# Economic Reforms for Philippine Competitiveness

Media Partner

# ***Economic Reforms for Philippine Competitiveness***



Edited by Maria Fe V. Mendoza and G.H. S. Ambat

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# Preface

*Economic Reforms for Philippine Competitiveness* is a policy monograph consolidating the priority measures that the Faculty of Management and Development Studies - University of the Philippines Open University (UPOU) is advocating to improve Philippine competitiveness. It is one of the outputs of its policy research project on "Improving Philippine Competitiveness through Policy Advocacy of Economic Reforms and Strategies," which generally aims to contribute to the continuing discourse on current development and social issues in the country and transform reforms into action in the 15th Congress.

The monograph draws from the opinions, perspectives and views of various stakeholders from the academe, the Executive and Legislative branches of the government, business, development organizations and media, who participated in the series of consultative workshops and forums conducted over the past six months. It is also informed by the review of studies and researches on the topic at hand, and capitalized on the wealth of experience and knowledge of a number of resource persons and experts the project engaged with.

The proposed reforms focus on sustaining macroeconomic stability, improving infrastructure development and the investment climate, lowering the cost of doing business and addressing issues on governance and regulation. These may not be totally alternative, new or earth-shaking, given the incremental nature of our policy system. However, in an economic environment replete with challenges and growing uncertainty, we hope this roadmap will contribute in our understanding of even the littlest steps to take to improve our comparative and competitive advantage. We also hope that these will find pathways and bridges to legislators and advocates in the next Congress.

The UPOU would not have succeeded in elevating this discourse to a higher consciousness plane without the support of its partners. We would like to acknowledge our co-workers in this reform initiative, namely: *the United Kingdom-Foreign Commonwealth Offices' (UK FCO) Low Carbon, High Growth (LCHG) Programme*, especially Ambassador Stephen Lillie, Economic Attaché Mark Emmanuel Canlas, Programme Managers Sherah Chua and Joseph Rey Imperial; *the Committee Affairs Department (CAD) and Congressional Planning and Budget Research Department (CPBRD) of the House of Representatives*, more particularly, Director-General Rodolfo Vicerra, Atty. Arlene Arnaldo, CAD Deputy Secretary General, Executive Director Violeta Veloso, Directors Lina Mortega and Manuel Aquino, Committee Secretary Portia Silang and a number of other experts from the CAD and CPBRD; *Senate Economic Planning Office* Director General Ronald Golding; and *the Philippine Chamber of Commerce and Industry (PCCI)* led by its Vice Chair, Ambassador Donald Dee. Special mention also goes to our media partner, *The Business World.*

We would also like to express our gratitude to our experts and resource persons. Special mention goes to Deputy Director-General Rolando Tungpalan and Director Dennis Arroyo of the National Economic Development Authority; Undersecretary Zenaida Maglaya of the Department of Trade and Industry, Ambassador Cesar Bautista, Vice Chair of the National Competitiveness Council; Mr. Meneleo J. Carlos, Jr., Chair of the Federation of Philippine Industries; Commissioner Crisanto Frianeza and Director Ryan Evangelista of the PCCI; Dr. Ma. Lourdes A. Sereno, Executive Director of the Asian Institute of Management Policy Center ; Dr. Raul Fabella, professor and former dean of the UP School of Economics; Prof. Leonor Briones of the UP National College of Public Administration and Governance; Mr. Manuel Cruz of the Department of Trade and Industry-Board of Investments; Mr. Napoleon Micu of the Department of Finance; and Dr. Suphachol Suphalachalasai of the Asian Development Bank.

The support of the UPOU Chancellor, Dr. Grace Javier Alfonso, and the rest of the UPOU faculty and staff has, needless to say, been our source of strength.

Personally, I would like to commend the hard work given by our competent Team, most especially, by our Project Coordinator, Ms. G.H. Ambat.

**Maria Fe Villamejor-Mendoza**
Project Leader

## MESSAGE

The Faculty of Management and Development Studies (FMDS) of the UP Open University (UPOU), with support from the United Kingdom- Foreign Commonwealth Offices' (UK FCO) Low Carbon, High Growth (LCHG) and Bilateral (BPB) Programmes, has embarked on a challenging task of crafting a legislative agenda to boost competitiveness. This was done under the project *Improving Philippine Competitiveness through Policy Advocacy of Economic Reforms and Strategies.*

Through a series of policy workshops, forums and consultations as well as policy research on the topic at hand, the UPOU, together with its partners from the Legislature, the academe, business and media was able to develop a set of legislative reforms in the areas of macroeconomy, infrastructure, governance and regulations.

These wealth of reforms, which started from the Roundtable Discussion on 'Tax Matters' in September 2009, continued at the Policy Forum and Launch on 'The State, Challenges and Prospects of Philippine Competitiveness' in Sulo Hotel in October last year, and in the Policy Consultative Workshops to 'Craft a Legislative Agenda for the Next Congress' in Tagaytay last January cannot just go down in the pages of history unceremoniously. The project, the workshops and the proposed legislative reforms must leave a mark, an impression that people will remember by. In this case, there is a policy monograph to remember these legislative reforms by. I must say that coming with a policy monograph is a brilliant idea.

This policy monograph is aptly called *Economic Reforms for Philippine Competitiveness*. It reflects proposed legislative reforms discussed in the context of studies and researches on improving competitiveness, and of expertise and experiences of the stakeholders engaged and consulted by the project. In the heart of this policy monograph are priority legislative reforms that the UP Open University is advocating. It has been a labor of love and perseverance, of critical thinking and practical considerations. It is a humble contribution of the academe to the next Congress.

I would say that the proposed legislative reforms here are neither revolutionary nor novel. In fact, most of these have been floated around and filed in the previous Congresses. But people should not be surprised given the circuitous, iterative political processes in Congress. Nevertheless, the idea of influencing policymaking and reform at a critical time when people are lulled to hollow political propaganda and circus is alternative and correct. We make sense and direct people to the crux of the matter amidst the dramatic developments around us — the election fever, the prospect of having a new leader, the last stretch of the global financial crisis and the changing market.

But even with the proposed legislative agenda on hand, the future is still not certain. What is certain though is that the next Congress —— the 15th Congress — will be forearmed with the proposed legislative reforms from our end.

**Dr. Grace Javier Alfonso**
Chancellor UP Open University

# MESSAGE

Congratulations to UP Open University, its partners in government, business and civil society on the publication of this policy monograph. This paper encapsulates the findings of the numerous consultations and the workshop held in Tagaytay earlier this year.

As British Ambassador in Manila, it is my mission to work in partnership with the Philippine government and society to support the growth of a successful and prosperous Philippines. This is a UK interest as much as it is a Philippine interest. Last year, the British government launched a research, which showed that the Philippines is seen as an attractive business location by 500 global business executives. In 2008, the Philippines ranked 23rd among non-BRIC emerging markets. By 2009, the country had shot up the rankings to become the ninth most favoured emerging market.

This provides a challenge and an opportunity to rise still higher; to increase competitiveness still further and to replicate other Asian markets more favoured by international business.

Economic reform is fundamental to enhanced competitiveness. The work on reform does not end with the current congressional session. That is why this project, and the resulting monograph, is so valuable. It is intended to provide a basis for continuing consultations and discussions on needed reforms. I hope it will play a part in maintaining momentum behind reforms across the change of administration.

UPOU and its partners in government, academia and civil society discussed extensively and came up with a priority agenda for Philippinecompetitiveness. This agenda is enshrined in this policy monograph. While the views expressed are those of the authors and not of the UK government, I cannot help but agree with many of the recommendations and suggestions in the paper, including the need for fiscal consolidation, or the continuing imperative to tackle climate change even after the creation of the Climate Change Commission. Climate change is a global market failure that developed and developing countries have to address with globally coordinated national policies.

The monograph also puts a conducive investment climate for business high on the agenda. As our survey of business executives shows, there is significant and increasing investment interest in the Philippines but there are a lot of fears that we need to dispel. With further economic reform, the Philippines will be a more attractive location for both local and foreign investment.

This project has been a genuine public-private partnership, bringing together valued partners from the executive, the legislature, the private sector, civil society and academia. This has made for a rich, inclusive and stimulating policy debate – a conclusion which readers of this paper will surely endorse. I'm grateful for your support and look forward to continued co-operation towards our shared goal of a more prosperous Philippines.

*Mabuhay tayong lahat!*

**Stephen Lillie**
British Ambassador to the Philippines

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# Introduction

## Entering an era of economic uncertainty

What started as a monetary crisis in a few industrialized countries quickly turned into the most difficult global economic crisis in generations —— resulting in record high contraction of world gross domestic product (GDP) and unprecedented unemployment rates.

Developing countries like the Philippines have not been spared from the adverse effects of the fallout as demand for exports and prices of commodities declined. The economic fallout was also coupled with significant reductions in foreign investment. A global liquidity shortage has also negatively impacted access to finance for companies and governments alike (World Bank, 2009).

While the Philippine economy still managed to grow in the past two years and is projected to grow at a minimal rate in 2010, the next set of Philippine leaders will be ushered in to an economic environment replete with challenges and growing uncertainty.

With Asian economies leading the global recovery, it is imperative for the Philippines to put in place policies and strategies underpinning economic growth and development.

## Competitiveness in a nutshell

Sala-i-Martin, et.al. (2008) defines competitiveness as a set of institutions, policies and factors that determine the country's level of productivity. The World Economic Forum (WEF), in its recently released Global Competitiveness Report1 (GCR)[1] , further expounds:

> *"The level of productivity, in turn, determines the sustainable level of prosperity that can be earned by an economy. In other words, more-competitive economies tend to be able to produce higher levels of income for their citizens.*
>
> *The productivity level also determines the rates of return obtained by investments in an economy. Because the rates of return are the fundamental drivers of the growth rates of the economy, a more-competitive economy is one that is likely to grow faster in the medium to long run."*

[1]World Economic Forum. (2009). The Global Competitiveness Report 2009-2010: Contributing to Long-Term Prosperity amid the Global Economic Crisis.

# Improving the Investment Climate through Macroeconomic Stability

## Factors that affect competitiveness

The determinants of competitiveness are many and complex since competitiveness as a concept involves static and dynamic components. The determinants have been grouped into 12 pillars by WEF:

1. *Institutions.* The institutional environment is set by the legal and administrative framework within which individuals, firms and governments interact to generate income and wealth in the economy. The quality of institutions influences investment decisions and the organization of production plays a central role in the distribution of costs/benefits of development policies and strategies within the society. While traditional economics continuously calls on government to reengineer its systems and procedures, i.e., curb excessive bureaucracy and red tape, ease regulation and increase transparency and integrity in public service, the recent global financial crisis along with numerous corporate scandals highlighted the crucial need for private institutions to uphold accounting and reporting standards and transparency for preventing fraud and mismanagement, ensure good governance, and maintain investor and consumer confidence.

2. *Infrastructure.* In many countries, significant investments in infrastructure resulted in economic growth and poverty reduction. Extensive and effective infrastructure especially in transport, power and telecommunications makes a country more attractive to investors and tourists alike while reducing production costs and increasing industrial productivity. The provisions of irrigation systems, post-harvest facilities and farm-to-market roads have been shown to increase incomes and productivity in the rural sector. Moreover, improving infrastructure has been shown to have an impact on non-income poverty in the rural areas. For instance, better roads improve access of people to education and health services, as well as reduce travel time. Provision of electric power also improves productivity in the rural sector.

3. *Macroeconomic stability.* The low productivity of a nation cannot be remedied by macroeconomic stability alone. However, it should also be recognized that macroeconomic disarray harms the economy. High interest payments o accumulated debt limit government from investing in development programs an providing services efficiently. Runaway inflation rates prevent firms from operatin efficiently. In sum, the economy cannot grow in a sustainable manner unless the macroeconomic environment is stable.

4. *Health and primary education.* A healthy labor force results in efficient operations and higher productivity. The quantity and quality of basic education received by the

population also determines the efficiency and productivity of the workforce. Thus, investment in the provision of health services and basic education is critical for clear economic, as well as moral considerations.

5. *Higher education and training.* Today's globalizing economy requires well educated workers who can adapt rapidly to their changing environment. Quality higher education and training is crucial for economies that want to move up in the value chain beyond simple production processes and products.

6. *Goods' market efficiency*. Healthy market competition, both domestic and foreign, is important in driving market efficiency. Thus, business productivity, by ensuring that the most efficient firms and producing goods demanded by the market, thrives. The best possible environment for the exchange of goods requires minimal impediments to business activity through government intervention.

7. *Labor market efficiency.* To ensure that workers are efficiently used in the economy, and provided with incentives to give their best effort in their jobs, it is critical that labor markets are efficient and flexible. Labor markets must therefore be flexible to shift workers from one economic activity to another rapidly and at low cost, and to allow for wage fluctuations without much social disruption. A clear relationship between worker incentives and their efforts, as well as the best use of available talent, which includes equity in the business environment between women and men, must also be ensured.

8. *Financial market sophistication.* The role of a sound and well-functioning financial sector for economic activity is crucial following the crisis. An efficient financial sector allocates the resources saved by a nation's citizens, as well as those entering the economy from abroad to their most productive uses. Since investments are crucial in increasing productivity, financial markets that can make capital available for private-sector investment from sources such as loans from a sound banking sector, well-regulated securities exchanges, venture capital and other financial products are imperative. To fulfill these functions, the banking sector needs to be trustworthy and transparent, and—as has been made so clear recently—financial markets need appropriate regulation to protect consumers from harmful practices.

9. *Technological readiness.* The ability of an economy to adapts to emerging technologies to enhance productivity is becoming increasingly important for firms to compete and prosper. Whether the technology used has been developed within the country or elsewhere, the main point is that the firms operating in the country have access to advanced products and blueprints, and the ability to use them.

10. *Market size.* Productivity is affected by the size of the market because large markets allow firms to exploit economies of scale. In this age of diminish in national borders,

international markets have become a substitute for domestic markets, especially for small countries. There is vast empirical evidence show in that trade openness ipositively associated with growth. Even if some recent research casts doubts on the robustness of this relationship, the general sense is that trade has a positive effect on growth, especially for countries with small domestic markets.

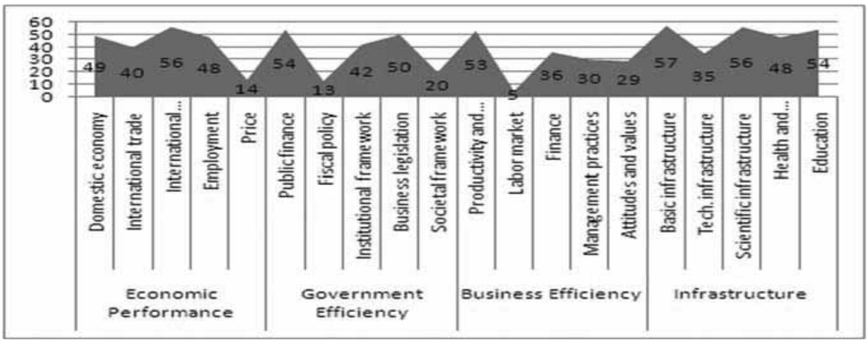
11. *Business sophistication*. Business sophistication is concerned with the quality of a country's overall business networks as well as the quality of individual firms' operations and strategies. It is particularly important for countries at an advanced stage of development, when the more basic sources of productivity improvements have been exhausted to a large extent.

12. *Innovation.* Although substantial gains can be obtained by improving institutions, building infrastructure, reducing macroeconomic instability, or improving human capital, all these factors eventually seem to run into diminishing returns. The same is true for the efficiency of the labor, financial and goods markets. In the long run, standards of living can be expanded only with innovation. Innovation is particularly important for economies as they approach the frontiers of knowledge and the possibility of integrating and adapting exogenous technologies.

**State of Philippine competitiveness**

In the 2009 World Competitiveness Yearbook, the strengths of the Philippines are anchored on its labor market, where it ranked 5th; fiscal policy, 13th; prices, 14th; and societal framework, 20th.[2] However, of the 57 economies ranked in 2009, the Philippines has become the least competitive country in the Pacific region. It lagged behind its neighbors in economic performance, government efficiency and infrastructure (Figure 1).

**Figure 1. Philippine competitiveness landscape**




*Source: 2009 World Competitiveness Yearbook*

[2] International Institute for Management Development. (2009).

The country slid by nine notches to rank 51st in the economic performance criterion because of the considerable decline in exports and foreign direct investments, coupled with the impact of high prices of oil and food in 2008.

In terms of government efficiency, which measures the conduciveness of government policies to competitiveness, the country went down to rank 42nd due to continuous difficulty in doing business. The country's ranking in infrastructure also slid to the 56th because of high dependency ratio, lack of energy infrastructure and issues affecting future energy supply.

**Table 1. Global competitiveness index, Philippines**

| Description | Rank (out of 133) | Score (1-7) |
|---|---|---|
| GCI 2009-2010 | 87 | 3.9 |
| GCI 2008-2009 | 71 | 4.1 |
| GCI 2007-2008 | 71 | 4.0 |
| **Basic requirements** | 95 | 3.9 |
| 1st pillar: Institutions | 113 | 3.2 |
| 2nd pillar: Infrastructure | 98 | 2.9 |
| 3rd pillar: Macroeconomic stability | 76 | 4.5 |
| 4th pillar: Health and primary education | 93 | 5.1 |
| **Efficiency enhancers** | 78 | 3.9 |
| 5th pillar: Higher education and training | 68 | 3.9 |
| 6th pillar: Goods market efficiency | 95 | 3.9 |
| 7th pillar: Labor market efficiency | 113 | 3.9 |
| 8th pillar: Financial market sophistication | 93 | 3.8 |
| 9th pillar: Technological readiness | 84 | 3.3 |
| 10th pillar: Market size | 35 | 4.6 |
| **Innovation and sophistication factors** | 74 | 3.4 |
| 11th pillar: Business sophistication | 65 | 4.1 |
| 12th pillar: Innovation | 99 | 2.8 |

*Source: Global Competitiveness Report 2009-2010*

Moreover, in the 2009- 2010 GCR, the Philippines ranked 87th among 133 countries. Furthermore, the country placed 144th among 183 countries that were surveyed by the World Bank-International Finance Corporation in its annual Doing Business report. The report rank countries by the efficiency and effectivity of their business regulations.

Though some indices used by the said organizations vary, all the reports analyze the ability of nations to provide an environment in which enterprises can compete. Businesses use the results of the reports for basic research on location decisions, while governments use them to compare their countries' performance vis-àvis their competitors.

**Critical determinants to improve competitiveness**

While there are several factors that determine a country's competitiveness, the project focuses on the critical determinants namely: macroeconomic stability, governance, infrastructure, and regulation.

*Improving the investment climate through macroeconomic stability*

The stability of the macroeconomy is tested by its ability to react to shocks. Institutions need to be designed to absorb shocks in order to enhance performance. Shocks produce business cycles, controlling both the impact of shocks and the response of the economy to the shock are important issues for policymakers (Barrell, R., et. al., 2005).

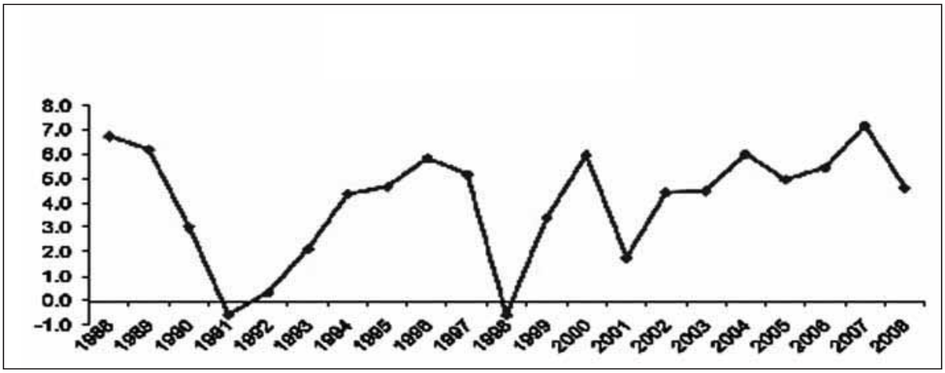
Economic policy has many objectives, but raising the level and enhancing the stability of incomes and welfare are likely to be central to any set of objectives. To achieve these goals, economic policy should contain three core dimensions: ensuring a high and growing level of output, achieving (low and) stable inflation, and limiting cycles (Barrel, 2005).

Governments use economic policy to attain high levels of output, and to assure sustainable trajectories for growth. The government fiscal position indicates the capacity of the country to spend as well as the investment levels, which suggests the capacity of the country to earn. A strong fiscal position and a sustained high level of investment result in a higher growth path. Macroeconomic policy must therefore be geared to create a stable environment that maximizes the potential for output growth.

The boom-bust cycles, which characterize the economic performance of the Philippines in the past 20 years, show that macroeconomic stability remains to be an elusive goal for the country. Observers attribute the instability to the absence of some dimensions that make a stability-oriented policy framework.

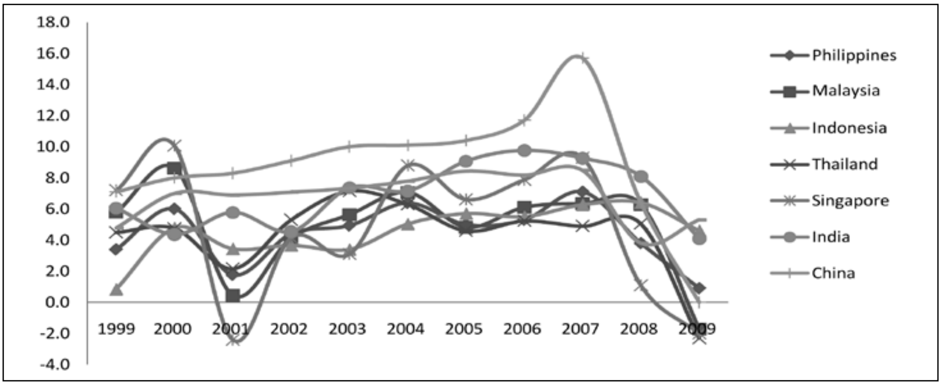
From 1988-2008, nothing much has changed in the structure of the Philippine economy. Growth is anchored on private consumption, abetted by strong remittances and low inflation. The economy has achieved a modest annual average growth of 5 percent since 2000, peaking at 7.2 percent in 2007, which is the highest recorded growth, post-EDSA revolution. However, the global economic slump in 2008 halted the growth momentum. Domestic output decelerated to 4.6 percent in 2008 and further contracted to 0.9 percent in 2009.

**Figure 2. GDP growth rate, 1988-2008**




*Source: National Statistical Coordination Board*

**Figure 3. Real GDP, selected Asian economies, 1999-2009**




*Source: Bangko Sentral ng Pilipinas*

While the Philippines posted a modest growth post-1998 Asian financial crisis, its neighbors such as Malaysia, Thailand, Singapore, Vietnam and China traversed a higher growth path. In particular, China and Vietnam were able to sustain their growth momentum and thus enjoyed a relatively stable economy.

The global financial crisis that started in the US has spilled over to most Asian economies. By the first quarter of 2009, Malaysia, Singapore, Thailand and India suffered an economic crunch due, in part, to their close economic ties with the US. Surprisingly, the Philippines was able to weather the economic storm that ravaged its neighbors in spite of its close economic ties with the US. Robust OFW remittances, a resilient services sector, sound monetary policy, and the fiscal stimulus package kept the Philippines from teetering on the edge of recession. However, such impressive feat by the country — keeping recession from the door — is not felt by the real sector as reports of incidence of hunger and poverty are rising.

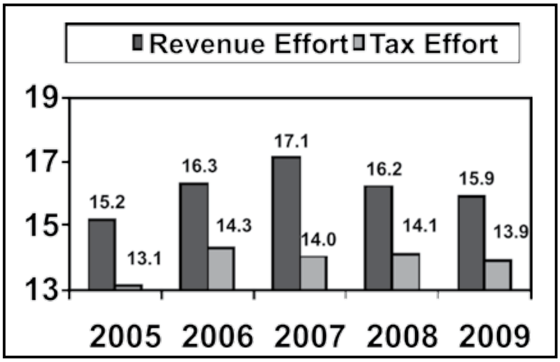
*The Philippine fiscal position: why it matters?*

The channels through which fiscal policy affects macroeconomic stability include the supply-side effects of distortionary taxes (e.g., lower or remove trade barriers), the pro -cyclical behavior of public spending (e.g., government spends in times of crisis) and the conventional effect of automatic stabilizers (e.g., conditional cash transfers and food stamps) operating through disposable (permanent) income.

While the pump-priming efforts of the government kept the economy afloat (NEDA, 2010), there is another side to the story — the trade-offs. The sharp rise in public spending surely had an impact on the fiscal state. Any government expenditure that is financed by borrowing is a contribution to the budget deficit. Sustaining growth through relentless foreign and domestic borrowing implies that interest payments for these loans will eat up the share of the budget earmarked for economic and social services. Rising public debt, if left unchecked, inexorably constrains any gove rnment from meeting its policy objectives of economic development and quality of life for all.

The government's explanation for the drag in the fiscal viability of the economy is the huge deficit (GDP ratio of 3.9 in 2009) of the national government which is attributed to lower revenue and recent higher spending. On the spending side, the fiscal stimulus package (also called Economic Resiliency Plan) accounted for the 40-percent increase, while more than 20 percent was the increases in salaries of state employees following the passage of the Salary Standardization Law (SSL III). Most of the deterioration stems from the revenue side. While tax reforms were passed to increase revenue, the tax effort is now lower than in 2005 (the year of tax reforms). Moreover, in response to the series of global shocks since 2008, permanent tax cuts or exemptions were introduced resulting in large erosion of gains from the 2005 reforms such as the E-VAT (World Bank, 2010).

**Figure 4. Declining Revenue and Tax Efforts**




*Source: Department of Finance (DoF)*

To stave off a recession in 2009, the government has shored up its borrowings to finance its spending. National government debt rose to PhP4.3 trillion in 2009 from PhP4.2 trillion in 2008. By the end of 2009, the deficit swelled to PhP298.5 billion, breaching the PhP205-billion target for the year. Consequently, the consolidated public sector debt accounted for 72.9 percent of GDP in the third quarter of 2009.[3]

Another trade-off is that the chronic fiscal deficit has dragged down the national savings and investment rate. As Sicat (2007) pointed out, public sector borrowing crowds out private sector borrowing. This simply means that the amount of loanable funds that can be used by the private sector for its own investment and operation is reduced. As a result, the capacity of the private sector to generate higher income and savings is stunted.

[3] The consolidated public sector debt includes the national government debt as well as debts of the central bank and a number of monitored government-owned and controlled corporations.

**Table 2. Revenue eroding laws enacted in the 14th Congress**

| Particulars | Revenue impact (in billion PhP) |
|---|---|
| **A. Already with full impact in 2010** | **(52.40 – 57.40)** |
| 1. Individual Income Tax Relief ( RA 9504) | (26.00) |
| 2. Corporate Income Tax Reduction (RA 9337) | (15-20) |
| 3. Abolition of DST on secondary trading stocks ( RA 9648) | (1.40) |
| 4. Impostion of franchise tax on power transmission in lieu of all taxes (RA 9679) | (9.0) |
| 5. Tax exemption of Home Development Mutual Fund or PAGIBIG (RA 9679) | (1.00) |
| 6. New Cooperatives Code (RA 9520) | to be computed |
| 7. Tax incentives for the development of renewable energy (RA 9513) | to be computed |
| **B. Impact on revenues may be felt in the 2nd half of 2010 because IRRs are still being drafted** | **(31.65)** |
| 1. Tourism Incentives (RA 9593) | (6.00) |
| 2. PERA (RA 9505) | (12.0) |
| 3. Bataan Freeport (RA 9728) | (3.00) |
| 4. REIT Incentives (RA 9856) | (2.70) |
| 5. VAT Exemption of Senior Citizens (RA 9994) | (1.68) |
| 6. Income tax exemption and condonation of unpaid taxes of local water districts (RA 10026) | (0.80) |
| 7. Restructuring of DST on life insurance policies and | (0.07) |
| reduction of premium tax on lfe insurance policies from 5% to 20% (RA 10001) | (1.30) |
| 8. DST exemption of OFW remittances (provided under RA 10022 amending RA 8042 or the Migrant Workers Act of 1995) | (1.00) |
| 9. Tax deductibility of actual free legal services rendered by lawyers or professional partnerships to the poor (RA 9999) | (0.10) |
| 10. VAT and income tax exmption of micro, small and medium-scale organic farming (RA 10068) | n.a. |
| 11. Conversion of the Aurora Special Economic Zone into a Free Port (RA 10083) | (3.0) |
| **C. For submission of ratified copy to Office of the President** | |
| 1. Tax exemption of firm undergoing court-approved rehabilitation under the proposed Financial Rehabilitation and Insolvency Act | n.a. |
| TOTAL(A+B+C) | (P84.05-89.05) |
| VS. RVAT REVENUES | 80.00 |

*Source: DoF*

The chronic public sector debt has also led to the stockpiling of external debt. In 2008, total external debt amounted to US$53.9 billion, 75 percent of which comprised of public and publicly guaranteed debt. The Philippines' huge external debt and its high dependence on f oreign capital make the country highly vulnerable to currency speculation and external shocks and thus pose a danger to the domestic economy. These conditions of low national savings and macroeconomic instability are considered as major constraints to investment in the Philippines.

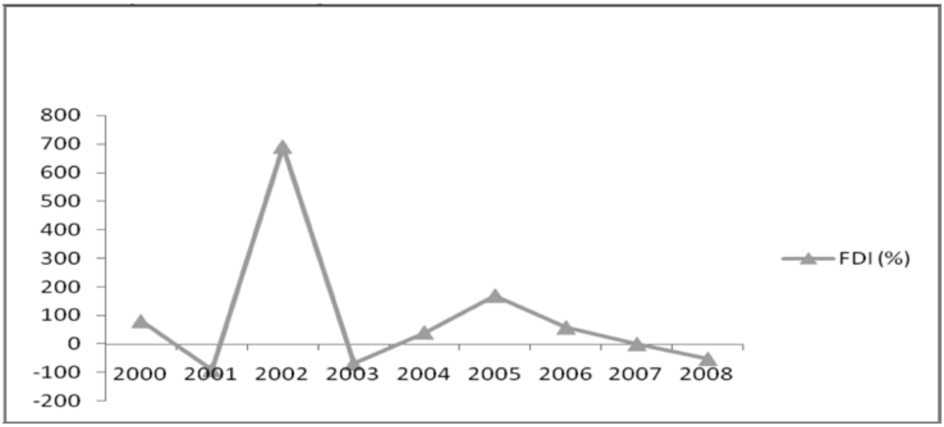
**Table 3. Public sector debt, 1998-2008**

| Year | National government outstanding debt (PhP) | Debt-to-GDP ratio | Consolidated public sector debt (PhP) | Public sector debt-to-GDP ratio |
|---|---|---|---|---|
| 1998 | 1,496,222 | 56.1 | 25,222.40 | 94.6 |
| 1999 | 1,775,356 | 59.6 | 3,020.00 | 101.4 |
| 2000 | 2,166,710 | 64.6 | 3,623.80 | 108.0 |
| 2001 | 2,384,917 | 65.7 | 3,850.20 | 106.0 |
| 2002 | 2,815,468 | 72.5 | 4,369.10 | 110.2 |
| 2003 | 3,355,108 | 77.7 | 5,074.00 | 117.6 |
| 2004 | 3,811,954 | 78.2 | 5,289.20 | 108.9 |
| 2005 | 3,888,231 | 71.4 | 5,033.90 | 92.9 |
| 2006 | 3,581,506 | 63.9 | 4,943.60 | 81.9 |
| 2007 | 3,712,487 | 55.8 | 4,773.60 | 71.8 |
| 2008 | 4,220,903 | 56.9 | 5,271.40 | 71.0 |
| 2009 | 4,396,639 | 57.3 | 5498.9* | 72.9* |

*Note: As of third quarter of 2009*
*Sources: Bureau of the Treasury and DOF*

Also, the growth of the country's foreign direct investments (FDIs) has been steadily declining since 2005. Despite the high-growth, low-inflation environment in 2007, the Philippines only attracted US$2.916 billion worth of net FDIs, slightly lower than the US$2.92 billion investment in 2006. In 2008, net FDIs further slid down to US$1.4 billion, reflecting the global economic turmoil during that period.

**Figure 5. Net FDI, (%) 2000-2008**




*Source: Bangko Sentral ng Pilipinas*

The key to restoring FDI flows worldwide is economic growth, while the basic factors determining FDI flows such as the quality of infrastructure, the availability of skills and technological capacity in host countries remain crucial. Thus, the Philippines, while it can hope for a restoration of FDIs in 2010 due to a favorable growth outlook, needs to satisfy the basic factors for attracting FDIs into the country to reap the benefits of increased investments like job generation and employment.

Another reason the huge fiscal deficit is undesirable is that the country could be at the mercy of any sudden increase in global interest rates, which would cause difficulties in repayment, whether or not the government defaulted formally. This scenario would result in a sharp cutback in subsequent credit, particularly from foreign lenders, and a downgrade in credit rating, which would aggravate the situation even more. Creditors are on edge should the government with a ballooning fiscal deficit default, and they will be unable to get their money back. Investors, on the other hand, would hesitate to invest in a country that seems headed towards another crisis. The growing size of the debt and deficit are undoubtedly the biggest reasons that investment and growth in this country have remained sluggish (De Dios, et. al., 2004). Put differently, high investment rates (e.g., investments in infrastructure) financed less from loans but from FDI and domestic saving (which, together with intense and fair competition, result in high productivity growth) are foundations for a sustained economic growth.

**Key challenges to the next administration**

- *Structural weaknesses in tax system.* The passage of revenue eroding measures exacerbated the deteriorating efficiency of revenue collection and made taxation more prone to compliance risks (refer to Table 3).

- *Increased pressure on the deficit.* While sustaining expenditures for reconstruction efforts and infrastructure helps put recovery on a more solid footing, it also increases pressure on the precarious fiscal situation. Aside from the pump-priming activities of the government amid the global recession, agreements entered into by GOCCs and public-private partnerships were also pointed out by Arroyo (2010) as fiscal risks, which can likely increase the deficit.

**Table 4. Contribution of GOCCs to the deficit (in billion PhP)**

| | 2008 Actual | 2009 Programmed | 2010 Programmed |
|---|---|---|---|
| Total Surplus/(Deficit) | 28.7 | (233.9) | (210.2) |
| % of GDP | 0.004 | -3.0% | -2.5% |
| NG | (68.1) | (250) | (233.4) |
| CB Restructuring | (9.6) | (14.1) | (15.0) |
| 14 MNFGCs | (27.7) | (63.6) | (61.9) |
| SSIs | 66.7 | 41.1 | 51.4 |
| BSP | 9.4 | 1.0 | 1.0 |
| GFIs | 7.5 | 7.0 | 8.0 |

*Source: DoF*

- *Continuing threats to growth.* Developments such as the El Niño phenomenon, imminent power shortages and volatile commodity price movements all require a more pro-active stance from Congress and the Executive, business sector, academe and the international financial institutions (see discussion on Climate Change).

**Reform proposals**

Experts have underscored that to improve Philippine competitiveness, the fiscal problems must first be fixed and urgent fiscal reforms have to be in place before anything else (Arroyo, Tungpalan, et al., 2010).

The World Bank (2009) generally recommends balancing the medium-term need for fiscal consolidation with the risk of a premature unwinding of the fiscal stimulus that would endanger the nascent recovery. Fiscal consolidation is needed to (1) protect and/ or increase priority spending in health, education, and infrastructure; and (2) remedy the increasing debt-to-GDP ratio so as to reach levels that are less prone to create periods of fiscal stress. A specific medium-term fiscal plan, which includes strategies for unwinding the fiscal stimulus would minimize a fiscal crisis risk and enhance credibility.

***Of fiscal stimulus and tax cuts.*** *Keynesian economics requires the government to adopt discretionary fiscal policy—deliberate action to change taxes and expenditures in order to correct for recession or inflation. Intervention such as income tax cuts is expected to increase money supply, thus lower interest rates and stimulate business investment. Keynes also called on government to adopt a policy of deficit spending for capital formation and to allow the budget to go unbalanced during periods of depression so as to increase aggregate demand for good and services.*

Cognizant of the importance of a rational fiscal policy in realizing economicstability, the main goal is to raise government revenues by simplifying the tax system, plugging loopholes and improving efficiency in tax collection (CPBD, 2007).

To improve the country's fiscal and financial position, legislative and administrative reforms have been enacted and implemented since 2004. The Reformed Value Added Tax (RVAT) Law (RA 9337), which expanded the VAT base by removing unnecessary exemptions and increased the rate from 10 percent to 12 percent is considered one of the crucial policy decisions that helped avert the looming fiscal crisis in 2005.

Administrative efficiency was increased through BIR computerization, Third Party Information, strengthened audit process and upgraded operational systems while tax administration was improved by simplifying tax compliance and enhancing taxpayer/ customer service. Governance measures were also implemented such as the RATE (Run After Tax Evaders), RAT (Run After the Smugglers) and the RIPS (Revenue Integrity Protection Service). The Lateral Attrition Law, which established a system of rewards and incentives for BIR and BOC employees was also passed to motivate revenue and customs workers to improve collection.

However, some vital fiscal reforms that will ensure macroeconomic stability and contribute significantly to the improvement of the investment climate remain pending in Congress. These are as follows:

***Rationalization of Fiscal Incentives.*** With about 92 different incentive laws being administered by several government agencies, the fiscal incentive system has become unwieldy, inefficient, and prone to abuse, such as double or multiple availments, fraudulent claims, unauthorized transfer of tax credit, and tax arbitraging or the shifting of income from a taxable sector to a tax-exempt or lesstaxed activity. Hence, there is a need to rationalize the grant of fiscal incentives (CPBD, 2007).

According to Reside (2006), some 90 percent of the fiscal incentives granted by the Board of Investments are redundant. In 2004, the government lost approximately PhP43.2 billion or almost 1 percent of GDP due to redundant incentives. These consist of incentives that take the form of income tax holidays, tax and duty exemptions for capital goods, and deductions on labor expenses among others, which benefit corporations that would have made those same investments despite existing taxes.

World leaders at the 2006 WEF agreed that a level playing field, predictability in government regulations, good governance and adequate infrastructure remain more important than fiscal incentives in attracting investments.

Fiscal incentives should be rationalized with clear criteria, time-bound and enabling laws encapsulated under the Tax Code. Given the challenge of balancing investment promotion and fiscal consolidation, the DoF and experts agree that the fiscal incentives system, among others, should: 1) focus on the grant of tax incentives to exports, strategic projects and domestic investments in the 30 poorest provinces; 2) replace redundant instruments with performance-based types of tax incentives, e.g., accelerated depreciation, and longer carry over of losses, double deduction of training/research and development; 3) make the VAT relief for exporters efficient and equitable; 4) increase incentives for human resource development; 5) apply uniformly the new fiscal incentive package to all prospective investments; and 6) institute a monitoring mechanism for tax expenditures of all investment promotions agencies.

***Fiscal Responsibility Bill.*** The said proposal aims to instill fiscal discipline in the public sector by specifying principles of responsible financial management and promoting full transparency and accountability in government revenue, expenditure and borrowing programs. Specifically, it provides for the:1) reduction of nondiscretionary portions of the budget, e.g., personal services and interest payments, to channel more resources to growth-inducing capital investments; 2) granting or broadening of tax breaks conditioned on the imposition of countervailing mechanisms through revenue generation programs; and 3) repealing of automatic guarantees by GOCCs and disclosure of contingent liabilities.

***Balancing the budget.*** *When President Gloria Arroyo submitted the 2008 General Appropriations Bill for deliberation of Congress, she proudly declared that it is a "balanced budget," with PhP1.227 trillion in expenditures matched by an equal amount in revenues, and that her administration is ahead of its 2010 schedule of achieving fiscal balance. However, the global shock in food and fuel prices in 2008 hindered the attainment of the said goal.*

*Recently, plans to equally balance spending and revenue by 2013 has been put forward. One explanation of governments' eagerness to balance public budgets is given by James Mikesell who wrote that "governments may find it politically convenient or legally necessary to produce a balanced operating budget when reasonably produced figures would show deficit."*

*Considering the challenges in increasing revenue amid pressures to increase expenditures, the 2013 goal is drastic and most likely, only a phantom balance —- either through artificially high revenue estimates, or use of revenue crutch (such as one time sale of state assets), or budget manipulation, or delays in expenditure —- can be attained.*

*If fiscal balance can be truly achieved, can it be sustained? Surveying literature on budget concepts and practices, Briones (2007) explained that a balanced budget might look wonderful, but it can inhibit growth if it is attained by drastically reducing expenditures. The same holds true for a budget deficit. While it may lead to growth, a deficit that goes out of control can push an economy into the abyss of a debt crisis.*

*It is also crucial that when the governments resort to deficit financing, it must be allotted to health, education and infrastructure projects that significantly contribute to growth instead of debt servicing. In the past, the Philippine government has resorted to external and domestic borrowing to pay off its debts but to the detriment of crucial public investments in social and economic services (Diokno, 2008).*

***Excise Tax Reform on Tobacco and Alcohol Products.*** In 2004, RA 9334 also known as Rationalization of the Excise Tax on Alcohol, Cigarettes and Tobacco Products increased the excise tax rates for tobacco/cigarettes, alcohol and fermented liquor. It also lifted the exemption of taxes and duties on imported tobacco and alcoholic products except for duty-free products.

However, the current multi-tiered excise tax schedule entails a convoluted system for product classification (i.e., old brands vs. new brands) that offers a wide room for discretion. Such system for product classification has also adversely affected market competition such that similarly priced products are slapped with different tax rates. Moreover, the present structure induces a shift in consumption from high-priced brands towards low-priced brands. This makes the current excise tax system ineffective as a source of revenue and as a tool to curb consumption of sin products.

To compensate for the eroded revenue resulting from recent adjustments in the tax system and to promote better public health, the restructuring of excise tax on sin products should be a top priority. While the DoF proposes to maintain a specific form of excise taxation, (i.e., per piece, per pack, per proof liter, per liter) since it is easier to administer and does not provide an incentive for manufacturers and importers to under-invoice products, Diokno (2008) pointed out that in an environment where getting new taxes and upward adjustments of existing taxes are difficult to legislate, ad valorem system of taxation is superior to specific taxation.

***Simplified Net Income Taxation Scheme (SNITS) for professionals and selfemployed.*** Paying income taxes according to the present income tax scheme is deemed too complicated and difficult. Professionals and self-employed individuals in particular are given a wide leg room in terms of claiming allowable deductions which creates an opportunity to abuse the system such that individuals tend to report lower tax liabilities. The SNITS will simplify the taxation of the self-employed by limiting the allowable deductions to those expenses which are easily verifiable and are directly expended on the production of goods or in the rendition of services. SNITS is also seen to broaden the income tax base and make taxation more equitable for both selfemployed individuals and compensation income earners.

***Amendments to Tariff and Customs Code.*** Smuggling of goods hurts both the government tax collection as well as local producers of similar goods. Lost revenues were estimated to be around PhP100 billion to PhP174.2 billion annually.

The Senate's ratification of the Revised Kyoto Convention (RKC) through Resolution No. 220 on February 1, 2010, and the eventual submission/deposit of the Instrument of Accession to the WCO triggered the need to amend the pertinent provisions of the Code with the RKC. The proposed amendments will provide for advance transmission and publication of cargo manifests and bill of landing to the BoC and Philippine Ports Authority, conduct of spot checks and periodic audits of customs bonded warehouse, and private sector participation in valuation issues.

***Amendments to the IRA.*** The local government units (LGUs) must be empowered, specifically in their revenue mobilization efforts. Reformulating the internal revenue allotment (IRA) to include poverty-sensitive indicators must be prioritized to address the uneven level of development among LGUs, ensure the narrowing of fiscal disparities between urban and rural LGUs, and correct the mismatch in the distribution of revenue sources and cost of devolved functions (CPBD, 2007).

***Other proposed actions and strategies***

***Moratorium on the passage of tax-eroding measures.*** Since approximately PhP40.B is estimated to be lost from a number of tax-eroding measures pending in the 14th Congress, it would be prudent to take a break and review the effects of such proposals.

***Prudent and efficient allocation of resources in the annual national budget.*** On the expenditure side, it is imperative that decision-makers adhere to a sustainable fiscal policy and a clear set of strategic sectoral priorities. As such, there is a need to effectively link policy priorities and long-term spending plans, improve expenditure allocation and control, and ensure predictability of funds for priority programs and projects.

With Congress holding the power of the purse, the legislators must actively be engaged in the budget process to ensure that the annual General Appropriations Act is reflective of the government's priorities and would contribute to addressing national development requirements.

***Improving competitiveness through socially inclusive reforms.*** *While putting the fiscal house to order is crucial and urgent to accelerate economic growth, the reforms to be undertaken should not leave out the poor which compose more than 30 percent of Philippine population.*

*In light of the growing deficit, there is a proposal to increase VAT rate to 15 percent while lowering personal income and corporate income taxes to 25 percent or 18 percent. Being administratively convenient and easier to collect, increasing VAT rate from the current 12 percent to 15 percent will definitely deliver macroeconomic benefits. However, it will face an uphill battle from the public.*

*For a country plagued with massive levels of inequality like the Philippines, indirect taxes such as VAT impose tax burden of taxation on the lower income group (Briones, 2008). A study by Newhouse and Zakharova (2007) found that the increase in the VAT rate to 12 percent and the broadening of the VAT base to petroleum products, electricity, and professional services reduce consumption of poor Filipino households by 2.4 percent, while households in the top quintile lose 2.7 percent. This finding, while consistent with the consumption patterns of poor households who tend to rely more on unprocessed* *agricultural products that are exempt from the VAT, should not disregard the fact that the poor population experience disproportionately greater suffering from reduction of consumption and volatile income swings (Breen and Garcia-Penalosa, 2005).*

*Across the globe, the inability of the poor to cope with negative shocks, such as sharp spikes in food and fuel prices can result in a loss of human capabilities, which is difficult to reverse. Thomas and others (2004) have shown that poor families remove their children from school as a way of coping with the increased prices of goods and services. At times, nutrition of poor families is compromised to adjust to price increases (Dercon, 2006).*

*The increase in number of poor families from 4.0 million in 2003 to 4.7 million 2006 is attributed to insufficient rise in personal income for the said period and to increased prices of food and non-food basic needs following the rise in oil prices and the expansion of VAT coverage in November 2005 and the imposition of higher VAT rate in February 2006 (Santos, 2008).*

*While VAT reforms in 2005 included mitigating tax measures and increases in social spending (which aimed to reduce the average income loss from the VAT reform across all households by about 25%), households in the bottom quintile enjoy only about 15 percent of the benefit from the package of tax cuts and spending increases, while households in the top quintile enjoy about 30 percent of the benefit. The reduced energy and franchise taxes, which account for over 40 percent of the total mitigating package, are particularly poorly targeted, with the bottom quintile receiving only 7 percent of the total benefit and the top quintile receiving 43 percent (Newhouse, 2007).*

*The current proposal to hike VAT rate to 15 percent also calls for expansion of social safety nets such as the conditional cash transfer (CCT) to cushion the lower income groups from impact of tax increase. However, there are issues that have to first be addressed in order to devise and implement an effective CCT program.*

*Foremost, the conditionality aspect assumes that quality and accessible education and health services are available but underutilized. Such is not necessarily the case of the Philippines where there are shortages in classrooms, teachers, health centers, health facilities and health workers. Second, the capacity of implementing agencies to ensure effective monitoring of the program, including proper targeting of the poor and monitoring compliance of target beneficiaries to conditions—leaves much to be desired. Third, the prevalence of corruption raises* *considerable issues on the integrity and ability of the institutions to implement a program with billions of funding allocation.*

*Thus, rather than hiking VAT rate in the first year of the new administration, a review on VAT exemptions to determine whether objectives for exemptions have been met must first be undertaken. Rationalization of fiscal incentives and restructuring of sin taxes should top the fiscal reform agenda of the incoming government, not only because the said reforms are long overdue, but more so, because they are pro-poor.*

*In the estimates of Medalla (2006), a peso gained by big investors from tax incentives could be equivalent to as much as P2 worth of foregone spending for infrastructure and social services for the poor. Rationalizing fiscal incentives will unburden the poor and middle class taxpayers of the brunt of the fiscal cost of tax incentives. Restructuring sin taxes on the other hand make it more effective in deterring the consumption of tobacco and alcoholic drinks and will fairly allocate negative externalities.*

# Ensuring Adequate and Efficient Infrastructure

Infrastructure development has been central to achieving long-term sustainable growth (Tungpalan, 2010). In today's globalized and increasingly integrated markets, adequate and efficient infrastructure, especially in transport, power and telecommunications is critical to economic development and growth. The type and availability of infrastructure are an important factors that determine the variety and location of activities or sectors that can thrive in a particular economy.

*The lack of proper infrastructure facilities indirectly raises business costs and business costs directly dictate the competitive stance of a country. The quality of infrastructure may significantly, manifest itself in costs associate with disruptions/delays in service provision (ADB, 2007).*

Particularly for an archipelagic country, physical and digital connectivity improves efficiency. Countries with efficient and reliable infrastructure are able to reduce transactions costs and create value added for producers, which is the main criterion of investors in deciding whether or not to invest. Some studies provide evidence that differences in infrastructure development may explain variations in income and export growth among countries (Llanto, 2007).

In terms of reducing poverty and enhancing human development, availability of infrastructure, e.g., more school buildings, is fundamental in delivering education and enhancing the citizenry's capacity for intellectual growth and skills upgrade. Better hospitals also provide for a healthier workforce (Balisacan, 2002).

A strong infrastructure system is indispensable to economic development. Unfortunately, resource constraints have hampered the development of infrastructure in the Philippines. Government spending on infrastructure has been at less than 3 percent of gross domestic product (GDP), lower than the international benchmark of 5 percent. The World Bank states that the country's infrastructure spending should ideally be closer to that of China at 8 percent-9 percent GDP to address the huge backlog. For the maintenance of existing roads, 1 percent to 2 percent of GDP should be allotted for the maintenance of existing roads and around 4 percent for the upgrading existing infrastructure (CPBD, 2007).

In the 2009 World Competitiveness Yearbook, the Philippines ranked 56th among the 57 countries surveyed in terms of infrastructure.

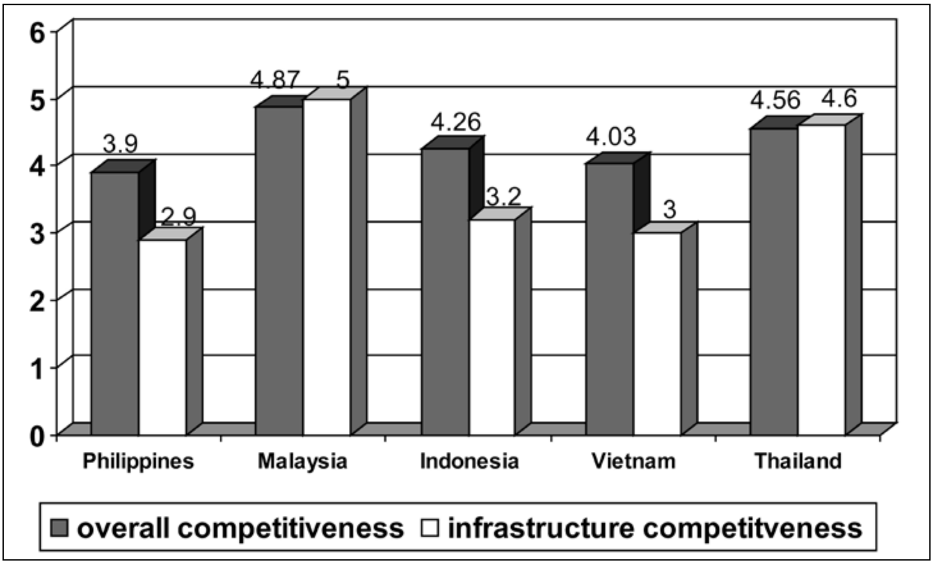
**Table 5. Infrastructure indicators for selected Asian countries 2007- 2009**

| Countries | Efficient distribution of infrastructure | | | Adequately financed and planned maintenance & development of infrastructure | | | Adequacy and Efficiency of Energy Infrastructure | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| Philippines | 52 | 51 | 56 | 51 | 43 | 50 | 49 | 43 | 52 |
| Indonesia | 54 | 53 | 51 | 49 | 47 | 51 | 52 | 50 | 53 |
| China Mainland | 31 | 40 | 33 | 18 | 26 | 25 | 33 | 31 | 37 |

*Note: In 2007 and 2008, 55 countries were surveyed, while in 2009, there were 57 countries*
*Source: World Competitiveness Yearbook*

In the 2009-2010 Global Competitiveness Report (GCR), the Philippines ranked 98th out of 133 countries in terms of infrastructure. Looking at the regional standing, the infrastructure competitiveness score of 2.9 is the lowest. Malaysia has the highest (at 5) while Vietnam managed to overtake the Philippines (3).

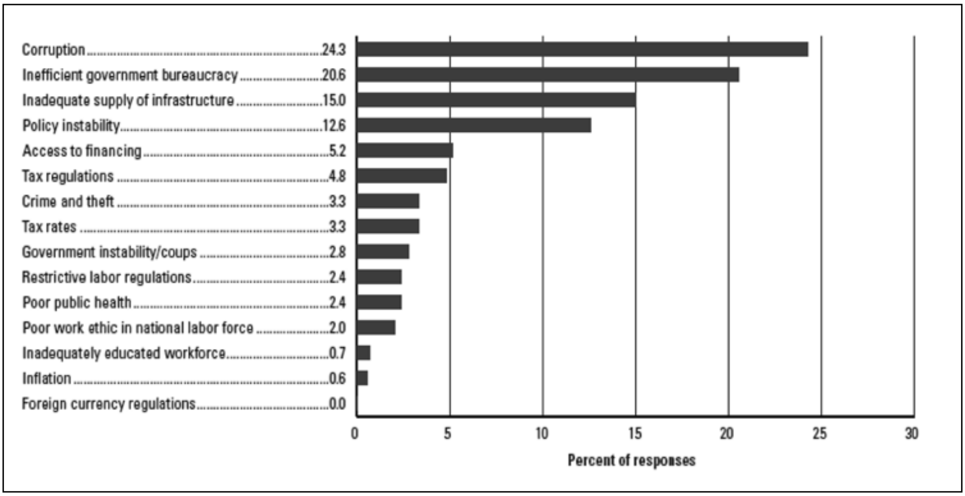
**Figure 6. Competitiveness ranking of ASEAN countries, 2009-2010**




*Source: GCR 2009-2010.*

The inadequate supply of infrastructure is the third most problematic factor for doing business as cited by business executives surveyed by WEF in 2009.

**Figure 7. Most problematic factors for doing business in the Philippines**




Note: From the list of 15 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings
Source: Global Competitiveness Report 2009-2010

Thus, the key challenge is for government to provide adequate infrastructure. To achieve such, the next administration needs to address the following: 1) backlog in transport infrastructure (low road densities and paved road ratios, especially in the countryside and need to decongest Metro Manila); 2) shortage of telecommunications infrastructure, such as telephone lines and Internet backbone; and 3) nationwide electrification and 100 percent energy self-sufficiency. There is also a need to further encourage private sector participation and promote more institutional and regulatory reforms (Tungpalan, 2010).

## State of critical infrastructure in the Philippines

### *Energy*

With the passage of the Electric Power Industry Reform Act (EPIRA) in 2001, the government introduced sweeping reforms in the energy sector, which included restructuring and deregulation of the entire power industry and the privatization of most state-owned power generation and transmission assets. By leveling the playing field in the power sector and encouraging greater private sector participation, the EPIRA was seen as the solution to the high power rates and unreliable power supply, which adversely affected both industries and households.

Nine years after its enactment, several provisions in the EPIRA have yet to be fully implemented and the promise of consumer choice and lower power rates has yet to be realized.

Adequate and reliable energy infrastructure is key in improving the investment climate. According to the World Bank Enterprise Surveys, private businesses in lower and middle income countries estimate that they lose on average 7.5 percent of their sales due to electricity and telephone outages and insufficient water supply. Energy costs in the Philippines is still one of the highest in Asia, second to Japan with US$0.13.6 cents per kilowatt-hour (NEDA, 2007).

The domestic private sector has always been critical of high energy costs, which has previously been estimated to account for 10 percent to 25 percent of total business cost. A report on improving the investment climate in the Philippines showed that over a third of the firms surveyed indicated that lack of affordable electricity remains to be a major constraint to their operations. These firms report that eight percent of what they produce is lost due to power outages, which number to an average of six a year. Power outages are more expensive for small firms (ADB, 2005).

While 41,722 out of 41,980 (99.39%) of barangays were electrified as of December 2009, the security of electricity supply remains a concern.

***Energy crisis anew***

Since 2009, Mindanao had been experiencing rotational two- to three-hour blackouts, with some areas even experiencing blackouts for the whole day. The shortage has been blamed to the decreasing water levels in reservoirs caused by the El Niño phenomenon. The critical water levels limit the generating capacities of various hydroelectric plants, which supplies majority of Mindanao's energy demands.

Meanwhile, rotating brownouts have also hit Luzon recently with no assurance that the new power plants, which could stabilize the island's erratic power supply situation would be up anytime soon. [4] The existing power facilities, meanwhile, are reported to be suffering from technical difficulties and/or fuel shortages.

The country's entire three power grid —— Luzon, Visayas and Mindanao —— are projected to suffer outages in the next five years if existing power capacities are not increased.

[4] The unbundling of the components of the power industry with power generation delegated to the private sector means that the government corporations are not allowed to construct power plants anymore. Thus, there is a need to attract private investments in power generation.

With the passage of the Renewal Energy Act, the power sector is expected to be weaned from its dependence on imported fossil fuels. The said law also aims to encourage investments in power generation to harness renewable energy sources across the country, and increase available power supply in the main island grid as well as off grid areas. However, while there are a number of power plants in the pipeline, regulatory uncertainties, bureaucracy and corruption remain the common concerns of potential investors in energy.

*Transport*

Being an archipelago, it is critical for the Philippines to have a good transportation system to ensure efficient delivery of goods and services. In agriculture, for example, farm-to-market roads are needed to spur growth of the said sector in the country. The benefits of an improved agricultural transportation system will accrue mostly to small farm producers and could considerably decrease the price of basic food products.

It is estimated that 90 percent of passenger movement and 50 percent of freight movement in the country rely on the country's road network. While national roads are extensive and serve priority production areas and population centers, roads that lead to many tourism destinations and conflict-affected areas are inadequate as a result of the poor maintenance, lack of absorptive capacity and lack of unified standards for local government units. Roads are mostly macadam-type surfaces that are not capable of bearing the wear and tear imposed by an increasing number of vehicles (Llanto, 2007).

A 2007 study by the Asian Development Bank, which compared the Philippines with other Southeast Asian countries pointed out that only 22 percent of the road network in the Philippines is paved, compared with 99 percent in Thailand; 81 percent, Malaysia; and 58 percent, Indonesia. For paved roads, the Philippines' road length is among the lowest in Southeast Asia.

In terms of water transportation, studies showed that around 40 percent of predicted maritime transport costs for archipelagic countries such as the Philippines can be traced to port inefficiency stemming from poor physical infrastructure, industry structure and regulation (Limao and Venables, 2000 as cited by Llanto, et al., 2005). Problems on security, sea worthiness and safety of vessels are also among the main concerns.

Lastly, while the Philippine domestic air industry now features lower airfare, improved service quality and efficiency in general, the country's quality of air transportation infrastructure still ranks low in the Asian region.

*Information and communications technology*

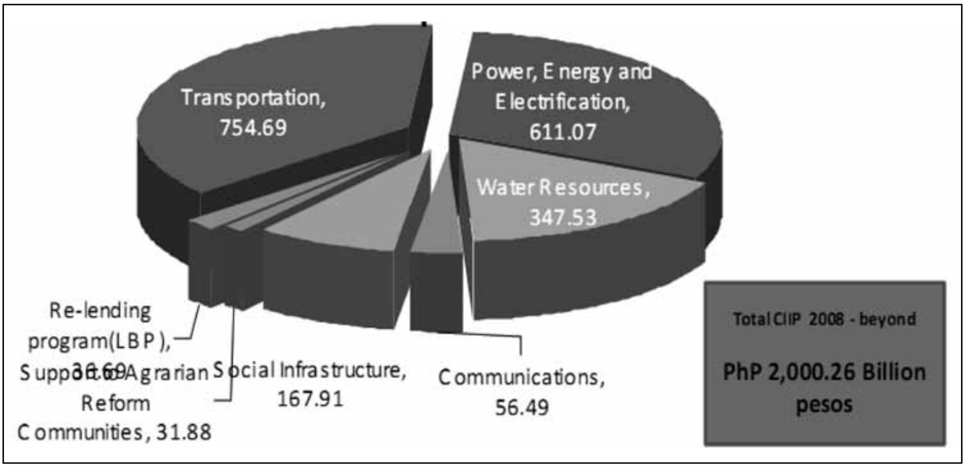
For developing countries, information and communications technology (ICT) offers renewed opportunities as it empowers citizens, expands the reach of government and improves governance, transforms business organizations while reconfiguring business relationships, and integrates economies seamlessly.

The private sector accounts for the bulk of telecommunications infrastructure and operates most of the country's telecommunications traffic. While leaps and bounds have been made by the private sector in infrastructure development, observers point out that there is still inadequacy of telecom networks and that the high cost of connectivity still hinders universal access to ICT, especially by the poor population.

**Existing reform initiatives**

*Comprehensive Integrated Infrastructure Program.* Currently, there is an existing Comprehensive Integrated Infrastructure Program (CIIP) in place. The CIIP is an expanded infrastructure portion of the Medium-Term Public Investment Program (MTPIP). As differentiated from the MTPIP, the CIIP contains projects funded by sources such as official development assistance (ODA) loans, General Appropriations Act (GAA), and corporate budget, as well as, those financed through public-private partnerships (PPPs), i.e., build-operate-transfer/joint venture (BOT/JV). It generally aims to increase infrastructure spending to address inadequacy of supply (Tungpalan, 2010).

**Figure 8. CIIP Investment requirement by subsector as of 2008**




*Source: NEDA*

**Table 6. The CIIP, 2009-2012**

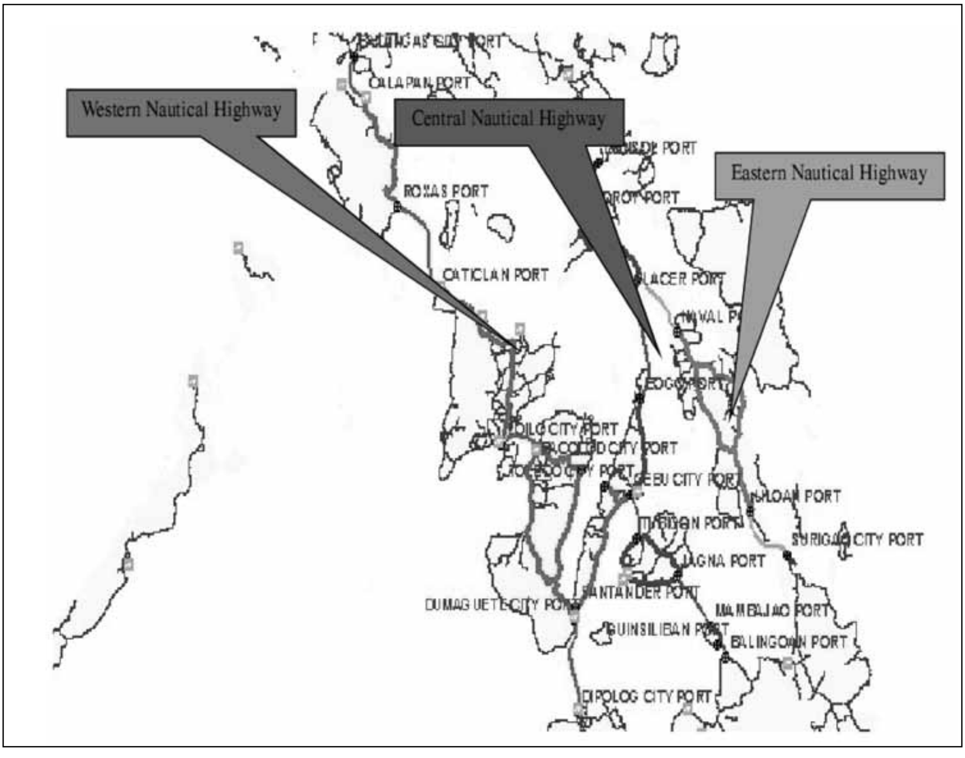
| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| DBCC GDP growth forecast (in %) | 0.8 - 1.8 | 2.6 - 3.6 | 3.8 - 4.7 | 5.0 - 5.9 |
| Average GDP estimate (in PhP) | 7,832.8 | 8,417.2 | 9,150.0 | 10,060.6 |
| CIIP annual investment (in PhP) | 327.1 | 821.9 | 597.6 | 684.8 |
| % of GDP | 4.20 | 9.80 | 6.50 | 6.9 |

*Source: NEDA*

Divided into subsectors, the CIIP investment requirement shows that the transportation, power, energy and electrification and water sub-sectors need the most investments (almost 80%).

Meanwhile, the CIIP forecast until 2012 targets increases in infrastructure investment beyond the international benchmark of five percent of GDP .

**Figure 9. The existing nautical highway**

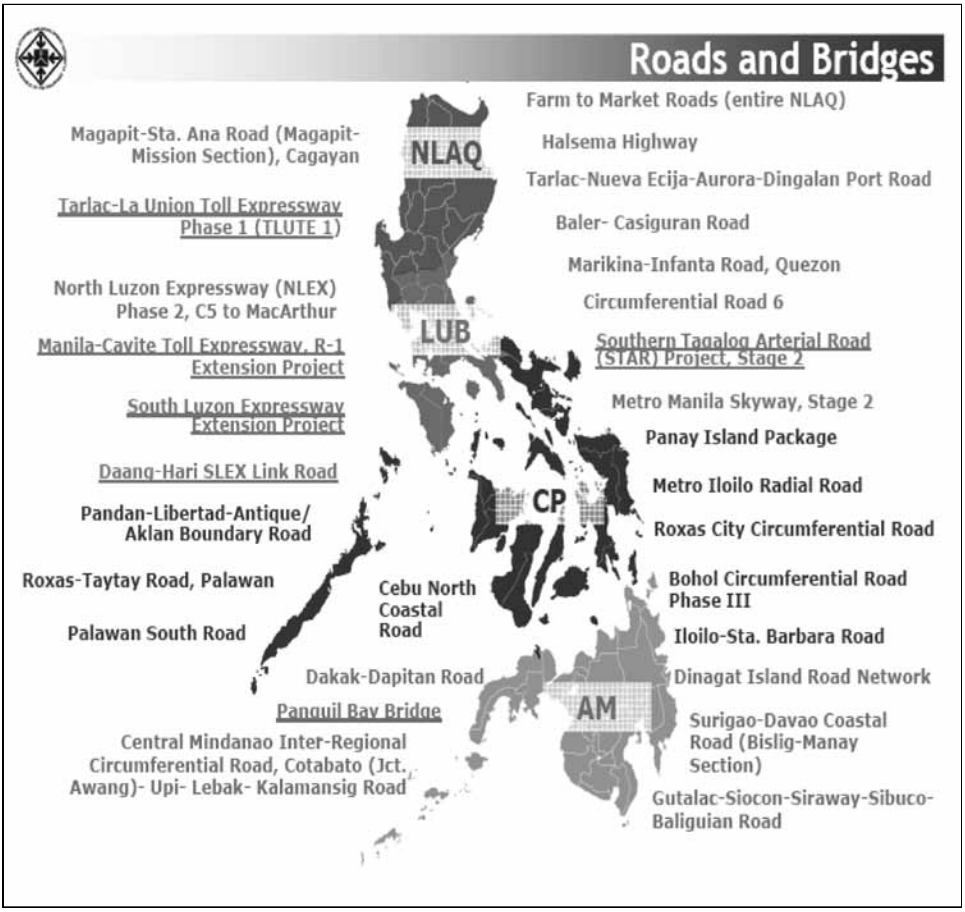



*Source: NEDA*

There is also the nautical highway, popularly known as roll on, roll off (RORO), which bridges the island provinces through the ocean liners and lowers transport cost across the archipelago.

Maintenance, construction and rehabilitation of roads and bridges are also being continuously undertaken to improve mobility, lower transport cost and reduce travel time. In the 2006 State of the Nation Address, President Gloria Arroyo announced the creation of super regions, which meant to distribute investments in a bigger geographic space, balance growth and carve a niche of industries to define these areas.

**Figure 10. Critical infrastructure in the super regions**




*Source: NEDA*

*Public and private investments.* As earlier mentioned, the poor state of infrastructure in the Philippines is partly blamed on the government's meager spending in this area. While the World Bank estimated that developing countries need to spend a minimum of 5 percent of GDP on infrastructure to meet their demands over the next decade, the Philippine public sector only spent an average of 2.4 percent of GDP from 1985-2008.

While the PhP330-billion Economic Resiliency Plan infused infrastructure budget by PhP100 billion, the 2010 National Budget reduced allocation for infrastructure by PhP31 billion from the previous year.

Experts predict that for 2010, the country's competitivenessstanding will further slide down due to the destruction of infrastructure resulting from the massive flooding and landslides brought about by typhoons *Ondoy and Pepeng* in September and October 2009.

The decrease in the 2010 National Budget for public infrastructures to PhP117.9 billion will compromise the rehabilitation of damaged infrastructure and at the same time, slow down the needed pump-priming activities in the country. The economic managers, however, said that the budget for capital outlays should be reduced and that foreign and domestic borrowings should be checked so as not to increase the country's debt stock.

In the face of chronic budget constraints, the government taps the private sector to invest in critical infrastructure through the BOT scheme. It is said that with the enactment of the BOT law in the 1990s, the private sector became active investors in the energy, telecommunications and transport industries (World Bank, 2009).

**Table 7. Private sector investments in infrastructure, Philippines 1990-2008**

| Sector | Sub Sector | Number of Projects | Total Investments |
|---|---|---|---|
| Energy | Elecricity | 62 | 18,836 |
| | Natural Gas | 1 | 432 |
| | Toal Energy | 63 | 19,268 |
| Telecom | Telecom | 10 | 14,280 |
| | Total Telecom | 10 | 14,280 |
| Transport | Airports | 1 | 520 |
| | Railroads | 1 | 655 |
| | Roads | 4 | 1,392 |
| | Seaports | 7 | 911 |
| | Total Transport | 13 | 3,478 |
| Water and sewerage | Utility | 5 | 8,071 |
| | Total Water and sewerage | 5 | 8,071 |
| Total | | 91 | 45,096 |

*Source: World Bank*

*The weaknesses in the BOT Law, however, make infrastructure projects prone to corruption and scams. Recent experiences in the implementation of the BOT Law showcase the lack of technical capacity and contradicting roles of agencies as well as the absence of accountability mechanisms—all contributing to the delays, rise of contingent liabilities among others, to detriment of the projects and their supposed beneficiaries.*

*While the BOT law allows unsolicited proposals to be accepted and undertaken by government on certain conditions, due to the loopholes in the law and implementation, most of the infrastructure projects that were marred with controversies were the unsolicited proposals (SEPO, 2008).*

Aside from underspending, the unequal distribution of infrastructure investment between rural and urban areas is also viewed as a major cause of regional disparities in income/welfare. Mass transport system such as the MRT is concentrated in the Metro Manila area, and a partly functioning heavy rail system operates to some destinations outside Metro Manila. While the planned construction of ports and airports to connect the country's major economic centers is already underway, completion of such may take a while as a result of financial, technical or administrative delays.

**Reform proposals**

Overall, there is a need to improve the environment/legal framework for private sector participation in infrastructure projects. Strengthening of infrastructure oversight and that of implementing agencies by institutionalizing value and risk analyses and improvement of management and ex post monitoring is also strongly recommended.

The World Bank (2009) generally recommends increasing the share of investment in the economy, especially in infrastructure. Domestic investment has been stagnant in real terms and has, over the long term, been unable to attract significant shares of foreign investment that have been available globally. A higher intensity of investment would raise the potential growth rate of the economy. Key to achieving this objective is for the Philippines to improve competitiveness, i.e., its ability to create business climate conditions conducive to fostering both domestic and foreign investment.

More specific proposals include the following:

***Amendments to the BOT Law.*** Experts have long recommended the review of amendments to the law's IRR as well as the implementation of the Joint Venture Guideline. Llanto (2007) outlined the outcomes expected from the revisions of the BOT as follows: (1) a legal and economic environment that is conducive to a mutually beneficial partnership; (2) clarity in articulating the duties and responsibilities of the parties to the contract; (3) certainty of recovering investments and availability of mechanisms for dealing with risks and unforeseen events; and (iv) transparency and credibility of the government's processes for review and approval of proposed BOT projects and the associated contracts for implementation.

According to Lim (2010) the Joint Venture Guidelines have been approved as of date but there is a need to rescind them because they actually promote less transparency and ineffective competition. Under the new JV Guidelines, the heads of agencies are given full authority to evaluate and approve JV agreements.[5] In the past, the Investment Coordination Committee of NEDA would review competing proposals and approve projects based on national, not sectoral or agency interests. It would appear that the new guidelines were made to fast track 11th-hourprojects of business cronies, by bypassing the faithful gatekeeper, which is NEDA.

***Amendments to the EPIRA.*** The EPIRA was passed to rationalize the power supply sector and lower electricity rates. With the slow progress in the achievement of the desired outcomes, lawmakers have introduced amendments to address the perceived weaknesses and clarify the ambiguous provisions of the said law.

*While amending the EPIRA is welcomed, others have cautioned the passage of some amendments such as:*

- *Implementation of open access and retail competition. It is hoped that with retail competition, electricity suppliers will compete with each other to sell electricity to end-users. This will eventually drive down power rates. However, it must be remembered that the EPIRA sets five pre-conditions which should be satisfied before declaring open access. The pre-conditions were set to foster an environment which can sustain a fair and robust competitive market for all players in the energy industry before moving forward to a regime of open access. The last pre-condition awaiting completion is the transfer of management and control of at least 70 percent of the total energy output of the National Power Corporation- Independent Power Producer (NPC-IPPs) to IPP administrators. Without satisfying the preconditions, the open access regime might be ineffective (SEPO, 2008).*

- *Reduction of royalties and taxes collected for the exploitation of indigenous energy sources. While decreasing royalties and taxes is expected to reduce power rates, the impact of such action on the revenues of the affected local governments (which are usually poor rural communities) must first be considered (Tagaytay workshop proceedings, 2010).*

[5] Lim, Alberto. (April 10, 2010). Infrastructure coalition. *Philippine Daily Inquirer, Business Matters, A13, 10.*

***Creation of the DICT. The Department of Information and Communications Technology (DICT).*** The DICT will supersede the existing CICT to ensure effective policy, planning coordination and implementation of country's national ICT industry/agenda. The DITC will also:

- Address the inadequate supply of telecommunications networks by granting incumbent operators more freedom to reinvest their earnings.
- Attract private sector investment by selling shares in government-owned telephone companies.
- Reduce cost of connectivity by encouraging competition and attracting market entrants.

The latter could be done by establishing the National Public Key Infrastructure (PKI) to provide secure online environment for both e-commerce and e-government.

**Other proposed actions and strategies**

***Infrastructure financing.*** The government should be bold in investing in infrastructure needs of 21st century industries, e.g., ICTs, BPOs, mining, aquaculture, high value agribusiness (Arroyo, 2010). For developing countries, the World Bank (2005) pointed to four main sources of funds for infrastructure development: 1) reinvesting user charges, 2) raising funds in financial markets, 3) availing of ODA, and 4) government financing.

- Ensure efficient collection and transparent utilization of the Motor Vehicle User Charge (MVUC). The Road Users Act (RA No. 8794) provides that the collection from MVUC is for road maintenance and improvement, installation of efficient traffic lights and road safety devices, and air pollution control.
- Impose of adequate user charges not only generates revenue, but also sends signal to private sector that investing in infrastructure development is financially viable.

For the transport sector, particularly for roads and bridges, develop "users pay" culture where road users will pay at least for maintenance of roads. There should also be an allocation of funds by LGUs for local improvement/maintenance and institutionalized systems for local road management. The national government should likewise continue the implementation of RORO Terminal System to link entire country and reduce logistics cost through the elimination of double cargo handling charges (Tungpalan, 2010).

# Regulation and Government Efficiency

Regulation is defined in various ways by different authors. Broadly, it is a sustained and focused intervention of government to influence, restrict or control the service and competitive behavior of business and other players of the industry, presumably for public interest. It is also a set of processes undertaken or adopted by regulators or implementers of regulatory policies. More specifically, it is a set of specific rules, jurisprudence, orders or decisions, having the force of law, formulated by regulators and binding on the regulatees and the regulatory issues at hand. In this age of globalization, deregulation and liberalization, it has become the new border between the state and the economy, and the battleground of ideas on how public interest should be promoted and how the economy should be run (Mendoza, 2003).

Black (2002) contended that although regulation is practiced by governments, it is not purely a government matter. Regulation goes beyond the state, enabling it to cover various forms of relationship between the state, the law and the society.

In the literature on competition, the main idea of regulation is to protect public interest by providing solutions to so-called market failures. Market failures occur when markets are left unchecked and government intervention, by way of regulation, is needed to safeguard public welfare. Many economic crises, including the Asian financial crisis in 1997 and the most recent global economic crisis, are said to be results of unfettered, unregulated market behavior. The main goal then is to open up industries to competition and regulate firms such that market competition is carried out in a fair manner and consumers (i.e., taxpayers) are protected from the adverse effects of the uncontrollable appetite for profit.

In the Philippines, regulatory bodies are created to ensure that market participants play by the rules (e.g., anti-competitive practices are discouraged) and also, to guarantee that consumer welfare is protected. The end result is that goods and services provided by firms are of good quality (e.g., health/safety standards are followed) and affordable (e.g., price-setting regulation are followed). Thus, regulation enhances competition within industries and therefore, contributes to achieving the efficiency and equity goals of society.

**Regulation in the Philippines**

Industry regulators in the Philippines are primarily agencies under the Executive branch, although some would call those vested with quasi-judicial powers as belonging to fourth branch, between the Executive and the Judiciary. The Judiciary and the Legislature also play important roles in the implementation process. Some regulatory mechanisms have developed outside the state as an alternative or complement to these state regulators. Despite sectoral specialization, it is rare that only one agency actually resolves a case, since there are layers of review, coordinating mechanisms and often recourse to the constitutional bodies— courts, the President or Congress (Carino, 2005). Industry regulators include the Energy Regulatory Commission (ERC) for electricity, the National Telecommunications Commission (NTC) for telecommunications, the Philippine Ports Authority (PPA) and the Maritime Industry Authority (MARINA) for shipping, and the Civil Aeronautics Board (CAB) for civil aviation. The 'public interest' character of public utilities in particular, would explain why these economic activities should come under substantial regulation.

Despite the reforms undertaken during the last two decades, the existing regulatory framework is inadequate to curb market behavior deemed inimical to social welfare. To date, there appear no clear procedures yet for dealing with market players involved in anticompetitive practices. Indeed, if one has to wade through Philippine jurisprudence, one will find no market player convicted and/or penalized on the grounds of anticompetitive behavior or one involved in any restraint of trade. Moreover, there is common set of criteria to justify firm behavior that might be regarded as 'unfair' and no standard framework to assess how public interest is or would be affected (Global Competition Forum, undated).

**Regulation issues of some industries**

*Electric power industry*

Since the beginning, the regulation of the electric power industry has been complex. The power of Public Service Commission (PSC) to grant franchises, issue certificates of public convenience or of public convenience and necessity, and fix rates and reasonable standards of safety in the electric power sector was passed on to the Oil Industry Commission in 1971, and to the Energy Regulatory Board (ERB) in 1997 and then to the Energy Regulatory Commission (ERC) in 2001. For a time, the National Power Corporation (NPC) played the role of main provider and regulator of the industry.

The passage of the Electric Power Industry Reform Act (EPIRA) in 2001 divided the electric power industry into four distinct subsectors: transmission, distribution, generation and supply. The first two subsectors are treated as natural monopolies and are subject to regulation, while the latter two were deregulated and opened up to competition.

With EPIRA, NPC was forced to divest many of its assets and contracts, and divided to form new offices: the Small Power Utilities Group (SPUG) for the missionary electrification function; the Power Sector Assets and Liabilities Management, Inc. (PSALM) to dispose of NPC's generating assets, power contracts and other disposable properties; and the Transmission Company (TRANSCO), a new public enterprise expected to be speedily privatized. EPIRA also envisioned a Wholesale Electricity Spot Market (WESM), which has yet to work well.

The current ERC inherited the function of rate fixing and protection of consumer interests. It gained new powers as the competition watchdog and is supposed to license new market participants, oversee mergers and consolidations, set technical, performance and service standards, encourage market development, ensure consumer choices, and penalize abuse of market power, among others. It is also the overall supervisor for the restructured industry, being the chief regulator of the transmission, distribution and supply sectors of the industry. In short, ERC is imbued with a relatively 'new' type of regulation, which aims to level the playing field, promote competition and encourage market development, as well as promote consumer choice and protection (Mendoza 2003).

Except for lack of fiscal autonomy, ERC seems to have been given all the conditions necessary for independent decision-making and has made several unilateral moves to reach out to consumers. In June 2004, it promulgated a Magna Carta for Residential Electricity Consumers, stating the rights and obligations of both distribution utilities and consumers (Baylon 2007). It has also promulgated the Rules for Customer Switching and Rules for Contestability to govern the operations in the WESM; required officials of distribution utilities to undergo mandatory regulatory education program; and established a consumer help desk as of 2007 (Mendoza, 2008).

However, consumer advocacy groups still complain that its decisions are biased in favor of industry players and power utilities claim that they are dictated by political considerations (Baylon, 2005). ERC was also perceived as leaning on the side of Meralco, the political powerful energy supplier for Metro Manila, in the case the latter lodged against its predecessor agency, the ERB.

Despite the reforms introduced by the EPIRA, improvements in regulation, service quality and sufficiency remains wanting as the Philippines continue to rank low in the Global Competitiveness Index. The cost of electricity in the country is still the second highest in the region, next to Japan. This is cited by most businessmen as a major impediment to foreign direct investment in the country (CPBD, 2007).

*Telecommunications Industry*

Telecommunication service in the Philippines has certainly improved since the mid-1990s. The increase in the number of telephone lines has been phenomenal, from 740,000 in 1992 to 6.9 million a decade later. Telephone density has also increased, from 0.9 in 1990 to 8.7 in 2002.

Market structure has also changed considerably. Local exchange carriers have increased from 49 (with PLDT as de facto monopoly) in 1993 to 74 in 2002. During the same period, the number of interexchange carriers increased from 1 to 14 and cellular phone providers, from 2 to 7. International gateway facilities likewise increased from 1 in 1989 to 11 in 2002.

The provision of telecommunications services is regulated by the National Telecommunications Commission (NTC), formerly under the Department of Transportation and Communication (DoTC) and recently transferred to the new Commission for ICT. NTC has jurisdiction over landlines, cellular phones and international gateway providers after franchises have been granted by Congress.

These improvements are largely attributed to the: (1) enactment of the Public Telecommunications Act of 1995 (RA 7925) that opened up the telecomm industry to competition; and (2) convergence in telecommunication, broadcasting and computing technologies that have "allowed for real competition to be possible" (Laffont and Tirole, 1999 quoted in Alampay, 2005).

Convergence poses a challenge to the industry regulator. What service is to be regulated? "Basic" services (voice) only? Or should one also include value-added services like texting, which is more popular and used by other service industries (i.e. , interactive participation with radio and television and even gambling)? How about the public use of Voice over Internet Protocol (VoIP)?

To date, the NTC seem to be facing a dilemma. On one hand, the NTC is mandated by Executive Order 109 (s.1993) to ensure 'universal access.' [6] On the other hand, RA 7925 prevents the NTC from fully acting on this mandate by stipulating that interconnection and access tariffs be determined by the service providers (through negotiations). Such stipulation essentially provides an incentive to industry players to delay the provision of an accessible, affordable and reliable telecommunication service.

*Money and banking industry*

The recent pre-need industry debacle has been blamed, in part, on the Securities and Exchange Commission's lack of capability to regulate the industry. The Legacy Group was still able to acquire the permit to sell new investment plans even though it had yet to act on the Commission's advisory to recapitalize in 2006. The same is true for College Assurance Plan (CAP) back in 2001 when the Commission issued a permit to sell despite a PhP2.6 billion deficit in its trust fund. One wonders whether the Commission was 'captured' or if it really was just short of the technical resources (they do not have their own actuary) to monitor and regulate such industries.

The amendments to the charters of the Bangko Sentral ng Pilipinas (BSP) and the Philippine Deposit Insurance Corporation (PDIC) are expected to enhance compliance with existing regulations and strengthen the framework for prompt corrective action (PCA) against distressed banks, incorporate fit and proper rule; and ensure the protection of bank examiners.

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[6] The end goal is to create a universally accessible and fully integrated nationwide telecommunication network that is affordable and reliable.

**Reform proposals**

There are numerous recommendations to improve government efficiency and regulation. Among them are enacting a law reducing the cost of connectivity by encouraging competition and attracting market entrants; establishing the National Public Key Infrastructure to provide secure online environment for both e-commerce and e-government; promoting open-source software; consolidating all ICT-related agencies to address overlaps; conducting comprehensive assessment of the EPIRA; amending the BOT law to ensure transparency in the contracts, and promoting public-private partnerships. These have been lingering in the halls of the 12th to 14th Congress and it would be wise to take a second look at them.

Specifically, attention should be given to revisiting the following legislative proposals in the 15th Congress:

***Anti Trust Act.*** The said law provides for more effective implementation of the Constitutional mandate against monopolies, combination and restraint of trade and unfair competition by redefining and strengthening existing laws, processes and structure regulating the same, and for other purposes. It declares the following acts as economic sabotage and provides criminal sanctions for the same: (1) smuggling; (2) technical smuggling; (3) misclassification of importation; (4) dumping; and (5) other forms of unfair trade practices.

***Amendments to the BSP Charter.*** Experience in the past highlighted the inability of the Bangko Sentral ng Pilipinas (BSP) to deal effectively and expeditiously with problem banks. The authority of the BSP over problem banks in general, is limited to the grant of emergency advances in case of illiquidity, or closure in case of insolvency. Prompt corrective actions cannot be implemented due to the absence of clear and strong legal basis. Such inability of the BSP often causes losses of hard-earned money of the depositors and also losses of public funds (Angara, 2009).

The proposed amendments seek to strengthen the BSP’s supervisory powers, empower the BSP in improving the quality of bank ownership, governance and capitalization, enhance the BSP’s administration of the monetary, credit and banking system, and provide a more responsive BSP organization. The amendments would lift the remaining constraints of the bank secrecy laws on examiners and at the same time enhances the scope for risk-based supervision including risk based approach to capital requirements.

***Creation of a Fair Trade Commission.*** The Commission will be provided powers and functions to regulate trade competition, and monopolies and for other purposes.

# Governance and Doing Business

**What is governance?**

Governance is the exercise of political, economic and administrative authority to manage a nation's affairs. It is the complex mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights and obligations, and mediate their differences (UNDP, 1997). It is the manner in which power is exercised in the management of a country's social and economic resources for development. Governance means the way those with power use that power (ADB, 1998).

Governance includes the traditions and institutions by which authority in a country is exercised for the common good. This includes (1) the process by which those in authority are selected, monitored and replaced, (2) the capacity of the government to effectively manage its resources and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them (World Bank, 2005).

There is no such thing as governance for its own sake. Governance must produce clear, measurable benefits (Diokno, 2000). Great emphasis must be put on the attainment of goals. While there are many players involved in governance, the government is the one tasked to lead the process of governance. Similarly, formal government structures are means by which decisions are arrived at and implemented. The way governments decide on their fiscal policy, for instance, is a tool to address issues relating to public finances. Fiscal policy as defined by Vito Tanzi (1993) is the use of public finance instruments to influence the working of the economic system to maximize economic welfare. That is, good fiscal policy may lead to strategic (re)allocation of public finances, enabling the government to better provide for the citizenry.

The quality of governance (and the nature and extent of corruption) depends fundamentally on institutions, defined broadly as the 'rules of the game' that shape the behavior of organizations and individuals (Campos and Lateef, 2004). The notion of an institution embodies several elements: formal and informal rules of behavior, ways and means of enforcing these rules, procedures for mediation of conflicts, sanctions in the case of breach of the rules, and organizations supporting market transactions (WTO, 2004).

Institutions exist to reduce the uncertainties that arise from incomplete information concerning the behavior of individuals. Thus, institutions have a great impact on the economic activities of a country. Institutions are key to governance in the following ways: They can (1) channel information about public goods and in the process help government regulate well; (2) reduce the likelihood of disputes and help enforce contracts or agreements through the judicial 34 system; (3) provide clear and transparent mechanisms governing businesses, thus reducing corruption and bureaucratic obstacles; (4) facilitate competition through a good regulatory structure; and (5) ensure, through a system of rewards and penalties, that resulting incentives lead to the desired behavior (World Bank, 2002).

**Governance and competitiveness**

Good governance is vital in meeting the country's development goals. Without it, even well-crafted plans and programs could not produce intended outcomes of growth, competitiveness, and improved quality of life. Quality government rests on basic principles of transparency and accountability, greater citizen participation, and efficient and effective implementation. It also requires political democratic processes (such as elections) to produce competent leaders that adhere to party programs/platforms and thus replace the politics of personality and patronage.

Governance and the quality of institutions strongly impact a country's competitiveness and growth. Both factors affect investment decisions and the organization of production, and play a central role in the ways in which societies distribute the benefits and bear the costs of development strategies and policies.

The World Economic Forum (WEF) underscores that the role of institutions goes beyond the legal framework.

*"Government attitudes toward markets and freedoms, and the efficiency of its operations, are also very important. Excessive bureaucracy and red tape, overregulation, corruption, is honesty in dealing with public contracts, lack of transparency and trustworthiness, and the political dependence of the judicial system impose significant economic costs to businesses and slow the process of economic development. Proper management of the public finances is also critical to ensuring trust in the national business environment (GCR 2009-2010, 2009)."*

A World Bank study showed that countries with good economic policies and stronger institutional capability grow much faster. In these countries, income per capita grew at an average rate of about three percent per year over the last three decades. On the other hand, income per capita grew by only 0.4 percent per year in countries with weak state capability and highly distorted policies (World Bank, 1997).

The absence of good governance is the reason many countries, especially the Third World, continue to fail in their efforts to reduce poverty and in their quest for economic and human development (ADB Country Governance Report, 2005).

## Philippine governance and competitiveness

The Philippines' perennial problems of corruption, inefficient government bureaucracy and inadequate infrastructure were the main reasons given for the further decline in the country's competitiveness ranking, according to the Geneva-based WEF said.

Out of 134 countries included in the WEF's Global Competitiveness Report 2009-2010, the Philippines ranked 87th, a substantial slide from its 71st ranking out of 134 economies in the 2008-2009 Global Competitiveness Index (GCI).

Respondents in the WEF survey cited corruption as the most problematic factor for doing business in the Philippines, followed by inefficient government bureaucracy and political instability[1].

In the past years, Philippine bureaucracy has been found to be one of the weakest in East Asia. The country's index of bureaucratic capability is low at 0.2 compared to the score of 0.6 for the rest of East Asia (CPBD, 2007).

The causal relationships in the Philippines between corruption, political instability and weak rule of law, on one hand, and investment, on the other hand, have been found by various studies. For example, political instability such as the numerous coup attempts in the late 1980s caused the decline of foreign direct investment inflows, in sharp contrast to surges in Malaysia, Indonesia and Thailand. A number of political events that tested constitutional processes in 2001, 2003 and 2005 also made investors apprehensive about investing in the country (ADB, 2007).

*Surveys have shown that in the Philippines, governance concerns, particularly corruption and political instability weaken investor confidence.*

The Philippines loses PhP1.92 billion to corruption a year. Over a 20-year period, that would be close to PhP2 trillion According to Renaud Meyer, country director of United Nations Development Programme (UNDP). The perception of worsening corruption was found to partly explain the low investment rate in the Philippines. Poor governance was also found to translate into higher lending rates, reflective of premiums for worsening corruption, political instability and internal conflict as it acts as disinc entives to private investment. Persistent corruption and patronage problems, which result in leakages in revenue collection, are also identified as key reasons for weak revenue generation as they cause lack of funding for infrastructure and human development programs (ADB, 2007).

**Table 8 . Philippine ranking in terms of institutions indicators**

| Indicator | Rank |
|---|---|
| **1st Pillar: Institutions** | |
| Property Rights | 124 |
| Intellectual property protection | 128 |
| Diversion of public funds | 131 |
| Public trust of politicians | 132 |
| Judicial independence | 132 |
| Favoritism in decisions of government officials | 129 |
| Wastefulness in government spending | 128 |
| Burden of government regulation | 51 |
| Efficiency of legal framework in settling disputes | 129 |
| Efficiency of legal framework in challenging regs | 120 |
| Transparency of government policymaking | 119 |
| Business costs of terrorism | 72 |
| Business costs of crime and violence | 117 |
| Organized crime | 114 |
| Reliability of police services | 131 |
| Ethical behavior of firms | 131 |
| Strength of auditing and reporting standards | 123 |
| Efficacy of corporate boards | 126 |
| Protection of minority shareholders' interests | 115 |

*Source: Global Competitiveness Report (GCR) 2009-2010.*

The latest GCR also showed that out of the 133 countries, the Philippines ranked 130 in the pillar of institutions.

In line with its assistance strategy, which focuses on governance as a crosscutting theme the World Bank assessed the state of governance of various countries using the following indicators: 1) control of corruption, 2) rule of law, 3) regulatory quality, 4) political stability, 5) government effectiveness, and 6) voice and accountability.

In the said assessment, the Philippines' scores have improved but most marks still lag behind regional averages. Out of the six measures of governance, the Philippines improved in four. The score for control of corruption, or the extent to which public power is exercised for private gain, improved to 26.1 percent in 2009 from 22.2 percent in 2007. The score, however, is significantly lower than the 45.1 percent average for the region.

In terms of the rule of law – the extent to which agents have confidence in and abide by the rules of society, including the quality of property rights, the police, and the courts, as well as the risk of crime – the country's score was a higher 39.7 percent, from 33.8 percent in 2007. But it was well below the regional average of 52.9 percent.

Regulatory quality or the government's ability provides sound policies and regulations that enable and promote private sector development improved to 51.7 percent from 50.5 percent. In this instance, the Philippines' score was higher than the 42.1 percent regional average.

Government effectiveness, which measures the quality of public service, the capacity of civil service and its independence from political pressures fell to 55 percent from 56.4 percent. The score, however, was higher than the regional average of 46.5 percent.

For voice and accountability --- the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, association, and the press --- the score worsened to 41.3 percent from 43.3 percent. This was below the regional average of 49.9 percent.

The Philippines' scored the worst in terms of political stability, where it notched just 10.5 percent, albeit a slight gain from 10.1 percent previously. The mark, again, was well below the regional average of 59.4 percent.

**Table 9. Governance indicators, 1998, 2003 and 2008**

| Governance Indicator | Source | Year | Percentile rank (0-100) | Governance (-2.5 to +2.5) | Standard error |
|---|---|---|---|---|---|
| Voice and accountability | 16 | 2008 | 41.3 | -0.2 | 0.12 |
| | 9 | 2003 | 50.5 | 0.06 | 0.17 |
| | 6 | 1998 | 60.6 | 0.39 | 0.23 |
| Political stability | 11 | 2008 | 10.5 | -1.41 | 0.2 |
| | 9 | 2003 | 14.4 | -1.18 | 0.23 |
| | 6 | 1998 | 40.4 | -0.17 | 0.24 |
| Government effectiveness | 13 | 2008 | 55 | 0 | 0.17 |
| | 11 | 2003 | 54.5 | -0.15 | 0.15 |
| | 8 | 1998 | 47.4 | -0.26 | 0.13 |
| Regulatory Quality | 12 | 2008 | 51.7 | -0.05 | 0.16 |
| | 10 | 2003 | 52.2 | -0.06 | 0.17 |
| | 8 | 1998 | 62.4 | 0.3 | 0.23 |
| Rule of Law | 18 | 2008 | 39.7 | -0.49 | 0.13 |
| | 13 | 2003 | 33.3 | -0.58 | 0.14 |
| | 10 | 1998 | 52.9 | -0.09 | 0.17 |
| Control of Corruption | 17 | 2008 | 26.1 | -0.75 | 0.13 |
| | 10 | 2003 | 36.9 | -0.51 | 0.14 |
| | 9 | 1998 | 41.3 | -0.37 | 0.17 |

*Source: World Bank*

**Doing business**

To determine factors that enhance business activity and those that constrain it, the World Bank-International Finance Corporation conducts an annual survey on Doing Business across 181 countries. Comparing cross country indicators on starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business, the Philippines ranked 140 in 2009.

**Table 10. Doing Business indicators across selected countries, 2009 (Ranking out of 183 countries)**

| Ease of... | Philippines | Malaysia | Indonesia | Thailand |
|---|---|---|---|---|
| Doing Business | 114 | 23 | 122 | 12 |
| Starting a Business | 162 | 88 | 161 | 55 |
| Dealing with construction permits | 111 | 109 | 61 | 13 |
| Employing workers | 115 | 61 | 149 | 52 |
| Registering property | 102 | 86 | 95 | 6 |
| Getting credit | 127 | 1 | 113 | 71 |
| Protecting investors | 132 | 4 | 41 | 12 |
| Paying taxes | 135 | 24 | 127 | 88 |
| Trading across borders | 68 | 35 | 45 | 12 |
| Enforcing contracts | 118 | 59 | 146 | 24 |
| Closing a business | 153 | 57 | 142 | 48 |

*Source: World Bank-International Finance Corporation (WB-IFC)*

The low ranking of the Philippines is attributed to the high cost of doing business, lack of transparency and accountability and long and circuitous processes.

The National Competitiveness Council, a public-private task force created in 2006 spearheaded reforms, among others, to improve transaction costs and flows in doing business. Its initiatives to improve the procedures for the entry and exit of business persons and goods, and standardize business registration and permits processes have resulted in reduced delays and to the connectivity (albeit still incomplete) and streamlining of processes in doing business in the country.

**Table 11. Improvements to Doing Business in the Philippines, 2005 and 2010**

| Criterion | | 2005 | 2010 |
|---|---|---|---|
| Starting a business | Procedures (number) | 15 | 15 |
| | Time (days) | 60 | 52 |
| | Cost (% of income per capita) | 25.4 | 28.2 |
| | Min. capital (% of income per capita) | 2.2 | 5.5 |
| Employing workers | Difficulty of hiring index (0-100) | 56 | 56 |
| | Rigidity of hours index (0-100) | 0 | 0 |
| | Difficulty of redundancy index (0-100) | 30 | 30 |
| | Rigidity of employment index (0-100) | 29 | 29 |
| | Redundancy costs (weeks of salary) | 91 | 91 |
| Registering property | Procedures (number) | 8 | 8 |
| | Time (days) | 33 | 33 |
| | Cost (% of property value) | 4.8 | 4.3 |
| Getting credit | Strength of legal rights index (0-10) | 3 | 3 |
| | Depth of credit information index (0-6) | 3 | 3 |
| | Public registry coverage (% of adults) | 0 | 0 |
| | Private bureau coverage (% of adults) | 3.4 | 6.1 |
| Enforcing contracts | Procedures (number) | 37 | 37 |
| | Time (days) | 862 | 842 |
| | Cost (% of claim) | 24.8 | 25 |
| Closing business | Recovery rate (cents on the dollar) | 3.8 | 4.4 |
| | Time (years) | 5.7 | 5.7 |
| | Cost (% of estate) | 38 | 38 |

*Source: WB-IFC*

Comparing 2005 and 2010 data, the cost of doing remains high and has, in fact, increased. Thus, much remains to be done by both the public and private sectors to lower the cost of doing business, with the end in view of improving Philippine competitiveness.

**Reform proposals**

In a 2007 study, the House of Representatives Secretariat pointed out that restoring public confidence in government requires well-meaning reforms that will pursue the fight against graft and corruption. Such reforms will entail greater access to public information, providing adequate protection to whistleblowers, intensifying oversight/audit activities, beefing up the capability of the Office of the Ombudsman, and encouraging transparency of government's decision-making processes at every stage. The inefficiencies brought about by unwieldy structures and tedious processes must also be addressed.

According to the exit polls conducted by the Social Weather Stations (SWS) during the recently concluded elections, more Filipinos are optimistic that economic growth will trickle down to their personal lives with a new administration promising to wage war against endemic corruption. Towards fulfilling campaign promises, a step to take is working for the passage of the following proposals:

***Freedom of Access to Information Act.*** In a democracy, information, when democratized and made widely available, allows citizens to actively participate on issues that have serious repercussions for governance. This law establishes a uniform, speedy, and effective means of accessing information and institutes penalty for unlawful denial of access. It ensures that citizens will be granted easier access to information on matters of public concern. It was passed on third reading by the Senate in December 2009. The House of Representatives failed to pass the bill on the last session day of the 14th Congress.

***Reforms to existing budget laws.*** The current budget process, which grants immense powers to the President and is mired with mis-prioritization practices, to the detriment of poor citizens, originated from budgetary laws passed during the years of martial law. The proposed reforms aim to prohibit unprogrammed funds, providing guidelines for reenacted budgets and for national budget savings. Proposals seeking transparency in bicameral meetings, as well as institutionalization of people's participation in budget deliberations are also put forward.

***Political Party Reform Act.*** Political party reforms had been embraced by electoral reform advocates as a major or even a key reform initiative. At the very least, they see these as necessary to develop a genuine political party system. These reforms are expected to impact the current traditional patronage politics, minimize personality-based political campaign, improve governance and redraw the rules of the political game in the country.

**Other proposed actions and strategies**

**Strengthening of the Office of the Ombudsman.** According to the latest report of Political and Economic Risk Consultancy (March 2010), the non-resolution of corruption cases is one of the major reasons why the Philippines continues to be perceived as one of the most corrupt countries in the world. The Office of the Ombudsman is the prosecutorial arm of the State tasked to go after erring public officials and employees. Numerous cases have been filed at the Sandiganbayan and the lower courts, but resolution of these cases is held up by the lack of prosecutors.

It is important to beef up the capability of the OMB in terms of additional plantilla positions, human resource development, and appropriate funding support. Alternative resource mobilization schemes should also be explored to help address the financial difficulties of the OMB in its operations. To augment the current personnel complement of the OMB, there is a proposal to hire and/or deputize private lawyers to aid in the prosecution and litigation of more sophisticated graft and corruption cases (e.g., involving multiple bank accounts, trust agreements, money laundering using local/international currency). (HOR, 2007)

***Full implementation of the Government Rationalization Program.*** The said program is seen to make an efficient, effective, professionalized, and properly compensated bureaucracy whose scope and focus of functions, programs, and activities support national development goals and efforts, and whose size and organizational structure promote economy, productivity, innovation, responsiveness and service to the general public.

***Full implementation of the Organizational Performance Indicator Framework (OPIF) and Medium Term Expenditure Framework (MTEF).***

***The real price of pad governance and corruption, is not paid in currency.*** *Corruption not only weakens institutions but has also resulted in inequitable distribution of social services, judicial 'injustice', economic inefficiencies and unchecked environmental exploitations. It hits hardest at the poor – who often depend heavily on public services and the natural environment and are least able to pay bribes for essential services that should be theirs by right, according to the 2008 Asian Pacific Human Development Report entitled Tackling Corruption, Transforming Lives of the United Nations Development Programme (UNDP).*

*In the Philippines, bad governance and pervasive corruption has led into a sorry, worrisome state where the poor are less educated, have less access to health and economic opportunity, and are less able to uplift themselves from their own poverty.*

*For the Commission on Human Rights (CHR), the level of corruption in the Philippines has reached a "humanitarian crisis at its core," encroaching and eating up not only the right of every citizen to good governance, freedom, and decent life, but as well as her and his dignity. "It is a very serious violation of human rights," says CHR chairperson Leila de Lima.*

# Crosscutting Issues

# Trade and Competitiveness: The Underlying Themes for Business[8]

**Roadblocks and challenges**

Competition is central to any objectives set forth by a more globally integrated economy. A more open an economy means a tighter competition. This becomes more evident as trade rises among countries. As defined by the Organisation for Economic Co-operation and Development (OECD), competitiveness is the ability to produce goods and services that can meet the tests of markets while promoting and maintaining a high living standard and quality of life for the people. Thus, trade liberalization is essential in inducing competition in markets and industries, as well as in promoting a higher standard of living and a better quality of life for all.

From the point of view of business, fostering a competitive business climate entails five necessary conditions that will complement trade liberalization and thus reap the most benefit from amore open trade. These conditions include:

- adequate and quality basic utilities
- seamless infrastructure
- national economic stability
- environmental sustainability
- policy consistency

The Philippines, however, has shown lackluster performance in these crucial indicators. The country is still faced with the daunting challenge of creating a competitive and conducive investment climate for both foreign and local investors. As a result, it is not surprising that the country has consistently ranked on the bottom-third of various international competitiveness surveys.

[7] Presentation by Mr. Ryan Patrick G. Evangelista, Executive General, Universal Access to Competitivenessand Trade and Deputy Secretary General, Philippine Chamber of Commerce and Industry, at the Consultative Forum and Workshop on Advocating Policy and Legislative Agenda to Improve Philippine Competitiveness for the 15th Congress.

**Table 12. Philippines' standing in various global competitiveness ranking 2008 & 2009**

| Corruption perceptions index | RP in 2008 | RP in 2009 | RP's league |
|---|---|---|---|
| Globalization Index | 57 / 208 | 85 / 208 | TT, AM, NA, BS, KG, GT |
| Global Services Location Index | 7/198 | 8 / 198 | IN, CN, MY, TH, EG, ID, CL, VN |
| Global Competitiveness Report | 71 / 133 | 87 /133 | VN, UA, MA, CO, UY, BG, SRL, SY, SV, NA |
| Corruption Perceptions Index | 141/180 | 139 / 180 | BD, BY, PK, CM, IR, YE |
| Index of Economic Freedom | 92/155 | 104 / 155 | BT, MA, PK, YE, BR, CAM, ALG, ZM, RS, SN |
| Ease of Doing Business | 136/183 | 144 / 183 | GM, HN, UA, SY, CAM, CV, BF, SL, LR, UZ |
| Tax Misery & Reform Index | 48/65 | 50 / 65 | US, MY, ID, IN, NZ, LT, LV, IE |
| E-readiness Rankings | 55/70 | 54 / 70 | JO, SA, CO, PE, VE, CN, EG, IN, RU |
| Inward FDI Potential Index | | 77 / 140 (2004-2006) | BR, MN, TR, AM, RSA, CR, AO, BW, MD, VN |

*Note: based on Ryan Evangelista's Presentation Consultative Forum and Workshop on Advocating Policy and Legislative Agenda to Improve Philippine Competitiveness for the 15th Congress.*

While the Philippines is considered to be globally integrated and has great potential and competitive advantage as a preferred location for global services activities such as business process outsourcing, the country needs to lower trade barriers, minimize corruption, manage government expenditures responsibly, properly administer property rights and ownership, and fairly impose tax rates. Hounded by corruption issues where the misuse of power for private benefit among public officials and politicians is highlighted, the country cannot seem to get out of this bad reputation. Public trust of politicians, particularly, is ranked very low at 130 out of 137 economies. This poor state of public trust is coupled with the persistence of a domestic oligarchy and a Constitution that is inclined to be economically restrictive, deficient economic policies and legislation. Thus, it is not surprising then that the Philippines is suffering from eroding competitiveness standing.

The recent global economic crisis that has shaken up investor confidence has brought to the fore the challenges faced by businesses. While the economy was kept afloat by strong remittances from overseas Filipino workers and private consumption, the manufacturing and exports sectors have suffered a sharp decline in outputs as foreign markets cut back on demand. Not only does the business sector have to face this daunting challenge, it also has to contend with the emerging regional integration plans in the ASEAN and East Asia. The establishment of the AFTA has resulted in increased trade within the region. From US$44.2 billion in 1993, intra-ASEAN trade grew toUS$95.2 billion in 2000 and, as of 2008, it has soared to US$459 billion. While this increasing intraregional trade is construed as an opportunity for the business sector, the private sector is quite apprehensive with the ASEAN's accelerated integration plans as these are poorly disseminated to stakeholders and thus, have little private sector "buy-in."

**Fitting the policies for business**

In broad strokes, business thrives on strong economic fundamentals as well as strong institutions. In particular, a stable, predictable macroeconomic environment characterized by low budget deficits, tight inflation control and competitive real exchange rates can help business in their plans and decisions. A balanced import regime that encourages business to restructure, optimize global production networks, minimize costs, promote local industry development and consumer choices is also essential. For exporters, a strong export strategy consistent with trade policy is vital in increasing market access gains, establishing intelligence networks in key markets, strengthening service-oriented trade promotion organizations, and promoting the viability of micro, small and medium Enterprises ((MSMEs) through a comprehensive export marketing program.

The cost of doing business is another important factor that investors consider, as well as the ease of entry and exit at industry level. Reduced transaction costs through streamlined procedures and regulations, particularly for small businesses can help develop vibrant MSMEs. While giving of fiscal incentives have been shown to be insufficient to attract investments into the country, a proactive investment strategy that puts emphasis on a few realistic sectors and host countries can be a more efficient use of limited resources. To persuade investors to stay for the long haul, an effective domestic competition regime must be in place and there must be the presence of a strong independent regulatory authority to deal with anticompetitive practices. Harnessing economies of scale and scope through promotion of industrial clusters involving small and large firms can maximize cooperation and synergies, as well as efficiencies from the provision of key infrastructure, technological support, trade finance and export marketing assistance.

Businesses need skilled workers to contribute to their company. To address this need and raise labor productivity, the government must increase and sustain investments in human capital at all levels (particularly tertiary-level scientific and technical education). It must also increase enterprise training, e.g., assistance for industry associations, to launch training schemes and an information campaign to educate SMEs on training benefits and tax breaks for training.

A more serious challenge for MSMEs is access to technology that will improve productivities and streamline production lines. To assist MSMEs meet this particular challenge, there is a need to provide a comprehensive technology support for quality management, productivity improvement, methodology and technical services (including grants for SMEs to obtain ISO 9000 certification, creating productivity centers and commercialization of public technology institutions).

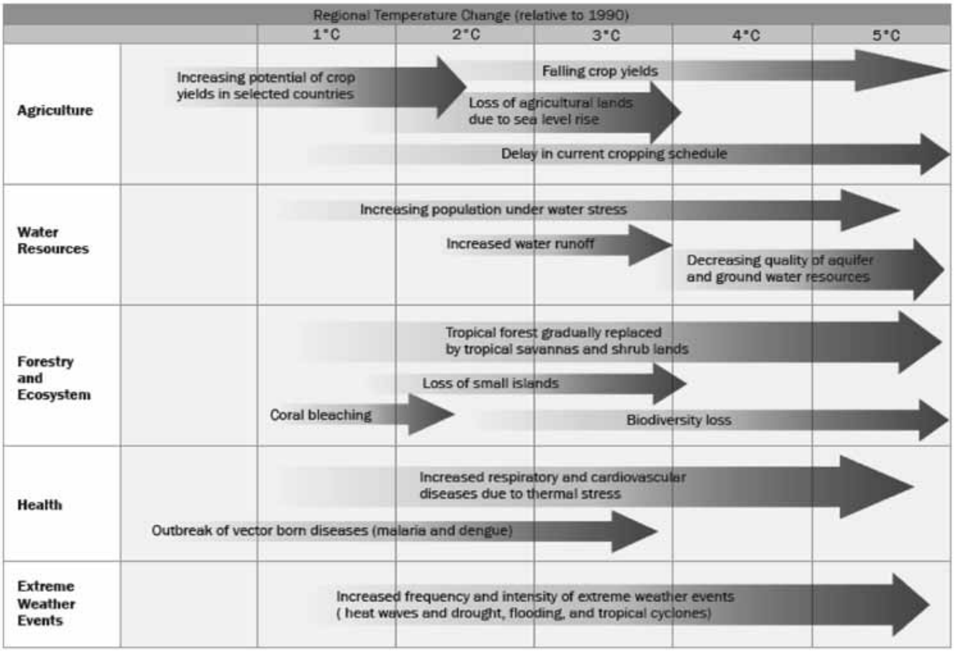
Setting a favorable business climate that promotes competition requires strong institutions. Local government reforms are needed to cut across the promotion and development of local economic hubs consistent with national policy sphere, agro-industrial development, employment generation, inventory and protection of resources and ingenious rights. Moreover, it is crucial that the principle of open access as mandated under EPIRA be fully implemented as well as policies related to biofuels, renewable and private sector participation in the energy sector. Finally, institutional reforms to protect industries from unscrupulous trade practices (i.e., substandard products, smuggled goods, intellectual property rights violations) must be supported and promoted. These measures that require government support are imperative in improving the productivity of local industries to be able to fairly compete with their ASEAN counterparts. Real benefits of a fully functional ASEAN free trade market can only be realized if local competitiveness problems of evolved roadmap for value-added and complementation of industries will be resolved.

# Mainstreaming Climate Change Agenda in the 15th Congress[9]

While in pursuit of sustained growth and inclusive development, countries must also come up with strategies to hurdle some global challenges the previous generations did not face such as climate change.

The Southeast Asian region accounts for only three percent of global carbon dioxide ($CO_2$) emissions but its economic growth will be reduced by 6.7 percent annually until 2100, twice the global average if the current trend of emission is not reversed. This fact highlights how climate change is the largest market failure facing the world today. Climate change discussions in Copenhagen did not deliver the level of global coordination that is required to fully address the severe implications of climate change because the cost and benefits of mitigation and adaptation varies across countries.

**Figure 11. Potential impacts of climate change on key sectors**




*Source: ADB study team, adapted Stern (2007)*

[8] Based on the parallel session held at the Consultative Forum and Workshop on Advocating Policy and Legislative Agenda to Improve Philippine Competitiveness for the 15th Congress.

Climate change requires global coordination to address the issues of climate financing, technology transfer and economic repercussions of policy change. These policies include eliminating fossil fuel subsidies in all economies while at the same time protecting the poor's access to energy. Moreover, financing infrastructure development to adapt to climate change (building dams and canals to address changes in rain and flood patterns) while maintaining fiscal sustainability should also be kept in mind. Ensuring that climate-related policies do not lead to losses in relative competitiveness so as to avoid politicizing the climate discussion (i.e., global coordination of polluters taxes on fossil fuel use particularly coal and oil so as not to aggrieve any specific country or sector)is also part of climate policies. Indeed, climate change policies will affect competitiveness of countries and industries.

On top of global coordination, governments are now required to craft and implement climate adaptation and mitigation strategies coordinated across its various departments and bureaus. How does the legislative department figure in this whole scheme? Here are a few suggestions that the next Congress could consider:

1. Global coordination and addressing market failure is the top goal but local conditions will affect the pace and breadth of reforms. Capacity building and awareness building are necessary but the Philippine fiscal picture provides significant constraint on financing institution building. Multilateral and bilateral support is available. Both Houses of Congress are urged to ensure that they maximize the available funding for awareness campaigns and capacity building for itsstaff.

2. The national budget is a subtle but powerful tool to address climate change. Allocations for infrastructure development should factor in climate adaptation needs. Investments in agricultural investments and extension services should integrate the ongoing affects of climate change a sit is the economy's most vulnerable sector to climate change. Budget deliberations provide a fertile ground for rich discussions on policy coordination on various issues – this should now include climate change.

3. Congress holds the power to tax and provide fiscal incentives. Getting prices right and global reflection of the real cost of fossil fuel use by eliminating subsidies across all economies are crucial. Once global coordination of fuel subsidies removal is agreed on, Congress can look into changing the structure of fossil fuel taxes. Currently, as percentage of price, taxes are lower for more polluting fossil fuels. At the minimum, to address climate change a flat ad valorem tax on fossil fuels is encouraged. But if the country would like to move into an ideal tax system for climate change mitigation, higher ad valorem taxes should be levied on dirtier fossil fuels. This will have serious repercussions on the country's energy mix by providing disincentives to coal plants vis-à-vis renewable energy plants.

4. Fiscal consolidation plans can be tied to climate change by taxing carbon-intensive activities. The Philippines' fiscal position is quite precarious with public debt at around 70 percent of GBP. Fiscal consolidation should be pursued with regard to the country's climate change strategy. Specific recommendations that Congress could consider are the following:

    a. Invest on a national carbon trading scheme and prod local government units (LGUs) to think of green businesses. This will reinforce LGUs' fiscal autonomy and reduce the irreliance on their share of national government tax collections. A way to do this is to highlight success stories of LGUs that earned millions or saved public funds by engaging in provincial biomass plants, methane power plants coupled with earnings from carbon trading credits; and increasing energy efficiency.

    b. Increase government spending on information campaigns that facilitate less carbon intensive growth such as viable businesses that reduce carbon footprint like biomass plants.

    c. Increase taxes for private cars to encourage the use of public transport.

    d. Reflect the real cost of Metro Rail Transit (MRT) and Light Rail Transit (LRT) in the irrespective pricing schemes. The LRT and MRT are heavily subsidized at about PhP30 per passenger.

    e. Nationalize carbon trading by creating a Philippine carbon trading scheme which could also spur investments in the capital markets when the trading scheme is put into the local stock exchange.

    f. The Department of Finance is considering a comprehensive review of the country's tax system due to overlaps in incentives and exemptions that lead to tax leakages. Should there view come to Congress, emissions taxes and mitigation incentives should be considered as part of the new phase of Comprehensive Tax Reform Program.

In no way is the above list exhaustive but this provides an initial list of ways that the Legislative can be engaged in climate-proofing the Philippine economy. It is clear in the list that Congress holds significant power to integrate the country's climate strategy into its economic policymaking. Urgent action is also needed as the longer the action is delayed, the cost of climate adaptation increases.

After all, a 6.7-percent reduction in annual growth is much worse that the effects of suffering through the global financial crisis every year. The job losses and national competitiveness repercussions of inaction would be immense.

# Equipping Human Capital for the Challenges of the Global Economy

For the next set of elected leaders, while fixing the fiscal problem is of utmost importance, equal attention must also be paid to ensuring that the country's human capital is ready for the challenges of the global economy.

Healthy and well educated citizens result in a productive workforce that can ably innovate and compete in an era increasingly driven by knowledge-intensive development.

Recent data however raise concerns on the capability of the future Filipino labor force to compete.

**Table 13. MDG Education Indicators, Philippines**

| | 1990 Baseline | 2015 Target | Latest Data (Year) |
|---|---|---|---|
| Net enrolment ratio in primary education | 84.6 | 100 | 84.8 (2007) |
| Proportion of pupils starting Grade 1 who finish Grade 6 | 69.7 | 100 | 75.3 (2007) |
| Primary completion rate | 64.2 | 100 | 73.1 (2007) |
| Literacy rate of 15 to 24 years old | 96.6 | 100 | 96.6 (2003) |

*Source: National Statistical Coordination Board.*

While there are slight improvements from 1990, the National Statistics Coordination Board (NSCB) points out that with the country's slow progress in the above mentioned indicators, achieving the Millennium Development Goal (MDG) on education by 2015 is highly unlikely.

*The role of education in national development is crucial as it provides professionals and skilled labor for the modernization and strengthening of local industries. Education opens opportunities to fight poverty and also enriches culture and transmits Filipino values from one generation to another.*

The same story holds true for health. The health outcomes of Filipinos improved over the last few decades in terms of longer life expectancy at birth (LEB), lower maternal mortality ratio (MMR), lower child/infant mortality rate (CMR, IMR) and better health outcomes in management of common diseases. However, progress has been slow. The Philippines is LAGGING behind its Asian neighbors.

**Table 14. Progress of Health MDGs Philippines & other Asian countries**

| Country | Infant mortality rate | Maternal mortality rate | Under 5 mortality | Life expectancy at birth |
|---|---|---|---|---|
| Philippines | 25[a] | 162[a] | 34[b] | 67 (total)[c] |
| Thailand | 16.3[d] | 14[d] | 20.4[d] | 71.45 (total)[d] |
| Vietnam | 16[c] | 75.1[c] | 26[c] | 72 (total)[c] |
| Malaysia | 6.3[c] | 30[c] | 8.1[c] | 74.05 (total)[c] |
| Japan | 2.6[c] | 4.9[c] | 3.6[c] | 82.4 (total)[c] |

*a - Statistical Indicators on Philippine Development – Health Services Chapter 2008 (Philippine National Statistics Coordination Board)*
*b - Philippine National Demographic and Health Survey 2008 Preliminary Report (March 2009)*
*c - Statistical Tables 2008 WHO Western Pacific Region*
*d - WHO Regional Office for Southeast Asia Website*
*MMR – per 100,000 live births*
*IMR – per 1,000 live births*

The poor education and health outcomes is attributed primarily to lack of resources for needed intervention and the lack of capacity of a considerable number of Local Government Units (LGUs) to deliver the devolved basic education and health services.

**Proposed reforms and strategies**

***Prioritize adequate funding for human capital development***. Investments in human capital will generate opportunities for growth, including opportunities unforeseen at the time of the investment. Investments in the health, knowledge, and skills of the people are as critical as investments in the more visible, physical capital of the country.

Considering the funding constraints that afflict the education sector, spending on education should be strategic. The timing of education spending matters as well as the amount. Investments in early childhood raise the returns to investments later in life—children must learn how to learn. If they do not, they may never regain the lost ground, leaving a society sapped of potential and scarred by inequality (UN, 2009).

Health is justifiably viewed by many as a right. Poor health and nutrition in early childhood seems to have a first-order impact on both growth and equality. It does so by causing lasting harm to a child's ability to acquire cognitive and noncognitive skills as he or she moves up through school— harm that is impossible or very difficult to reverse. In a world where cognitive skills are rising in value, this damage will jeopardize equality of opportunity, and, if widespread, impair a country's economic potential far into the future (UN, 2009).

***Reform the social health insurance program.*** Expanding coverage of the National Health Insurance Program (NHIP) will reduce the financial burden on individual families through effective social risk pooling. Full subsidy of premiums by the national government for indigent members is proposed. Subsidies for the National Food Authority (NFA), which registered a high leakage rate of 71 percent and low coverage rate of 18% (Manasan, 2008) maybe reduced substantially and diverted to fund the premium payments of the National Government for indigents. Reforming the premium-benefit structure to favor lower income groups and strengthening NHIP's system to ensure value for the money it spends on benefits is also called for.

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