) • 25 + 25 years of lease (Section 2, Chapter XII of the Constitution) • Tenurial instruments limit on crop mix • Frequent changes in forestry policies	P P P P
Lack of access to private lands	CARP provisions on • Land ownership ceiling • Transferability and holding period • Uncertainties of slow CARP implementation • Effects of the above on land consolidation and collateral value of agricultural lands • Construction and maintenance of access infrastructure (roads and bridges from farm areas to *barangay* (village) center to trade center to port)	 P P I P, I I
Inadequate infrastructure	• Availability of production infrastructure: irrigation, water supply, and reliable power • Quality of infrastructure (related to regular and periodic maintenance)	I I
Local governance weaknesses	• Limited development outlook of officials in LGUs • Misuse of IRAs • Lack of cost-sharing by LGUs in infrastructure and agriculture projects • Need for continuity of local policies in spite of frequent elections • Limited supply of loans for long gestating projects	C G I I M
Limited access to long-term financing	• Lack of appropriate provisions on grace and repayment periods • No capitalization of interest during the crop gestation period	M M
Limited access to technology	• Lack of funds for research and development • Insufficient access to information about technology • Lack of skills to evaluate alternative technologies and to adopt new technologies • Entrepreneurial inertia (lack of perceived need for technology) • Difficulty in meeting government requirements to avail of technical assistance • Inadequate mechanisms for technology transfer from abroad	M I C C C P
Limited access to raw materials	• Inaccessibility of raw materials due to poor transport and communication infrastructure • Increased cost of raw materials due to government policies (e.g., high tariffs on protected agricultural products like sugar) • Instability and unreliability of raw material supplies due to household and backyard production structure	I P M

continued on next page

Table A1.1 *continued*

Factor	Details	Nature
Lack of global market access	• Nontariff barriers on export of banana and pineapples to some countries • Discriminatory tariffs on export of canned tuna to the EU • Lack of bilateral fishing rights to support domestic tuna industry (Palau, PNG, FSM, and Kiribati—all Pacific countries) • Inability to respond to increased volume demands (e.g., individualism and unwillingness to team up with competitors) • Lack of quality standardization arising from lack of systems and institutions for assessing and maintaining quality standards	E E E C I
Unstable peace (law) and order	• Perceived risk to life and property • Theft of agricultural produce and inputs • Tolerance of local officials for lawless elements	I I G
Widespread corruption	• Irregular payments to various government agencies	G
Weak enforcement of contracts and laws	• Favoritism in decisions of government officials • Judicial interference • Weak enforcement of property rights • Organized crime	G G I I,G

CARP = Comprehensive Agrarian Reform Program, EU = European Union, FSM = Federated States of Micronesia, IRA = internal revenue allotment, LGU = local government unit, PNG = Papua New Guinea.

Notes: C = weak capacity (on the part of either government or private enterprise), E = external factors (e.g., policies of trading partners), G = weak governance/corruption, I = implementation weaknesses, M = market realities, P = government policies.

Source: Compiled from Dy (2005), and Habito and Bautista (2005).

A large proportion of public expenditures in agriculture through the years has been redistributive in nature, financing what are essentially private goods and services, including foreign and domestic grain trading, provision of seeds and planting materials, animals, agro-processing factories, tube well irrigation, and credit (David 2003). These procurements have been fraught with overpricing, underutilization, poor quality, and late delivery—especially of seeds and planting materials. During 1998–2005, the bulk of the more than twofold increase in the agricultural budget went to production subsidies, large-scale irrigation systems, and the operations of the National Food Authority (NFA) on rice importation, stock keeping, and distribution (World Bank 2007). All in all, less than half of public spending on agriculture has gone to productivity-enhancing expenditures for the public good. Public research and development (R&D) expenditures are inordinately allocated to rice at the expense of commodities with great potential for raising sector output and incomes, such as tropical fruits. Credit programs have proven to be unsustainable, beset with low repayment rates and high transaction costs. All told, public expenditures in agriculture have been largely misdirected, indicating that greater focus needs to be given to expenditure composition, rather than increasing the agriculture budget itself (World Bank 2007).

But possibly the most formidable stumbling blocks to significant progress in the Philippine agriculture sector have been the general shortcomings and ineffectiveness of the institutions and bureaucracy tasked with implementing agriculture development initiatives. Here, analysts have pointed to the following difficulties: (i) overcentralization, (ii) politicization of the bureaucracy, (iii) lack of clear organizational framework, (iv) fragmentation and weak coordination, (v) weak technical and managerial capability, (vi) unclear communication lines, (vii) unstable budget, (viii) corruption, and (ix) inappropriate mandates (David 1997, 2003; Tomas 2007). In particular, the role, mandate, and operations of NFA have long been questioned by agriculture sector analysts, given the institution's huge drain on public finances while it brings questionable benefits for farmers as a whole.

While many of the solutions to the various problems in the sector have long been well understood and even widely acknowledged, the main constraint in most cases appears to be a lack of political will and proper motivation to undertake the needed reforms. Thus, governance and bureaucratic reforms—particularly addressing the agriculture bureaucracy and the way it works (or fails to work) with local governments—appear to lie at the heart of efforts to overcome the age-old constraints to stronger performance of Philippine agriculture.

Where Do We Want To Go?

Against the backdrop of past shortcomings in Philippine agriculture, the sector must assume its logical role as the dominant driver for high and inclusive growth of the domestic economy, particularly in the rural sector. Agriculture must also fulfill its role in reducing rural poverty and achieving food security. In accordance with this, the main goals would be the following:

- increased farm income especially for small farmers and their families;
- improved farm productivity and production to meet ever-growing demands; and
- diversified production, especially toward more horticultural (high-value) crops.

It is important for the DA and the rest of the agriculture bureaucracy to assert their mission as not only increased agricultural production, but ultimately increasing the incomes and thereby uplifting the welfare of farmers and the rural population. Unfortunately, the former does not necessarily lead to the latter, and unless the DA consciously and deliberately aims to meet both objectives, raising farm incomes tends to be at best subordinated to production goals, and at worst neglected. Further reinforcing the situation is the tendency for legislators to focus inordinately on production targets—and hold agriculture officials primarily accountable for them—during annual budget deliberations in Congress, with farmers' income receiving little if any attention in the process.

An important international trend of strategic significance to Philippine agriculture is the rapid increase in demand for horticultural products overseas, further boosted by demands from the PRC and India in the face of rapidly growing incomes in those countries. Part of the observed shift in diet patterns in East Asian countries has been a significant rise in the per capita consumption of fruits, vegetables, fish, milk, alcoholic beverages, and nuts and oilseeds (Table A1.2). There is also evidence of the growing importance of horticultural crops (fruits and vegetables) and processed agricultural products in the agricultural trade of Organisation for Economic Co-operation and Development (OECD) countries. Although OECD countries are net exporters of cereals and dairy products, they are net importers of fresh fruits and nuts, processed fruits, and fresh and processed vegetables, as well as meat and meat preparations (Table A1.3). Notably, imports of these products by OECD countries have been growing rapidly, with fruits and nuts their largest and fastest growing imported agricultural products. Bananas, fresh and dried fruits (including pineapple), and edible nuts comprise the key imported fresh fruits and nuts, while fruit juice accounts for half of imported processed fruit. Similarly, OECD imports of fresh and processed vegetables have also grown quickly, especially frozen vegetables, dried vegetables, and vegetables preserved in substances other than vinegar.

All of these developments point to the strategic importance of efforts to further strengthen the country's existing comparative advantage in horticultural products, especially fruits, vegetables and nuts, or the so-called "high-value crops."

How Do We Get There?

Against the backdrop of the agriculture and agribusiness sector's long history of shortcomings and failures, the following stand out as the most critical and strategic among the numerous imperatives needed to meet the above goals for the sector (i.e., are expected to lead to greatest impact):

Table A1.2 Per Capita Food Consumption in Selected Asian Countries

Country	Years	Commodity								
		Cereals	Starchy Roots	Sweet-eners	Nuts and Oilseeds	Vegetables	Fruit	Meat and Offals	Fish and Seafood	Oils and Fats
Philippines	1974–1976	122	42	22	4	63	80	16	36	5
	1984–1986	133	39	24	4	63	124	16	34	13
	1994–1996	128	36	30	5	66	113	27	23	7
	2003–2005	145	28	27	6	62	106	32	32	7
Korea, Republic of	1974–1976	229	37	8	10	136	23	7	40	4
	1984–1986	191	20	21	10	174	445	19	47	8
	1994–1996	166	16	34	12	184	89	41	51	15
	2003–2005	145	17	37	14	220	68	52	52	18
Hong Kong, China	1974–1976	147	23	22	8	85	70	76	49	16
	1984–1986	134	18	29	8	78	74	100	46	20
	1994–1996	117	32	34	9	52	103	137	60	28
	2003–2005	–	–	–	–	–	–	–	–	–
Thailand	1974–1976	157	17	13	16	41	106	16	21	2
	1984–1986	133	9	15	21	35	98	20	20	4
	1994–1996	126	7	28	18	31	101	23	26	6
	2003–2005	125	18	34	28	43	89	28	31	7
Malaysia	1974–1976	156	22	31	18	18	50	21	33	12
	1984–1986	128	26	35	17	22	50	31	46	19
	1994–1996	128	26	52	18	33	52	54	54	15
	2003–2005	155	23	36	12	35	55	53	55	17
Japan	1974–1976	142	34	28	10	111	69	25	69	11
	1984–1986	136	17	33	10	112	58	36	69	14
	1994–1996	132	35	32	11	108	58	46	71	14
	2003–2005	115	32	30	12	104	54	47	64	16

– = No data available.

Source: Food and Agriculture Organization.

- Reform the agricultural bureaucracy and budget toward greater decentralization, depoliticization, elimination of overlaps, and stronger roles for local governments in program and project design, among other things.
- Boost rural public infrastructure investments under a holistic value-chain approach, with strong roles for LGUs in programming and provision coupled with transparency mechanisms operated in partnership with civil society.
- Promote and facilitate clustering of small and medium primary producers to gain the benefits of economies of scale and better access to markets.
- Foster small- and medium-scale agricultural-processing enterprises to widen rural non-farm livelihood and employment, while avoiding monopsonistic tendencies in primary product markets.
- Address bottlenecks in the CARP implementation and accelerate completion of agrarian reform, along with ample

Table A1.3 Commodity Imports, Selected Countries (%)

	Products	1990–2000	Estimated Annual Growth	2000–2007	Estimated Annual Growth
Total imports	Fruits and Nuts, Fresh or Dried	9.68	0.97	58.91	8.42
	Fruit Preparations and Preserved Fruits	37.24	3.72	75.81	10.83
	Fresh Vegetables	(2.89)	(0.29)	30.98	4.43
	Processed Vegetables	31.09	3.11	40.47	5.78
Imports per country:					
Canada	Fruits and Nuts, Fresh or Dried	47.92	4.79	10.18	1.45
	Fruit Preparations and Preserved Fruits	101.05	10.10	51.24	7.32
	Fresh Vegetables	7.46	0.75	9.44	1.35
	Processed Vegetables	177.93	17.79	(3.83)	(0.55)
France	Fruits and Nuts, Fresh or Dried	163.62	16.36	29.68	4.24
	Fruit Preparations and Preserved Fruits	60.59	6.06	104.18	14.88
	Fresh Vegetables	(13.40)	(1.34)	13.50	1.93
	Processed Vegetables	56.85	5.69	61.70	8.81
Germany	Fruits and Nuts, Fresh or Dried	46.99	(4.70)	92.79	13.26
	Fruit Preparations and Preserved Fruits	3.24	0.32	17.78	2.54
	Fresh Vegetables	9.34	0.93	25.51	3.64
	Processed Vegetables	(5.19)	(0.52)	16.29	2.33
United Kingdom	Fruits and Nuts, Fresh or Dried	142.29	14.23	58.25	8.32
	Fruit Preparations and Preserved Fruits	5.52	0.55	58.03	8.29
	Fresh Vegetables	94.09	9.41	41.95	5.99
	Processed Vegetables	58.23	5.82	36.95	5.28
United States	Fruits and Nuts, Fresh or Dried	95.87	9.59	85.77	12.25
	Fruit Preparations and Preserved Fruits	106.36	10.64	120.53	17.22
	Fresh Vegetables	(29.42)	(2.94)	53.20	7.60
	Processed Vegetables	62.10	6.21	60.93	8.70
Saudi Arabia	Fruits and Nuts, Fresh or Dried	74.14	7.41	48.45	6.92
	Fruit Preparations and Preserved Fruits	25.86	2.59	121.53	17.36
	Fresh Vegetables	113.28	11.33	(54.27)	(7.75)
	Processed Vegetables	(22.17)	(2.22)	87.26	12.47
United Arab Emirates	Fruits and Nuts, Fresh or Dried	(74.78)	(7.48)	103.65	14.81
	Fruit Preparations and Preserved Fruits	8.92	0.89	905.12	129.30
	Fresh Vegetables	(79.45)	(7.95)	419.37	59.91
	Processed Vegetables	(2.89)	(0.29)	193.68	27.67

Source: Organisation for Economic Co-operation and Development.

provision of agriculture support services for beneficiaries and farming communities in general.

These are elaborated in turn below.

Rationalize and Decentralize Agriculture Governance

The DA needs to move away from its overly centralized approach to managing the agriculture sector, which has led to a tendency toward "one-size-fits-all" approaches involving large-scale central procurement. Apart from having proven to be unresponsive to actual needs in many cases, such interventions have also been marked by corruption scandals that put the sector's substantial budgetary allocations under serious question.

The DA would best exercise its leadership in the agriculture and fisheries sector by focusing on "steering" functions while leaving "rowing" functions to local governments. Thus, DA needs to limit its role to standards-setting, exercising regulatory functions, and building technical capacity in LGUs, and leave it largely to the latter to undertake project development and implementation, except for national and trans-provincial initiatives.

Long-standing issues concerning the role, functions, and operations of NFA need to be addressed deliberately and decisively. The elimination of its market intervention functions, which have been both distortive and a source of tremendous drain on public finances, is long overdue. The responsibility of NFA must be limited to its regulatory functions and the maintenance of appropriate buffer stocks as a safety net for emergencies.

Determined efforts toward bureaucratic and budget reform in the DA began during 2004–2007 in compliance with Executive Order 366, the Government Reorganization Program.[1] The reforms proposed by the change management team in the department's Rationalization Plan included potentially far-reaching changes that would have, among other things (i) redefined the structure of the DA along functional rather than commodity lines; (ii) provided much closer partnership with LGUs in identifying, designing, and implementing agriculture projects; and (iii) led to a reconfiguration of the DA budget to significantly reduce the lump sum project budget subject to the (political) discretion of the DA Secretary. Unfortunately, the DA Rationalization Plan was caught in the transition between two DA Secretaries and has not been endorsed to the Department of Budget and Management (DBM) for approval and execution, so it remains unimplemented to date.[2] But the

Box A1.1 When Overcentralization Prevails: Deaf Ears from Manila

In a field visit, the author asked a poor Mindanao upland farmer what would be the single most important assistance he would ask of the government if given the chance. His ready reply: carabaos (water buffaloes). They needed carabaos to be able to till the land around them, which were noticeably farmable yet idle, in a place where rainfall comes all year round. Asked what he and his neighbors actually received from the government, he replied fertilizers and hybrid seeds. "We take them anyway (even though we can't use them)," he remarked, and he didn't have to say that these inputs ended up being sold for cash.

The author also interviewed the government extension worker in the area—an energetic and highly motivated young lady who had been working closely with the community, and clearly had that community's best interests at heart. Asked if she and her fellow extension workers had not communicated the actual needs of their client communities to their superiors, she asserted that they had done so countless times, but it had always seemed to fall on deaf ears. "All these programs come to us from Manila, and no matter what we tell them, they decide on the programs that they want anyway," was her rueful reply.

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1 The department's change management team, led by senior management, received technical assistance from the Ateneo de Manila University Economics Department at the time, through the Economic Policy Reform and Advocacy (EPRA) program led by this author.

2 Former DA Secretary Domingo Panganiban, who had replaced Secretary Arthur Yap upon the latter's detailing to the Office of the President, had already endorsed the Rationalization Plan to DBM. However, upon Panganiban's subsequent departure with the return of Secretary Arthur Yap, DBM as a courtesy sought Yap's endorsement as well; unfortunately, the re-endorsement never came.

fact that the bureaucratic and budget reform proposals had reached such an advanced stage indicates that such reforms are feasible, lacking only the political will of the top leadership to bring them into effect.

Expand Rural Infrastructure

The rural sector has been perennially lacking in public infrastructure, both for improved productivity and for linking farmers to the markets and processing centers. The most basic infrastructure needed is roads and bridges between farms and markets. The challenge is not only to provide adequate budgetary resources to respond to widespread needs—a long-standing problem—but also to deliver assistance for rural infrastructure in an appropriate manner. Local initiatives to pool resources (i.e., equipment and manpower) among neighboring municipalities to build rural roads have worked well and proven more efficient (Box A1.2), demonstrating the merits of empowering LGUs to take responsibility for rural public infrastructure provision. Experience with community-driven development projects via the KALAHI[3] program have likewise proven beneficial and effective. The DA, in partnership with the Department of Public Works and Highways, would do well to work in close partnership with LGUs and farming communities in responding to rural infrastructure needs. This could be achieved through matching grant mechanisms with flexible counterpart requirements sensitive to the ability of LGUs to pay.

Box A1.2 Local Government Units Can Do It Better: The PALMA Alliance

A kilometer of an all-weather road would normally cost 1 million pesos (P)—the average fee charged by private contractors. But in North Cotabato five contiguous municipalities, with the help of the provincial government, pooled their resources and proceeded to build a road network which cost them roughly only P30,000 per kilometer. Awarded the Galing Pook Award in 2007, the Kabalikat PALMA Infrastructure Project involved five local government units (of the municipalities of Pigcawayan, Alamada, Libungan, Midsayap, and Aleosan, the names of which provide the project's acronym) pooling their infrastructure equipment, machinery, personnel, and expertise to collectively work on road building projects in the member towns. Started on 20 February 2002, the project has rehabilitated and opened 281.45 kilometers of farm-to-market roads, at a total cost of P8.475 million. The improved road network has vastly improved the lives of the people in around 145 barangays (villages). Among the noticeable improvements were a 20% increase in agricultural productivity, resulting in more income for the farmers, reduced transport costs, a reduction in travel time by as much as 50%, improved access to social services for people residing in far-flung barangays, and expanded entrepreneurial opportunities for women.

What is noteworthy is that the people have conscious ownership of the initiative, as they are involved in planning, implementing, monitoring, and sustaining the project. At the barangay level, the community is responsible for providing lodging and food for the drivers and operators of the heavy equipment, securing and safeguarding the machinery, supervising and monitoring the implementation of the project in their locality, and helping in the upkeep and maintenance of roads in their locality. The municipality is tasked with the deployment of its equipment to the host municipality or barangay, ensuring that it is serviceable and in good working condition, contributing P200,000 annually to the PALMA Alliance, and monitoring and evaluating the implementation of the project.

Enabling mechanisms have been institutionalized to ensure the project's sustainability. These include a well-defined organizational structure, community participation, and information dissemination as well as legislative and budgetary support. With the realization that pooling resources and manpower is an effective way of developing their communities, the PALMA Alliance has also begun using the same strategy to pursue other development initiatives in environmental protection and health.

Source: Galing Pook Awards 2007 Souvenir Program, p. 6.

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[3] Acronym for "Kapit-bisig Laban sa Hirap" (arm-in-arm against poverty).

Rural infrastructure needs to be approached as a system spanning the entire supply chain from primary production to the consumer, ensuring the free and smooth flow of products through the system. Thus, while LGUs and communities would be best placed to decide on and construct the facilities most responsive to their needs, the DA must provide the wider perspective that ensures that the infrastructure requirements of the entire supply chain are amply provided for.

Adopt a Clustering Strategy

A small farmer acting alone faces tremendous challenges in running a farm enterprise. Providing easier access to necessary farm inputs such as credit, seeds, fertilizers, and mechanization is important to sustain the farm business, but in an industry in which trading and processing tend to be highly concentrated, achieving strength in numbers becomes a must. Cooperativism and clustering schemes permit small- and medium-sized producers to gain economies of scale and improved access to markets. The success story of NorMin Veggies in Northern Mindanao (Box A1.3) provides a basis and model for facilitating the grouping of small producers to achieve the advantages that clustering promises. Government, through local governments and the DA, would do well to foster and assist such clustering schemes, as well as more traditional farm cooperatives.

Foster Agricultural Processing by Small and Medium-Sized Enterprises

The Philippine farm sector has traditionally been marked by the presence of single large processing facilities in specific primary production areas, such as a coconut oil mill or dessicator in coconut areas, a rice mill in rice-growing areas, or a sugar central in sugarcane areas. In these situations, the processor becomes the sole ultimate buyer of the primary products of small growers in the locality. Such monopsonies in the agricultural supply chain have contributed to depressed farm-gate prices and deprived small farmers of a larger share of their product's final market value. A desirable policy direction, then, would be to foster and promote small- and medium-scale agricultural processing in primary production areas, which would widen nonfarm livelihood and employment opportunities as well as help overcome monopsonistic tendencies in primary agricultural product markets. This may be achieved through a combination of fiscal incentives and business start-up assistance programs that could be jointly established by the Department of Trade and Industry and LGUs.

Box A1.3 NorMin Veggies: Strength in Numbers

In a success story that needs to be told more widely, vegetable farmers in northern Mindanao decided in 2001 to band together and adopt an industry clustering strategy that paved the way for them to gain a foothold in the Cebu and Metro Manila markets. The previously fragmented farmers organized themselves into small, crop-based clusters that later grew to become the NorMin Veggies, a farmers' cooperative that as of its last count included 7,000 growers cultivating more than 3,000 hectares in Misamis Oriental and Bukidnon. They now grow a variety of vegetables that were previously only grown in the province of Benguet in Northern Luzon.

The farmers organized and incorporated NorMin Corporation, which acts as their consolidator, distributor and marketing arm. By organizing its own marketing unit, NorMin Veggies cut out the traditional layers of middlemen, shipping directly to wet markets and first class hotels and restaurants, and bringing down prices at the retail level, even while increasing farm-gate prices.

"We used to fault vegetable importers for their lack of support to our local farmers, only to find out that they are actually willing to support us if we are able to meet the requirements of quality and stable supply," attested one of the group's organizers. In 2008, NorMin Veggies reportedly shipped a weekly average of 70 tons of assorted vegetables to Luzon and the Visayas. An agriculture official has described them as having managed to beat the Benguet vegetable growers in markets where distance should have given the latter the advantage.

Source: Habito (2010).

Address Comprehensive Agrarian Reform Program Bottlenecks

The implementation of CARP, particularly on large private farm landholdings, must be completed within the 5-year extension period granted by Congress under Republic Act 9700 passed in 2009. There is empirical evidence that due to the slow pace of CARP implementation, landowners yet to be subject to CARP have scaled back their investments significantly (Habito et al. 2003; Briones 2002). The overall slowdown in investments in the sector may be partly attributed to this uncertainty effect. This has led to misplaced arguments by agrarian reform critics against the program itself, when the problem lies more in the lack of prompt implementation to remove the uncertainty. The de-collateralization of farmland is another problem that has undermined the beneficial impacts of agrarian reform, leading to the failure of CARP to give improved access by beneficiaries to formal credit. It has also contributed to the stifling of rural land markets. The solution is not legislation forcing banks to accept farmlands as collateral, which is futile and counterproductive, but rather to address what deters the banks from holding and acquiring farmlands (i.e., through loan defaults)—the fear of losing such lands to CARP just as a large private landlord would. Banks should thus be treated differently from landlords with large landholdings, such that land acquired by banks through loan defaults should be exempt from further redistribution via CARP. Banks would thus be permitted to sell such defaulted farmlands at market value, subject to CARP-prescribed landholding limits on the buyers, and possibly even restriction against purchase by previous owners of the land.[4]

Tourism

The tourism industry, based on the definition in the Philippine Tourism Satellite Accounts of the NSCB and the Department of Tourism (DOT), spans a wide range of service sector industries covering accommodation services, food and beverage services, transport, travel agencies and other reservation services, entertainment and recreation, shopping, and miscellaneous services such as medical tourism. These are in turn closely linked to other production activities in agriculture and the industry sector that supply tourism establishments with a wide array of products spanning food, furniture and furnishings, fuel, and pharmaceuticals. On this basis, tourism growth clearly translates to broad-based growth, with wide-ranging multiplier effects permeating throughout the economy. Hence, like agriculture, it too represents an important driver for high and inclusive growth.

Where Are We Now?

Tourism is estimated to contribute about 6.2% of the country's gross GDP, based on 2000–2007 data from NSCB, while contributing 9.5% of overall employment. The country attracted over 3 million foreign tourists in 2008, with the PRC, Japan, the Republic of Korea, and the United States accounting for the largest shares. Tourist arrivals from European countries like Russia and France have also grown rapidly. But the above figure pales in comparison to foreign tourist arrivals posted in the same year from neighboring Southeast Asian countries like Malaysia (22.0 million), Thailand (14.9 million), Singapore (9.2 million), Indonesia (6.2 milion), and Viet Nam (4.3 million).[5] Tourist arrivals have also consistently fallen short of the targets set in the MTPDP,[6] with the deficit widening through the years of the Plan period (Table A1.4). On the other hand, DOT estimates that tourism receipts had already exceeded the 2010 target as early as 2007, suggesting that higher-spending tourists have been coming into the country.

DOT estimates tourism employment as a function of international visitor arrivals, with the assumption that every international arrival leads to 1.22 tourism jobs. On this basis, it was estimated that employment generation in the Philippine tourism industry would fall short of MTPDP targets by 1 million–1.8 million jobs per year during 2008–2010. In fact, employment in

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4 This would address the fears of opponents of the farmland-as-collateral bill that such law would only pave the way for the return of "CARPed" lands back to their original owners.

5 Data from National Tourism Organizations and the UN World Tourism Organization.

6 National Economic and Development Authority (2004).

Table A1.4 Actual vs. Projected (Medium-Term Philippine Development Plan) Tourist Arrivals, 2004–2010

Year	2004	2005	2006	2007	2008	2009*	2010*
MTPDP Targets	2.30	2.67	3.07	3.53	4.02	4.50	5.00
Adjusted Post-2008 Targets					3.20	3.24	3.27
Actual Arrivals	2.29	2.62	2.84	3.09	3.14	3.14	3.14
% difference	(0.38)	(1.68)	(7.33)	(12.37)	(21.95)	(30.31)	(37.22)

( ) = negative, MTPDP = Medium-Term Philippine Development Plan.

* Official visitor arrival numbers for 2009 are not available from the Department of Tourism. But recent public pronouncements by the department suggest a zero growth scenario for 2009 and 2010, as a result of the 2008 global financial crisis.

Source: Alampay (2009).

tourism industries decelerated to 1.5% annualized growth in 2008 (from 3.7% in 2007), slower than the 2.6% growth of total Philippine employment. This implies that despite the greater value received by the country from international tourism, the direct employment benefits from these earnings were experienced by a substantially smaller number of Filipinos than the MTPDP envisaged (Alampay 2009). Medical tourism has been a fast-rising segment of the tourism industry. From the start of the DOT medical tourism program in 2006 to the end of 2008, total spending by tourist patients and wellness seekers reached an estimated $350 million per year, an average spending per medical tourist of about $3,500. DOT aims to raise this to $1 billion by 2012, or about 300,000 medical tourists.[7]

In 2009, the Philippines was ranked 86th out of 133 countries in the Travel and Tourism Competitiveness Index ratings of the World Economic Forum (WEF 2009), scoring 3.73 on a scale with a maximum score of 7. By specific criteria, the country rated lowest compared with its neighbors in "government prioritization of tourism" and "effectiveness of marketing and branding." But the greatest weakness of the Philippines lies in the business environment and infrastructure for travel and tourism, including air accessibility—which is critical given that 98% of arrivals are by air (Box A1.4).

In recent years, domestic tourism has been growing briskly, with internal tourism expenditures outpacing overall GDP growth. While the global economic downturn significantly affected foreign tourism, double-digit growth in the volume of domestic tourist visits to major sites continued in 2008 last year, far outpacing the growth in foreign tourism (Table A1.5). This is a positive development, particularly because the MTPDP tourism thrusts appear to have a dominant focus on international tourism, with foreign exchange generation seen to be the industry's primary contribution to the economy. The resulting focus on priority tourism destinations and their vicinities tends to limit the scope and breadth of the industry's ability to contribute to poverty reduction. Yet domestic tourism has much greater potential for more widespread benefits and employment growth, and ultimately, poverty reduction.

Where Do We Want To Go?

Based on National Statistics Office data, close to two-thirds of the country's 2.9 million unemployed workers received no more than a high school education (with most of them having not completed high school). Both agriculture and tourism lend themselves to providing gainful employment for this group of the unemployed—who are obviously neither equipped nor qualified for the new jobs being generated in the outsourcing and offshoring industry in the short to medium term with little or no additional training. This suggests the need to aim for a surge in tourism growth to create at least 1 million new jobs in the sector within the short term (i.e., by 2012).

To maximize the contribution of tourism to high and inclusive growth, tourism development needs to pursue rapid growth in both international and domestic tourism. For international

[7] DOT website: www.dot.gov.ph

Box A1.4 Policy Impediments to Air Accessibility

Air transport infrastructure limitations can be addressed through additional investment. On the other hand, the limited air services and air connections are functions of government aviation policy. Here, the solutions depend less on financial resources and more on mustering the necessary political will. The government's ambivalence toward increasing international air access to Diosdado Macapagal International Airport (Clark) and Subic Bay International Airport (Subic) is the prime example of this.

Executive Order 500 was issued in January 2006, designating Clark and Subic as developmental routes. This allowed budget airlines to fly to Clark without limitations on traffic rights, capacity, or air freedom rights except cabotage (transport between two points within the country). Clark's passenger traffic practically doubled from roughly 230,000 in 2005 to 471,000 in 2006. Despite the apparent benefits of the new air policy for Clark and Subic, the government chose to amend it upon representations by major local carriers through issuance of Executive Order 500–A, just 7 months after the original Executive Order. The amendments required airlines to be first designated by their country of origin through bilateral air service agreements with the Philippines. It also limited airlines to third and fourth air freedom rights, thereby preventing budget airlines from traveling to a third country. Reportedly due to the regulatory uncertainties created by Executive Order 500–A, in March 2007 Tiger Airways reduced the frequency of its flights from Singapore to Clark.

Source: Alampay (2009).

Table A1.5 Tourism Volume in Major Destinations, 2008 and 2009
(January–September only)

	2009			2008			Growth Rate (%)		
Destinations	**Foreign**	**Domestic**	**Total**	**Foreign**	**Domestic**	**Total**	**Foreign**	**Domestic**	**Total**
Cebu	484,341	749,361	1,233,702	501,378	710,763	1,212,141	(3.40)	5.43	1.78
Camarines Sur	206,937	1,022,092	1,229,029	159,805	387,389	547,194	29.49	163.84	124.61
Baguio City	28,092	502,614	530,706	38,685	568,864	607,549	(27.38)	(11.65)	(12.65)
Boracay	163,820	343,076	506,896	169,724	311,533	481,257	(3.48)	10.13	5.33
Davao City	42,996	458,310	501,306	40,677	446,025	486,702	5.70	2.75	3.00
Zambales	57,146	189,283	246,429	55,290	182,543	237,833	3.36	3.69	3.61
Bohol	72,555	166,190	237,745	59,966	151,166	211,132	20.99	9.94	13.08
Cagayan Valley	10,709	214,904	225,613	11,008	213,107	224,115	(2.72)	0.84	0.67
Puerto Princesa City	18,328	176,806	195,134	14,873	150,823	165,696	23.23	17.23	17.77
Negros Oriental	34,035	138,282	172,317	30,813	131,919	162,732	10.46	4.82	5.89
Ilocos Norte	10,279	128,844	139,123	17,109	120,888	137,197	(39.92)	7.29	1.40
Total	1,129,238	4,089,762	5,219,000	1,099,328	3,374,220	4,473,548	2.72	21.21	16.66

( ) = negative.

Source: Department of Tourism.

tourism, the objective is to see a steady increase in both the number of tourist arrivals and their average length of stay and spending per visit, with the goal of an accelerated annual growth in arrivals beyond the 8% average of recent years, to at least 10%. For domestic tourism, the goal is to sustain growth at the current double-digit rates.

Nonetheless, tourism growth must not happen at the expense of social and environmental integrity. Gambling and prostitution are undesirable elements that have accompanied rapid tourism growth elsewhere, both of which have long-term negative effects on society, and must therefore be carefully avoided in the drive for increased tourism. Similarly, rapid tourism growth exerts various pressures on the environment, including on waste management (as experienced on Boracay Island, for example) and increased pollution. These negative effects must be anticipated and planned for properly, especially by local governments hosting tourism facilities.

How Do We Get There?

Making tourism a true engine of inclusive growth requires further intensification of the momentum already being built, and will require policy reform and increased investments, both public and private. In particular, the following are needed:

- attract tourism investments via implementation of the Tourism Act of 2009;
- upgrade airport terminals and domestic air links; and
- adopt an open skies policy for secondary airports.

Make the Tourism Act of 2009 Work

The Tourism Act of 2009 aims to provide better direction to the supply side of the tourism market, by addressing the institutional requirements for putting in place needed facilities and infrastructure and attracting private investments therein. Among its salient features is the reorganization of existing tourism bodies into (i) the Tourism Promotions Board, to take charge of marketing and promotion; and (ii) the Tourism Infrastructure and Enterprise Zone Authority, that will designate, regulate, and supervise tourism enterprise zones and tourism projects. It also provides increased funding for tourism from various sources. DOT is mandated to lead the establishment of a tourism infrastructure program and coordinate with other agencies to identify vital access roads, airports, seaports, and other infrastructure requirements in identified tourism areas.

Upgrade Airport Terminals and Domestic Air Links

Among the most critical public infrastructure facilities in need of dramatic improvement are the country's airport terminals, especially in the international airports. Domestic air links are likewise need to be improved and upgraded, as poor flight availability continues to hamper the direct movement by foreign visitors to many otherwise attractive tourism sites. Air carriers need to be more actively involved in planning to optimize tourist access to the country's various tourism sites.

Liberalize Air Access

On the demand side, the remaining policy impediment to increased foreign tourism has been the still relatively restrictive air access policy environment. This has had the effect of limiting the availability of seats on flights into the country, and raising the costs of traveling to the Philippines relative to other Southeast Asian tourist destinations. There has been a tendency on the part of government to defend its restrictive air access policies on the basis of the tourism sector "not being ready" with the necessary tourism facilities and infrastructure. The issue is a vicious cycle which—as the experience of Executive Order 500 has shown—can be broken through liberalization of air access. As air passenger arrivals surged with the entry of Asian budget airlines into Diosdado Macapagal International Airport in Clark upon its opening to foreign carriers in 2003, the tourism industry in Region III (Central Luzon) readily responded with expanded facilities and amenities (Box A1.5).

A similar easing of entry by budget carriers into the country's secondary airports, especially in the Visayas and Mindanao, could potentially unleash a surge of employment-creating tourism in these areas. The argument for reciprocity, usually invoked by domestic carriers to oppose such liberalization, has long been answered through a broader definition of reciprocity in the national policy since 1995, which goes beyond numbers of airline seats. Executive Order 219 states:

> "The exchange of traffic rights and routes with other countries shall be based on (a) the National Interest which shall include value for the Philippines in terms of promoting international trade, foreign investments and tourism, among others; and on (b) the reciprocity between the Philippines and other countries. Reciprocity shall be interpreted to mean the exchange of rights, freedoms, and opportunities of equal or equivalent value. The Civil Aeronautics Board (CAB) shall determine "national interest" taking into consideration the larger interest of the country, especially the users of air services."[8]

Thus, benefits to be derived from air traffic agreements should properly count growth in tourism, regional growth and investment, and job creation.

Box A1.5 "Let Them Come and They Will Build It"

The experience of opening up Diosdado Macapagal International Airport (Clark) and Subic Bay International Airport (Subic) to foreign air traffic offers proof that the reverse of the famous movie quote "if you build it, they will come" also holds. In 2003, the Civil Aeronautics Board (CAB), via Executive Order 253, unilaterally granted air rights to Diosdado Macapagal International Airport in Clark and the Subic Bay International Airport. Air access to each of the two airports was declared then as a developmental route, promotion of which is regarded as essential to expanding investments, trade, and tourism under the "liberalized charter policy" articulated in CAB Resolution No. 23 series of 2005.

As a direct result, annual air passenger traffic flowing through Clark ballooned to 225,000 in 2005, from less than 8,000 in 2003 and 49,500 in 2004. The economic impacts have been staggering, with thousands of new jobs created in the local economy. Local hotels have enjoyed much higher occupancy rates of 80% to 90%, and have invested in new rooms and facilities and hired more workers. Local tour operators have developed tour packages with local communities, increasing the multiplier effects of tourism. Real estate developers are investing in retirement communities in Pampanga and Subic, supporting the government agenda of making the Philippines a premier retirement haven in the region. Opening up Clark literally gave new life to the local economy.

Source: Habito (2007).

Business Process Outsourcing

Business process outsourcing (BPO) is reputed to be the fastest-growing industry in the world today. The industry includes services such as contact centers; business back-office operations such as finance, logistics, and accounting; medical and legal transcription; software development and maintenance; animation; and engineering and architectural design. The international investment consultancy firm McKinsey & Company projected that global demand for outsourcing services would reach $180 billion in 2010, with the customer contact services, finance and accounting, and human resource subsectors accounting for the largest shares of this demand.

Input–output analysis indicates that the industry has weak linkages with other sectors of the Philippine economy (Magtibay-Ramos, Estrada, and Felipe 2007). But like other services sector industries, BPO is relatively labor-intensive, and therefore promises job-creating growth.[9] However, the industry requires a relatively high level of education and skills, and in particular, high proficiency in English and computer literacy.

[8] Executive Order No. 219, Section 1.2.

[9] Private business services, the closest category corresponding to the industry in the 1994 Input-Output Table of the Philippines produced by NSCB, has a labor coefficient of 0.24, well above the overall average of 0.17.

Except for entry-level jobs in animation, almost all positions in the industry require a college education and additional training in specific areas. This effectively excludes most of the country's currently unemployed, who, while predominantly young (80% are below the age of 34), are also mostly undereducated with at most a high school education. Sustaining growth in this industry, therefore, requires deliberate efforts to maintain a pipeline of trained qualified workers to respond to the industry's growing demands.

Where Are We Now?

In the Philippines, the BPO industry has reportedly been growing at annual rates above 30% since 2006, led by call centers.[10] The industry employed an estimated 435,000 workers at the end of 2008 (from 372,000 in 2007) excluding entities not covered by the BOI and the Philippine Economic Zone Authority.[11] BPO output for 2008 was $6.1 billion (up from $4.5 billion in 2007). This placed the Philippines as the third largest BPO destination (15%) after India (37%) and Canada (27%). It is expected to reach $7.2 billion–$7.5 billion in 2009. The industry was optimistic of 18% growth in its headcount in 2009.

Most of the BPO facilities are located in Metro Manila and Cebu. Other cities hosting BPO firms include Baguio City, Angeles City (Clark), Dagupan City, Lipa City, Urdaneta City, and Legazpi City in Luzon; Tacloban City, Dumaguete City, Iloilo City, and Bacolod City in the Visayas; and Davao City, Cagayan de Oro, and Iligan City in Mindanao.

Overall, the Philippine BPO industry is projected by the government to earn $11 billion–$13 billion and employ up to 1 million people by 2010; a more technical analysis by ADB researchers believes 500,000–600,000 workers to be more likely (Magtibay-Ramos, Estrada, and Felipe 2007). Meanwhile, with more than 300,000 graduates in "cyberservices"–related courses annually (Table A1.6), there would appear to be an ample supply of potential recruits trained for the needs of the industry. Magtibay-Ramos, Estrada and Felipe (2007) point out, however, that not all these tertiary graduates would necessarily be interested in a BPO job and that the current hiring rate is quite low due to the large proportion of unqualified applicants. Hence, the supply of qualified applicants is actually less than the demand, with the absorption rate (proportion of graduates who are hired) estimated at only 30% (Mapa 2006). In fact, the analysis of the BPO sector in the 2006 Workforce Development Summit predicts a shortfall in employees for all the BPO sectors between 2006 and 2010.

To achieve and sustain the projected rapid growth in the industry, the Philippine government is offering significant fiscal and non-fiscal incentives to attract foreign direct investment in these industries as part of the 2007 Investment Priorities Plan. The plan was prepared by the BOI as the lead agency in promoting investments, focused on the sectors identified in the MTPDP (BOI 2006).

The United Kingdom's National Outsourcing Association awarded the Philippines the Best Offshoring Destination of the Year Award for 2009, the country's second such award since 2007.

Table A1.6 Forecast Number of College Graduates

Number of Tertiary Graduates	2006	2007	2008	2009	2010
Total Cyberservices-inclined	302,914	314,817	326,721	338,626	350,527
Other disciplines*	151,904	157,874	163,843	169,812	175,783
Grand Total	454,818	472,691	490,564	508,438	526,310

* Other disciplines: Agriculture, Forestry, Fisheries, and Veterinary Medicine; Education and Teacher Training; General; Home Economics; Religion and Theology; Service Trades; and Trade, Craft, and Industrial.

Source: Commission on Higher Education (as cited by Mapa 2006).

10 Industry estimate from BPO Services Association Unlimited.

11 Industry estimates from the Board of Investments, Business Process Association of the Philippines (BPAP) and BPO Services Association Unlimited (BSA/U).

Where Do We Want To Go?

Global demand for BPO is projected to continue exhibiting strong growth. Around the world, the industry is seen to be still developing, as more and more organizations discover the cost-saving advantage that comes with offshoring and the outsourcing of services. A McKinsey & Company study valued the global addressable market for BPO at $450 billion. On the other hand, actual penetration was estimated at only 10%–12% of that addressable market, indicating enormous growth potential in the BPO market. The recent global financial crisis and economic downturn has further demonstrated the resilience of the industry, as companies turned to outsourcing as a cost-saving coping mechanism.

The objective of the industry in the Philippines has been to raise its 5% share of the global BPO market in 2007 to 10% by 2010 (BPAP 2007). This was to imply an annual growth rate of 40%. Significant investments have been made in facilities to house more BPO industries, and in particular, more contact centers. All of this is in anticipation of continued brisk growth in the market and greater employment opportunities in the industry in the years to come. The local BPO industry believes that it can firmly anchor the Philippines as a leading destination for BPO operations.

How Do We Get There?

Sustaining the momentum of the BPO industry requires the following:

- address the growing gap in qualified personnel relative to industry needs;
- expand facilities outside of Metro Manila to take advantage of yet untapped workers in the regions; and
- further improve the business environment for BPO firms.

Expand the Pipeline of Skilled Workers for the Industry

As indicated above, the stronger constraint to future growth in the BPO industry in the Philippines lies on the supply side, and in particular, the availability of skilled human resources to fill positions in the industry. While there is already a pipeline of talent in the school system, the Business Processing Association of the Philippines (BPAP) estimates this to only be sufficient to support growth of about 15% per year, far short of the 40% annual targeted growth to achieve the target 10% global market share.

The industry association is taking a proactive stance in addressing the human resource pipeline problem, and has lined up five complementary efforts:

- developing a comprehensive assessment and training program;
- creating awareness of career opportunities in the industry;
- tapping alternative labor pools, including housewives, retirees, non-graduates, and career switchers, and seeking available talent outside the National Capital Region (Metro Manila);
- helping students to continue funding their education; and
- working with the education sector to make college and high school curricula more responsive to the needs of the industry.

Develop New Locations

BPAP has identified at least 13 additional locations that can support operations of more than 5,000 employees, and 5 cities that could serve as hubs employing 3 to 10 times as many BPO workers. BPAP and the Commission on Information and Communications Technology are collaborating to assess a broad range of cities and segment them based on perceived BPO readiness and needs. What each location needs to enhance readiness to host BPO firms varies case by case. The development support needs of these cities are also being assessed, and based on market demand, BPAP aims to develop the capability and capacity to deliver developmental support to interested locations.

Improve the Business Environment

In addition to talent and real estate, the business environment is key to attracting investments in the industry. Four relevant areas have been raised by the industry in this regard:

- financial incentives;
- support to investors;
- risk environment; and
- overall government support to develop the industry.

BPAP considers the financial investment incentives in place in the Philippines attractive enough (BPAP 2007). There is scope for further improvement throughout the end-to-end support services for investors, from initial consideration, through securing incentives, to actual start-up. The risk environment has been perceived to be a challenge, with political and peace and order risks among the top concerns. There is also scope for improving the legal framework under which the industry operates.

Overall support by government for the industry is important. To this end, BPAP helps educate local governments about the potential growth and economic benefits to be realized through the BPO industry, and about ways in which they can more effectively attract investment to their localities.

Food and Design-Based Manufacturers

Growth in food demand will continue indefinitely with the expanding population, and would be further boosted by expansion of tourism. As average incomes rise, food tastes also move toward more processed forms of food products, suggesting that this largest subsector of manufacturing (accounting for 46% of the sector) will continue to be an important growth driver in the future. Growth in this industry will naturally be broad based and inclusive. For one thing, it is closely linked to the agriculture sector as provider of raw materials, and to the wholesale and retail trade industry for distribution of its products to markets nationwide—even as exports will continue to account for a significant portion of industry output.

Input–output analysis further reveals the extensiveness of the industry's linkages with the rest of the economy. It has strong backward linkages, manifested in a total intermediate inputs coefficient of 0.69, the bulk of which (0.47) comes from agriculture. This means that intermediate inputs from the rest of the economy make up 69% of the value of the industry's production, with agriculture providing 47%. The industry's backward linkage index is 4.6, indicating that its total intermediate inputs coefficient (backward linkage) is 4.6 times the average across all industries. Likewise, the industry has strong forward linkages, with a forward linkage index of 13.2, indicating that the industry's forward linkages to the rest of the economy are 13.2 times the average across the sectors.[12] Thus, relative to the rest of the economy, food manufacturing has strong backward and forward linkages, making it a key driver for broad-based growth in the economy.

While the PRC has emerged as a dominant base for manufacturing industries worldwide due primarily to low labor costs, the Philippines remains competitive in manufacturing industries where design is a crucial element. These include higher-end garments, furniture and fixtures, and housewares. Filipino designers are said to be well attuned to Western tastes, due to the unique mix of western and oriental cultural influences in the country's long colonial history. While industry practitioners lament how cheaper Chinese competitors are quick to copy their successful designs, this only indicates that the industry must remain proactive and dynamic to stay ahead of the competition and sustain growth.

Where Are We Now?

As mentioned above, food manufacturing accounts for close to half (45.7% as of 2009) of the manufacturing sector, with the share having grown from 41.8% in 2007. While it contracted by 0.3% in 2009, this was much slower than the 5.1% overall contraction in the manufacturing sector.

While much smaller than food manufacturing, garments (comprising 3.2% of manufacturing output, including footwear) are the second

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[12] This index was derived by taking the average of the row totals in the technical coefficients matrix of the 59-sector 1994 Input–Output Table, where row entries indicate the contribution of the respective industry on that row to the production of the other industries' outputs. The row total for the Food Manufacturing industry is 2.4 times the average of these row totals.

largest export revenue earner for the country after electronic products, earning the country over $2.3 billion in 2007. The garment exporters are now primarily serving the higher-end markets over the mass markets, with products increasingly finding their way into retailers catering to more selective, higher-income consumers (e.g., Macy's, JC Penney's, GAP, Old Navy, Ann Taylor, Liz Claiborne, Polo Ralph Lauren) rather than mass market retailers (e.g., K-Mart, Wal-Mart). Rapid expansion of the garment industry through the years has led to the spread of subcontractor arrangements to rural areas. As well as lending itself to participation by smaller, rural-based enterprises, garment production is a labor-intensive enterprise, thereby providing wide benefits across the population. While currently hit by the slump in world demand due to the global economic slowdown, the industry should be able to ride the global recovery with new opportunities in both new and traditional markets.

Philippine-made furniture and fixtures likewise continue to be competitive in international markets, particularly due to superior designs that are attractive in Western markets. Along with housewares and other craft-based manufacturing, there is much scope for growth in the industry, especially with rising incomes both domestically and in markets abroad.

Where Do We Want To Go?

As discussed in the section on agriculture and agribusiness, there is much merit in fostering growth in the processing by SMEs of agricultural and fishery products in the countryside, and in particular food products. As well as expanding nonfarm livelihood and employment opportunities in rural communities, this would help widen the markets for primary agricultural products. In turn, this would reduce monopsonistic tendencies that have traditionally kept farm-gate prices low and limited the ability of small farmers to get remunerative prices for their products. Key products would include the processing of traditional crops like coconut oil (where new technologies make smaller-scale processing plants both feasible and competitive), sugarcane milling (especially with the increased popularity of less-refined products like muscovado sugar), and rice and corn milling. There are also new opportunities in emerging growth products such as abaca, coffee, biofuel crops such as jatropha, and other horticultural crops that are in growing demand in overseas markets.

While global garment markets are highly competitive, Philippine garment exports have found their niche in the higher-end segment of the market where design is the key consideration. Rising incomes in recovering and rapidly growing economies should provide positive medium- to long-term prospects for the industry. The same holds true for other design-based manufacturing like furniture and house wares. Aggressive efforts by the government for wider market access will be important, both in traditional and non-traditional markets for Philippine exports.

How Do We Get There?

Maintaining a viable and competitive manufacturing sector is crucial to the pursuit of broad-based, job-generating economic growth. The Philippine manufacturing sector has suffered in the global economic downturn, adding to the pressure it was already under due to cheap competing products from the PRC. Electronics will continue to be a prominent subsector in manufacturing, although its weak domestic backward and forward linkages limit the inclusiveness of its growth. Manufacturing industries with much stronger domestic value added thus merit strong focus. The country remains competitive in food manufacturing, owing to its large agriculture sector, and in manufacturing industries where design is a prime consideration, such as garments, furniture, and house wares, owing to a rich pool of talented artists and designers. Manufacturing based in SMEs in these industries holds great potential for providing a significant boost to high and inclusive growth.

The imperative, then, is to provide an enabling environment conducive to more intensified development of SMEs. Studies have consistently shown the needs for such an environment to lie in access to financing, technological support, raw materials, and markets.

To this end, the following are key imperatives:

- widen financing options for SMEs;
- strengthen technology support for SMEs;

- facilitate establishment of processing SMEs in primary production areas;
- encourage and facilitate clustering to expand and sustain market access; and
- assist in gaining market access through development diplomacy.

Widen Financing of SMEs

Financing has persistently been cited by SMEs as the foremost unmet need, whether in the Philippines or internationally. The problem is that most SMEs have neither the security required for conventional collateral-based bank lending, nor high enough returns to attract formal venture capitalists or other risk investors. In spite of countless ideas and initiatives to address the finance challenge for SMEs, ranging from guarantee funds to venture capital funds, the problem persists. As publicly-created funds such as those provided by the Small Business Guarantee and Loan Corporation will never be sufficient to meet the aggregate needs, the problem ultimately boils down to the unwillingness of most private banks to extend enough loans to SMEs. Guarantee facilities can help ease this hesitance on the part of banks, but again, the funds available for such guarantee schemes can never meet the entire need. Venture capital funds for SMEs have also been proposed and attempted, but have found limited success. The Bangko Sentral ng Pilipinas, the central bank, has recently announced new measures to assist banks to improve their capability to handle loans for SMEs. All of these developments notwithstanding, efforts must continue by all players, including banks themselves, to help widen the access of SMEs to financing. One particular direction worthy of pursuing is finding innovative mechanisms to harness overseas remittances as a source of finance for SMEs, whether as loans, guarantees, or venture capital funds. Declaring the development of SMEs as the centerpiece economic program of government, as proposed in this paper, could heighten the commitment of all players enough to make a substantial difference in easing financial flows to SMEs.

Strengthen Technology Support and Services

SMEs normally lack the resources to undertake their own research and development, and must rely on publicly or commercially available technologies for application in their production enterprise. There is a particular need for environmentally-friendly production technologies and pollution abatement and control. An enabling environment for SMEs should include public research support facilities for these technology needs. The required institutional support includes appropriate standards and corresponding testing facilities, which are essential for export-oriented enterprises for which quality control is critical—and usually demanded by foreign buyers, especially in more affluent markets. Expanding the scope and reach of the Technology and Livelihood Research Center would be one way to respond to this need. The Department of Science and Technology, through its regional offices nationwide, is likewise a logical agency to utilize in strengthening such dedicated support for SMEs and making it widely available across the country.

Foster Agri-Processing by SMEs in Rural Areas

The need to connect SMEs to raw material sources would be well served by facilitating the establishment of processing enterprises at or near primary production sites. This could be achieved through the use of government incentives, information dissemination, and matchmaking services (i.e., between primary producers and processors). As argued earlier (in the section on agriculture and agribusiness), fostering more and smaller agriprocessing enterprises in rural areas would have the double benefit of overcoming monopsonies in the farm product markets, while expanding nonfarm livelihood and employment in the rural areas.

Facilitate Clustering Schemes

A common downfall among exporting SMEs is the inability to meet large volume orders from overseas. While the logical response would be collaboration between two or more SMEs to meet volume demands, the tendency for individualism among Filipino entrepreneurs has been cited as an obstacle. Experience provides growing evidence that enterprise clustering schemes can be effective in building sustainability and lowering costs among small and medium-sized producers (Box A1.3). Forming such business clusters usually requires an external mediator, a role that can be played by local governments or by nongovernment entities such as nongovernment organizations or business associations.

Development Diplomacy for Increased Market Access Overseas

Government must be able to use its missions abroad to assist in gaining wider access to overseas markets, especially for the products of Philippine SMEs. The country would do well to emulate the example of some of its Southeast Asian neighbors who are known to have been more aggressive in such development diplomacy work, and have provided ample budgets and staffing for this key function.

A particular example of overseas opportunity, in which this form of dedicated diplomatic work could well provide wide benefits at home, is lobbying for House Resolution 3039 (the "Save Our Industries Act") in the US House of Representatives (Box A1.6).

Mining

Among the growth drivers identified here, mining is the most controversial due to questions relating to (i) social and environmental impacts of the industry; and (ii) inclusiveness of growth that may be achieved in the sector, including the magnitude of its eventual benefits accruing to the state and to Filipinos, especially where foreign companies are involved.

The potential wealth that the Philippines can gain from its known mineral resources is estimated at P47 trillion. With 9 million hectares of mineralized land, the country is considered the fifth most minerally-endowed in the world, and has established reserves of 13 known metallic and 29 non-metallic resources spread across the country. Based on specific mineral endowments, the country is ranked globally as third in gold deposits, fourth in copper deposits, fifth in nickel deposits, and sixth in chromite deposits.

There is no doubt that mining can potentially be a driver of rapid growth, especially given the industry's recent growth performance. Mining (and quarrying) was the fastest growing industry in the Philippine economy in 2009, posting a rapid 21.1% annual growth rate[13] at a time when most of the industrial sectors were contracting.

What is debatable, however, is the *inclusiveness* of the growth that the sector can provide. The relevant questions in this regard are (i) how much employment growth in the sector would generate; and (ii) how much other sectors in the economy would benefit from mining growth,

Box A1.6 House Resolution 3039: The Save Our Industries Act

The Save Our Industries Act of 2009 (SAVE Act) is a bill submitted by Rep. James McDermott (D-WA7) that proposes the granting of duty-free treatment, subject to specified conditions, for certain apparel wholly assembled in the United States (US) or the Philippines, or both, and components of such apparel consisting entirely of: (i) fabric components cut in the US or the Philippines, or both, from fabric wholly formed in the US from yarns wholly formed in the US; (ii) components knit to shape in the US from yarns wholly formed in the US; or (iii) any combination of such components. The SAVE Act grants: (i) a reduction of duty for such apparel, provided the same criteria are met; and (ii) duty-free treatment for apparel that meet both the requirements for duty-free treatment and reduction of duty. The Act would require the Comptroller General to evaluate the effectiveness of the preferential duty treatment afforded under the Act for apparel imported from the Philippines. It prohibits preferential duty treatment of apparel imported from the Philippines unless the President certifies to Congress that it is meeting certain trade enforcement conditions with respect to such apparel. The proposed preferential treatment for Philippine-made apparel is time-bound, terminating (i) 10 years after the effective date of the Act; and (ii) when the Philippines becomes ineligible for designation as a beneficiary country under the Generalized System of Preferences.

Source: Official Summary of H.R. 3039, US Congress (http://www/opencongress.org/bill/111-h3039/show).

[13] Based on the National Income Accounts for 2009 reported by the National Statistical Coordination Board.

through its backward and forward linkages. This would be indicated by the industry's labor intensity (labor–output ratio), and measures of its backward and forward linkages with the rest of the economy. Input–output analysis, using the 2000 Input–Output Table of the Philippine Economy,[14] sheds some light on this question.

In terms of employment generation, mining and quarrying has relatively low labor–output ratios. Labor compensation accounts for only 13.3% of the sector's output, against an economy-wide average of 20.7%, giving a labor absorption index of 0.64.[15] With a backward linkage index of only 0.46, the industry uses relatively little input from other domestic industries. Likewise, a low forward linkage index of 0.82 indicates that forward linkages are below the average for all sectors of the economy. This is consistent with the fact that a major proportion of the industry's products are currently exported in primary form (e.g., as raw mineral ore), with little processing taking place within the country. Thus, while mining advocates often argue that the products of the mining sector find their way into most products encountered in our daily lives, currently these forward linkages are not occurring within the Philippines The clear imperative is to move toward more domestic processing of the mining products, to help widen the domestic linkages of the sector, and thereby make growth in the sector more inclusive.

Where Are We Now?

In spite of the industry's prominence, mining has contributed a relatively miniscule share of national GDP over the years. Based on the National Income Accounts, the sector has contributed on average only 1.44% of the country's total GDP since 1975. The highest contribution of mining to GDP was 2.16% in 1985, but this was more due to the contraction of other sectors of the economy, in the face of a general economic slowdown. Mining's share of total exports has averaged 11.3%, with a high of 24.6% reached in 1973.

Job generation in the mining sector has decreased, as mining companies have employed more labor-saving technologies and means of production. Overall mining employment dropped from an annual average of 134,000 in the 1980s to 118,000 in 2004, although this had risen to 177,000 by 2009 as a result of recent growth in the sector. Meanwhile, real gross value added (GVA) per unit labor had risen from P70,000 in 1980 to P158,000 in 2004. Another way of looking at this is that 14 workers were employed for every P1 million of mining GVA in 1980; by 2004, this was down to 6 workers per P1 million of GVA.[16] The same trend is seen in the input–output tables: the labor coefficient for the mining sector in the 1994 table was 0.17; in the 2000 table, it had fallen to only 0.13.[17] Labor absorption is likely to continue declining over time as more labor-saving technologies are adopted in the industry. On the other hand, the largest share of the value of output accrues to operating surplus, amounting to 43%, indicating that the benefits from mining accrue primarily to investors, and hence a relatively narrow segment of society.

Further undermining the inclusiveness of future growth in the mining sector is the nature of the fiscal regime governing foreign mining ventures under the current legal framework. Under the Mining Act of 1995 (Republic Act No. 7942), foreign companies may engage in mining activities in the Philippines under two modes: MPSAs, or FTAAs. Under MPSAs, the share of the state is limited to the excise tax, which is 2% of the value of the mineral extracted. The fiscal regime under FTAAs was originally defined by Department Administrative Order (DAO) 99-56 of the DENR, and was subsequently amended by DAO 2007-12. In his dissenting opinion to the Supreme Court's upholding of the constitutionality of the Mining Act in December 2004,

14 Available on CD from NSCB.

15 The labor absorption index used here is derived as the ratio of the sector's labor–output ratio, indicated by the input–output technical coefficient for labor compensation, to the economy-wide average. The labor absorption index of 0.64 means that the sector generates a little less than two-thirds of the average employment generated per unit value of output obtained economy-wide.

16 Figures are from the quarterly Labor Force Survey of the National Statistics Office.

17 From the Input–Output Tables produced by NSCB.

Justice Antonio Carpio pointed out that under the provisions of DAO 99-56, the state stands to receive no share of the value of minerals extracted by foreign firms, other than the usual taxes that must be paid. This was later confirmed by DENR Secretary Angelo Reyes in 2007, who affirmed that the profit-sharing scheme under DAO 99-56 is disadvantageous to the State. In what is now an oft-cited quote, he declared that the probability of the government receiving an additional and fair share of its minerals from the mining companies was "somewhere from zero to nil." While he issued DAO 2007-12 to rectify this by providing for a guaranteed 50% share for the government of net mineral values, the new rules were prospective and did not apply to the two FTAAs existing at the time, which covered 49,373 hectares of mineral lands. Two new FTAAs have since been granted, covering 49,144 hectares. Furthermore, most of the existing agreements governing mining ventures are covered by 312 MPSAs covering 499,954 hectares of mineral lands, where the state stands to receive only the 2% excise tax on the minerals extracted (Table A1.7). Given the low and declining labor intensity of the sector (as indicated above), the bulk of the income from mining activities is expected to accrue to a relatively narrow and wealthy segment of society.

The other and more prominent concern in mining is the environmental and social impact of mining activities, especially in uplands and indigenous lands. Open-pit mining, which has been banned in several industrialized countries including Canada and the United States, tends to be environmentally destructive. Unfortunately, most of the FTAAs and MPSAs granted in the country will employ open-pit mining or a combination of open-pit and other forms of extraction. Smelters and waste materials from mining are also known to produce sulphurous dust clouds that cause acid rain. Tailings run-offs can contaminate nearby water sources with heavy metal pollutants used in mining, such as cadmium, mercury, sodium cyanide, and zinc, rendering them useless as sources of food, water, and livelihood. It has been estimated that 160,000 tons of mine tailings find their way into rivers, lakes, and irrigation systems across the country every day. The 1996 Marcopper tragedy in Marinduque spilled tons of mine tailings into the Boac and Makulapnit rivers and into Calancan Bay, destroying the livelihoods of thousands of fisher families. This and other environmental accidents in mines have led to strong opposition to mining activities from some groups, and a general demand for responsible mining practices in the industry. Much confidence building still needs to be done if mining is to be widely accepted as a growth driver for the Philippine economy.

Where Do We Want To Go?

For mining to be more inclusive, local communities argue for equal opportunities for small- and medium-scale mining activities. However, the latter have had a mixed history marked by irresponsible and environmentally-destructive practices. Thus, it is imperative that government exercises proper regulation over mining firms, whether large or small, to ensure strict adherence to

Table A1.7 Approved Mining Permits and Contracts

Type	Number	Area Covered (ha)
Mineral Production–Sharing Agreements	312	499,954
Financial or Technical Assistance Agreements	4	94,715
Exploration Permits	51	187,518
Mineral Processing Permits	39	NA
Industrial Sand and Gravel Permits	211	2,930

ha = hectare, NA = not available.

Source: Mines and Geosciences Bureau.

environmentally and socially responsible mining practices. Local governments should have the capacity to exercise such regulatory authority, by establishing an appropriate accreditation system for mining enterprises, together with a monitoring capability to ensure proper enforcement. Civil society must have a strong role in the accreditation and regulatory system, to ensure transparency and accountability in the process and mechanism. Agusan del Sur is an example of a provincial government that has taken such steps to properly manage mining development within its jurisdiction.

The forward linkages of the mining sector need to be strengthened through greater domestic processing and value adding of mineral products. The country needs to move away from export of raw mineral ores, as this is the least inclusive way of extracting the benefits of the country's mineral wealth.

There is also a need to address the conflicts surrounding mining projects in ancestral domain areas. This will include ensuring the integrity of the free prior informed consent obtained from indigenous communities where mining projects are undertaken.

Finally, it is important to strengthen the legal basis for more equitable sharing of the value of minerals with the state, which is currently only provided for by a DENR department order. As asserted in the dissenting opinion of Justice Antonio Carpio regarding the constitutionality of the Mining Act, the power to prescribe the fiscal regime of the FTAAs lies with Congress. The stability of policy will be better served if the fiscal regime for mining investments is provided for in law. Revisions to the fiscal regime of the MPSAs are also strongly warranted, inasmuch as they govern the bulk of mining ventures in existence, and yet fail to provide the state with any share of the value of the mineral output, beyond the minimal excise tax.

How Do We Get There?

The following are concrete imperatives for mining to become a propeller of economic growth that is *not only rapid but also inclusive*:

- capacitate provincial governments to accredit and regulate small- and medium-sized mining enterprises;
- establish and strengthen partnerships with civil society in the promotion and assurance of responsible mining;
- foster investments in domestic processing of minerals and greater value adding;
- move toward banning the export of raw mineral ores;
- address and settle conflicts over ancestral lands; and
- amend the Mining Act to incorporate the fiscal regime governing the FTAAs, while revising the fiscal regime for the MPSAs to provide for a rightful share for the state of the value of mineral products extracted.

Accredit and Regulate Small and Medium-Scale Mining Firms at the Provincial Level

While the bulk of mining activities is undertaken by large firms making substantial capital investments, there has also been a long history of small- and medium-scale mining activities in the Philippines. In the country's experience, the latter have been prone to social and environmental problems, which have sometimes been more damaging than those of large-scale firms. Nevertheless, promoting inclusiveness calls for "democratizing" the industry by providing equitable opportunities for mining activities by both large enterprises and SMEs, with an appropriate regulatory framework to address the latter as well as the former. There must be a close partnership between DENR and provincial governments in developing an accreditation and regulatory mechanism for small- and medium-scale mining operations that ensures strict adherence to environmentally sound practices. This is best achieved with civil society participation in the accreditation and regulatory mechanism, particularly in monitoring the practices of mining firms. DENR must provide the necessary technical support to provincial LGUs for the latter to attain the capacity to establish and maintain such a system. This should be part of a government-wide effort to capacitate LGUs and empower civil society so that national government agencies can focus on "steering" functions, while passing on the "rowing" functions to LGUs.

Establish and Strengthen Partnerships with Civil Society

DENR, local governments and the private sector need to work in partnership with civil society groups in developing the accreditation and regulatory mechanism described above, and monitoring systems to support it, to ensure wide acceptability of industry outcomes. This will require earnest confidence-building efforts and honest communication efforts, especially given the hard-line stance of some groups against mining, amid widespread mistrust for the government. Ultimately, the test of inclusiveness in the mining sector's growth is whether government and private sector initiatives in the industry are met with wide (though not necessarily universal or unanimous) support from civil society.

Foster Investments in Domestic Processing and Value Adding of Mineral Products

Attaining inclusiveness in growth coming from the mining sector hinges on widening and strengthening the forward linkages in the industry, given its average backward linkages and relatively low, declining level of labor absorption. Thus, there is a need to provide a hospitable environment for investments in processing and further value adding of mineral products, including their inclusion in the Investment Priorities Plan to be eligible for various incentives granted by the Board of Investments. The government must be deliberate about this goal of increased domestic value adding in the mining industry to maximize the benefits to be derived from the industry by a wider spectrum of domestic stakeholders.

Phase Out Exports of Raw Ores

A mining industry that simply exports raw mineral ores will yield very narrow benefits and cannot foster inclusive growth. In line with the above, the eventual phase-out of direct export of raw mineral ores needs to be deliberately pursued. For example, the government may include this as a condition for entry by large new players into the industry. That is, large mining enterprises, especially foreign ones, could be required to set up processing facilities within a reasonable specified time period after the commencement of commercial operation.

Address and Settle Conflicts over Ancestral Lands

There is a need to satisfactorily address conflicting claims arising due to (i) community stakeholders invoking the IPRA governing ancestral lands, and (ii) mining project proponents invoking the Mining Act. It is also important to define a mechanism to ensure the authenticity of the free prior informed consent the IPRA requires from indigenous communities for the commercial utilization of ancestral lands.

Amend the Mining Act to Strengthen the Fiscal Regimes of Mineral Agreements

Amendments to the Mining Act are required, in particular to clarify and improve the fiscal regimes associated with the FTAAs and MPSAs. The current fiscal regime for the FTAAs embodied in DAO 2007–12, while now deemed fair in contrast to that provided for in DAO 99-56, needs a stronger legal basis to ensure policy stability. On the other hand, the MPSAs suffer from the same weak economic framework under which traditional logging concessions operated, whereby the natural resource was so grossly underpriced as to lead to excessive economic rents and wanton overexploitation and environmental destruction. The fiscal regime needs to internalize the external costs involved in minerals extraction, and ensure that the state is able to recover a substantial part of the economic rents to be derived from the industry. Revenues can then be utilized in a way that provides wide benefits to all stakeholders in the industry, especially workers and surrounding communities directly affected by mining operations. Only then can mining truly be a driver not only for rapid economic growth in the Philippines, but for growth that is broad-based and inclusive as well.

Appendix 2
E-Mail Quick Survey

An e-mail survey was sent out to a purposive sample of over 100 individuals, consisting primarily of Philippine Economic Society members, prominent academic and practicing economists, and several personalities in business and civil society known to be actively involved in economic development work.

To maximize the likelihood of obtaining a response, two simple questions were asked in the survey, answerable with a short list of phrases or sentences:

- What, in your view, have been the top three impediments to rapid and broad-based (inclusive) growth in the Philippines?
- If you were the President, what top three concrete measures (i.e., strategic measures which you believe that once achieved, would lead other issues to fall into place) would you implement to achieve rapid and broad-based (inclusive) growth for the Philippines?

Appendix 3

Measuring Interindustry Linkages[1]

The backward, forward, and total linkage indexes are summaries that gauge the interindustry dynamics of an industry, with the other industries as providers of input (i.e., backward linkage) and as a source of input to the other sectors (i.e., forward linkage). Backward linkage measures the relative importance of a sector as a buyer of inputs from the other sectors. It is computed as the sum of the sector's column elements in the inverse matrix of the input–output table. Forward linkage measures the relative importance of a sector as a supplier of inputs to the other sectors, and is obtained as the sum of the sector's row elements. The linkage index of a sector is the ratio of its linkage, whether backward or forward, to the average of all the sectors' linkages. The total linkage index is the sum of the backward and forward linkage indexes.

These measures assume an identical increase in demand by one unit for all of the sectors. Since this is not likely to occur, Hansda (2003) proposes multiplying each element of the inverse matrix by the share in final demand of the relevant input sector (i.e., the row sector). The resulting weighted inverse matrix is then used to calculate the linkages and the indexes. Sectors with indexes of backward and forward linkages both greater than one are regarded as the key sectors of the economy. Key sectors are important in terms of investment because growth in these sectors will stimulate more production in other sectors of the economy.

1 This draws heavily from Magtibay-Ramos, Estrada and Felipe (2007).

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An Agenda for High and Inclusive Growth in the Philippines

While Asia has seen faster poverty reduction accompanying rapid economic growth compared with the rest of the world, the Philippine experience has been a glaring exception, as growth has generally been slower and poverty has actually risen even with record economic growth. The Asian Development Bank has identified four critical constraints as having impeded Philippine economic growth: (i) tight fiscal situation; (ii) inadequate infrastructure, particularly in electricity and transport; (iii) weak investor confidence due to governance concerns; and (iv) inability to address market failures leading to a small and narrow industrial base. In light of this, dramatic improvements in revenue generation, infrastructure provision, and enterprise development assume central importance in the government's economic policy agenda. The study identifies needed measures supporting these thrusts, along with key sector growth drivers that would ensure both accelerated growth and broad-based participation and benefits within the economy. But all these will have little success without a governance and institutional reform agenda that would restore the public's overall trust in government, the lack of which has led to low tax compliance, inhibited investment, and in turn constrained growth of the economy through the years. Overcoming this will require decisive actions on several fronts from the new Aquino administration.

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Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org
ISBN 978-92-9092-178-3
Publication Stock No. RPT102567

ISBN 978-92-9092-178-3

Printed in the Philippines