

**2007 PHILIPPINES DEVELOPMENT FORUM**  
**8-9 March 2007, Cebu City, Philippines**

***Achieving Broad-based Growth by Sustained Reforms and Higher Investment***

**I. BACKGROUND**

1. The Forum was the third annual gathering of the consultative group held under the revised format introduced in 2005 to facilitate more inclusive participation leading to action-oriented activities to support the Philippines development agenda. The Philippines Development Forum (PDF), which is a year-round *process* built around regular meetings of seven thematic working groups<sup>1</sup>, is chaired by Finance Secretary Margarito Teves and co-chaired by World Bank Country Director. This year's meeting included about 250 participants from the executive, legislative and judicial branches of government, local government, government agencies, business community, civil society, academia, and bilateral and multilateral development partners. Both President Gloria Macapagal-Arroyo and Vice President Noli de Castro addressed the Forum, and received briefings on the principal recommendations. Development partners welcomed Government's willingness to dialogue in such an open way with representatives of all key stakeholder groups. PDF documents are available at the web site: [www.pdf.ph](http://www.pdf.ph).

2. The first PDF (Davao, March 2005)<sup>2</sup> focused on the limited window of opportunity to grasp the then favorable domestic and international circumstances to initiate the difficult measures to reduce fiscal vulnerability. The PDF characterized 2005 as *the year for tax legislation*. The second PDF<sup>3</sup> acknowledged the significant progress during the past year and agreed that the country had moved away from perceived acute risk of instability to generating a virtuous circle of fiscal reform, concrete progress, and restored market confidence. It characterized 2006 as *the year for enhanced tax implementation*. Attachment 1 summarizes the principal actions recommended by the second PDF; the PDF website includes a detailed summary of the status of progress over the past year.

3. This year's PDF congratulated Philippines on meeting its targets for fiscal consolidation, the benefits of which are seen in such things as lower interest costs and borrowing spreads, lower inflation, and more favorable perceptions by financial markets. Especially commendable was the 20% increase in tax revenues, which helped to raise the tax/GDP ratio from 13% in 2005 to 14.3% in 2006, the first significant increase since 1997. The PDF characterized the year ahead as one for consolidating fiscal reform, and leveraging it to support broad-based growth through sustained reforms and higher investment. ADB noted Philippines could now expect a strong dividend from Government's fiscal consolidation success, which has the potential to be a tipping point for the economy by (i) creating budget space and policy space for addressing other development constraints; (ii) confirming the capacity and willingness of the authorities to deliver on key elements of the development agenda; and (iii) crowding in private participation and additional ODA support. However, ADB also noted the need to avoid

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<sup>1</sup> The seven working groups, each chaired by a senior Government official (often at secretary level) and co-chaired by a development partner, are: (i) economic and fiscal reform; (ii) the Millennium Development Goals (MDGs) and social progress; (iii) Mindanao's peace and post-conflict development; (iv) decentralization and local government; (v) growth and investment climate; (vi) governance and anti-corruption; and (vii) sustainable rural development.

<sup>2</sup> *2005 Philippines Development Forum*, Board Information Paper IN.75-05, 8 April 2005.

<sup>3</sup> *2006 Philippines Development Forum*, Board Information Paper, IN.152-06, 26 June 2006.

any complacency, as fiscal consolidation is but a means to the ends of higher growth and less poverty, and very significant challenges remain.

4. In accordance with commitments made by Philippines and development partners under the *Paris Declaration*<sup>4</sup>, harmonization and development effectiveness is integral to PDF deliberations. The Philippines is customizing the Paris Declaration to the country's circumstances, with support from ADB technical assistance<sup>5</sup>. As was done last year, ADB facilitated a pre-PDF workshop, at which Government informed development partners of progress towards meeting its Paris declaration commitments. Feedback from development partners was strongly supportive, acknowledging the efforts that place Philippines among the leaders in this effort to achieve greater development impact.

## II. DISCUSSION HIGHLIGHTS<sup>6</sup>

### a. Achieving Broad-based Growth: the Millennium Development Goals (MDGs) and Investing in Human Development

5. Enhancing social inclusion, including reductions in income poverty and lack of access to services, continues to be a major challenge for the Philippines. The social sectors (education, health, water and sanitation) have suffered a declining share of the budget since 1999, and have been hurt disproportionately by expenditure compression as part of the fiscal consolidation effort. Constrained spending complicates achievement of some of the MDGs; participants were informed that the MDG goals remain severely under-funded. For example, erosion in the quality of basic education was noted, characterized by overcrowded classrooms, poor instruction, lack of materials, and high drop-out rates. In this context, the PDF noted that benefits of growth must be more widely shared, partly by more closely linking the economic and social policy agendas. At the macro level, the improved fiscal situation provides opportunity for improving service delivery, while a better investment climate will support job creation.

6. Participants agreed there is a need to invest in human development through higher financing of social sectors, and supported Government's intention to allocate a major portion of increased tax revenues to that end. However, positive outcomes will depend on better execution of the planning-budgeting-investment process, including development and adherence to a multi-year financing framework. To augment public spending, more partnerships with the private sector for service delivery need to be explored. Participants prioritized needs for front-loading investments for basic education, complementing enhanced financing with regulatory efforts in the health sector that would provide effective social protection and lower the cost of drugs and services, ensuring better maternal health, and containing the threats of HIV/AIDS and avian influenza.

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<sup>4</sup> *The Paris Declaration on Aid Effectiveness*, 2 March 2005, commits about 60 partner countries (including Philippines) and more than 50 multilateral (including ADB) and bilateral development institutions to supporting an agenda of (i) *partner country ownership*, (ii) development partner *alignment* with partner country priorities, (iii) *harmonized* processes and procedures to reduce transaction costs, (iv) *managing for results* focusing on impact and outcomes rather than inputs and outputs, and (v) *mutual accountability* for development results.

<sup>5</sup> ADB. November 2005. *Harmonization and Managing for Results*, for \$700,000. Among others, support is provided for harmonizing policies and procedures related to procurement; financial management and audit; environment; gender; land acquisition and resettlement.

<sup>6</sup> This summary reflects the deliberations of the PDF's four parallel break-out sessions.

7. Participants noted that, as with other aspects of the development agenda, improved service delivery and better access will depend on good governance and sustained anti-corruption efforts. Better economic governance, particularly in the fiscal process, will contribute significantly to generating resources for social spending. To avoid leakages, channeling funds directly to front-line providers will be encouraged. Civil society participants sought a greater role in ensuring accountability for disbursement of public funds for social sectors. In support of better governance, participants noted the need to improve monitoring of key indicators disaggregated to local government level, who are mandated to deliver many of the social services.

8. There was concern about the Philippines' high population growth rate and its negative impact on achieving broad-based growth and reduced poverty. Some participants called for a more proactive role from the national government, to supplement local governments' efforts. Concrete population management solutions and partnerships which operationalize population policies are needed. The PDF called for preparation of a Social Protection Strategy to address needs of the poor and vulnerable. It noted also the vulnerability of Philippines to natural disasters, the link between poverty and disasters, and the need for better disaster preparedness and response.

**b. Sustaining Fiscal Progress: Strengthening Revenue Collections, Implementing the 2007 Expenditure Program, Intensifying Governance Reforms**

9. The PDF congratulated Government on its success in reducing the fiscal imbalance. Participants cautioned, however, the need to avoid any sense of complacency as much remains to be done to ensure fiscal sustainability. The overall recent success is tempered by a degree of vulnerability. For example, further progress relies on a good working relationship between the executive and legislative branches of government for actions requiring legislation, while the mandatory budget spending item for debt service (one third of total spending) is susceptible to unfavorable exchange rate and interest rate movements. Furthermore, meeting the target for a balanced budget by 2008, while increasing expenditure in priority areas, will require an increase in tax/GDP ratio of about 2.5 percentage points during 2007-2008, compared to an increase of 1.2 percentage points in 2005. Difficult decisions will be needed on tax levels (eg, inflation-indexing of excise taxes), and rationalizing fiscal incentives to phase out redundant elements. Efforts to improve tax administration will have to continue and intensify. As one indicator of the need to improve tax enforcement, the record of successful prosecutions of high profile tax cheats in the courts remains low<sup>7</sup>.

10. Government outlined its revenue enhancing measures, including: (i) monitoring targets under the ongoing tax reform administration group (TRAG); (ii) prosecuting high profile cases under the Run After Tax Evaders (RATE) and Run After The Smugglers (RATS) programs; (iii) linking the databases of the Bureau of Internal Revenue, Social Security System, Securities and Exchange Commission, Land Transportation Office, among others, to share information and limit tax evasion; and (iv) auditing tax assessments by a neutral agency.

11. Participants noted that fiscal targets need to be achieved through increased revenues and higher quality spending rather than from compressed expenditure. Improving the quality of government spending will rely on upgrading the quality of public

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<sup>7</sup> The effort is supported by ADB's preparation of a comprehensive process map for the prosecution of tax evasion in Philippines, including identifying impediments to convictions.

expenditure management, including implementing reforms such as the multi-year medium-term expenditure framework, organizational performance indicator framework, and the new government accounting system. Expenditure leakage will be reduced by wider application of public procurement reforms and enhanced budget transparency measures. The PDF recognized the valuable contribution that could be made by improved governance and management of government-owned and controlled corporations; several participants specifically noted that the National Food Authority could be a source of significant fiscal savings.

12. Philippines continues to labor under perceptions of endemic corruption, and often Government feels that its efforts to redress the situation are not well known. Indeed, the immediate reaction to the latest corruption perception survey of Political and Economic Risk Consultancy, which identified Philippines as the most corrupt of 13 Asian countries, was to claim the survey did not reflect reality. To address this, the PDF proposed Government invest in an information system identifying monitorable indicators to assess and publicize the effectiveness of anti-corruption efforts. The Integrity Development Review<sup>8</sup> was proposed as a means to gauge corruption vulnerabilities of selected agencies, and to monitor their progress in addressing vulnerability to corruption. Another proposal to show Government's commitment to good governance was to increase the budget allocation of the Office of the Ombudsman and invest in its capacity-building.

### **c. Enhancing Competitiveness: Reducing Transaction Costs, Supporting a Seamless Infrastructure Network, Ensuring Energy Cost-Efficiency and Self-Sufficiency**

13. The PDF noted that international competitiveness surveys give a low rank to Philippines, reflecting such things as poor quantity and quality of infrastructure, high costs of doing business, and restrictions on entry to and lack of competition in protected sectors. On its part, Government identified five strategic measures to strengthen and sustain the country's competitiveness: plentiful food at reasonable prices to lower the cost of labor; a lower cost for electricity; modernized infrastructure to support efficient movement of goods and people; better knowledge dissemination to upgrade technologies and productivity; and reducing red tape to lower business transaction costs.

14. Under Government's comprehensive integrated infrastructure program 2006-2010 (CIIP), total investment is estimated at almost P2 trillion (\$40 billion, or \$8 billion per year), 43% of which is expected to come from the national government, 33% from the private sector, 17% from government corporations, and 7% from other sources. Illustrative of the urgency in reducing the infrastructure deficit, Government presented 10 priority infrastructure projects while the private sector presented another 20. Many of the projects could be fast-tracked, as they are at advanced stages of preparation. Adherence to the Government's existing project screening process through the interdepartmental Investment Coordinating Council was stressed for coordination of priorities and assessment of budget implications. It was proposed also to develop a water sector comprehensive policy and institutional framework.

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<sup>8</sup> The IDR is designed to contribute to prevention of corruption in the public sector, based on three pillars: (i) systems diagnostics to identify vulnerabilities to corruption; (ii) recommending safeguards for efficient and transparent systems and service delivery; (iii) monitoring corruption prevention safeguards. In 2006, IDRs were conducted for Bureau of Customs, Bureau of Internal Revenue, Land Transportation Office, Department of Works and Public Highways, and Philippine National Police.

15. The PDF noted that the cement industry, maritime transport, civil aviation and agriculture are four areas in which prospects are significant for generating investment and creating new jobs through competition. Just as Philippines telecommunications deregulation in the 1990s produced jobs in information technology and the business processing outsourcing industry, effective competition in these industries could lead to significant economic gains. Reform of the cement industry could reduce what are one of the highest prices in Asia, undermining competitiveness across a broad range of activities. The cost of exporting a 20-foot container from Philippines is 60%-300% higher than in other Asian countries. More competition in the civil aviation sector would benefit overseas workers and underwrite tourism. Protection of agricultural outputs, including rice, and heavy involvement of the National Food Authority in marketing, have raised the price of food and reduced labor market competitiveness.

16. For promoting competition in the Wholesale Electricity Spot Market the government plans to accelerate privatization of generation assets in 2007 including the privatization of TRANSCO under the Electric Power Industry Reform Act (EPIRA) framework. Participants welcomed the move believing that it would eventually augment long-term power supply capacity, yield operational efficiencies, and reduce costs.

**d. Nurturing Regional and Local Growth: Enhancing Local Government Services, Sustaining Rural Development, Focusing on Mindanao**

17. Economic growth is constrained by limited own-resource generation by local government units (LGUs), and their limited access to other funding sources. At the local levels, rollout of governance reforms and consolidated capacity-building programs for LGU) were called for to match the need of LGUs for financing and affordable credit for development projects. The meeting noted what could be inter-LGU cooperation in planning and financing complementary infrastructure requirements to take advantage of scale economies. Investment plans that are co-terminus with the political election cycle also inhibit productive and sustainable investments. The PDF encouraged LGUs to work towards investment plans which transcend the three-year terms of elected officials.

18. Participants discussed rural development in the context of competitiveness and agricultural profitability, and a strategic for land use administration and distribution. Efforts to expand agricultural market access, promote convergence of service delivery between national agencies and LGUs include prioritizing public expenditure for rural development. Resolution of the issue on the extension of the timetable for implementing the Comprehensive Agrarian Reform Program (which expires in 2008) was encouraged.

19. At last year's PDF, President Arroyo encouraged partners to begin committing resources to the Mindanao Development Fund grant facility, even before a peace agreement is signed with the Moro Islamic Liberation Front (MILF). In response, several development partners have provided capacity building assistance to the Bangsamoro Development Council<sup>9</sup>. However, the poor peace and order situation in some areas of Mindanao discourages investments. Concluding a peace agreement with the MILF would support a more favorable climate for investments in Mindanao.

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<sup>9</sup> While ADB expects to support the grant-based Mindanao Development Fund after a peace agreement is signed, it will continue to provide loans and technical assistance for Mindanao operations in the usual manner.

**PHILIPPINES DEVELOPMENT FORUM 2006 ACTION PLAN and IMPLEMENTATION**(A detailed summary of progress made over the past year is available at [www.pdf.ph](http://www.pdf.ph))

Sector / Cluster	Proposed actions
Economic and Fiscal Reforms	<ul style="list-style-type: none"> <li>• Improve tax effort by 1.4% of GDP in 2006</li> <li>• Achieve a deficit of not more than P125bn or 2.1% of GDP for 2006</li> <li>• Achieve a balance budget by 2008 for National Government and budget surplus for consolidated public sector deficit by 2008</li> <li>• Sustain improvements in tax administration</li> <li>• Accelerate reforms in the power sector</li> <li>• Passage of revenue bills by end 2006: consolidated fiscal incentives; simplified net income tax.</li> <li>• Adopt plans for better oversight of Government Owned &amp; Controlled Corporations</li> </ul>
Governance and Anti-Corruption	<p>Governance</p> <ul style="list-style-type: none"> <li>• Revive multi-year budgeting system for 2007 budget (medium-term fiscal expenditure planning in 2007)</li> <li>• Develop integrated government financial management and information system</li> <li>• Completion of the government e-procurement system and compliance monitoring</li> <li>• Complete the rationalization program and review and revise the compensation scheme</li> <li>• Passage of the fiscal responsibility bill</li> </ul> <p>Anti-corruption</p> <ul style="list-style-type: none"> <li>• Develop performance indicators and monitoring mechanisms to objectively measure results of anti-corruption reforms</li> <li>• Develop comprehensive communication plans to inform public on gains and benefits of anti-corruption initiatives</li> <li>• Promote accountability and sustain capacity building through active participation of CSOs/NGOs/local institutions</li> <li>• Mainstream and operationalize the National Anti-Corruption Plan of Action (NACPA) process</li> </ul>
Infrastructure	<ul style="list-style-type: none"> <li>• Upgrade transport, tourism, and digital infrastructure</li> <li>• Enhance communication strategy on government infrastructure programs</li> <li>• Enhance preparation, financing and credit in projects</li> <li>• Increase infrastructure to GDP spending from 2.2% to 4-5%</li> <li>• Develop and adopt clear guidelines for infrastructure project financing</li> </ul>
Investment Climate	<ul style="list-style-type: none"> <li>• Coordinate with national line departments for a unified position on rationalization of fiscal incentives</li> <li>• Secure passage of rationalization of fiscal incentives bill</li> <li>• Pursue energy independence and competitive power rates</li> </ul>
SMEs	<ul style="list-style-type: none"> <li>• Develop communication plan to inform local governments on best practices and benefits of formalization of informal businesses</li> </ul>

	<b>Proposed Actions</b>
Millennium Development Goals and Social Progress	<ul style="list-style-type: none"> <li>• Advocate for a stronger national population management policy/legislation and program</li> <li>• Adopt a multi-year budgeting framework starting 2007 for the social sector</li> <li>• Secure additional revenues from fiscal reforms and savings from debt servicing to benefit social programs</li> <li>• Scale up community-based monitoring system (CBMS)</li> <li>• Strengthen coordination and harmonization of sector-wide approaches and adoption of harmonized gender and development (GAD) guidelines</li> <li>• Address human resource development and management challenges across social sectors in a concerned manner</li> </ul>
Rural Development	<ul style="list-style-type: none"> <li>• Harmonize programs of Departments of Agriculture, Agrarian Reform, and Environment &amp; Natural Resources</li> <li>• Harmonize national government initiatives with local governments</li> <li>• Promote income diversification or income-enhancing activities</li> </ul>
Mindanao	<ul style="list-style-type: none"> <li>• Increase social mobilization activities</li> <li>• Develop multi-year funding for projects in Mindanao</li> <li>• Design a workable disarmament/decommissioning program with donor community support and local government involvement</li> <li>• Conduct of environmental mapping especially in conflict areas</li> <li>• Increase support to basic services, peace building effort, social protection and institutional strengthening</li> </ul>
Decentralization and Local Government	<ul style="list-style-type: none"> <li>• Adopt and implement common framework for local government financing; strengthen Bureau of Local Government Financing</li> <li>• Develop strategy to harmonize capacity building programs in local governments in for financial management, expenditure allocation, revenue generation, investment program and project development</li> <li>• Implement mechanisms for enhancing information sharing among stakeholders</li> <li>• Support full implementation, supervision and enhancement of local government performance monitoring system (LGPMS) and local government financial performance monitoring system (LGFPMs)</li> <li>• Implement agreements or action plans for further devolution in agriculture, environment, and natural resources</li> <li>• Review and revise the Local Government Code of 1991 and Internal Revenue Allotment formula</li> </ul>