

2008 PHILIPPINES DEVELOPMENT FORUM
26-27 March 2007, Clark, Pampanga, Philippines

Accelerating Inclusive Growth and Deepening Fiscal Stability

I. BACKGROUND

1. The Forum was the 4th 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 groups¹, is chaired by the Philippines Finance Secretary and co-chaired by World Bank Country Director. This year's meeting included more than 300 participants from the executive, legislative and judicial branches of the government, local government, business community, civil society, academia, and the international development community. President Gloria Macapagal-Arroyo and Vice President Noli de Castro addressed the Forum. The forum format involved limited plenary sessions and three parallel break-out sessions: (i) accelerating growth through improved competitiveness; (ii) creating opportunities for more inclusive growth; and (iii) deepening macro-fiscal stability and improving governance. The Government discourages participants from reading prepared statements, preferring to engage in real-time dialogue. This process worked well, resulting in a lively exchange of ideas.

2. The first PDF² 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, and characterized 2005 as *the year for tax legislation*. The second PDF³, which acknowledged significant progress in moving away from perceived acute risk of instability to generating a virtuous circle of fiscal reform, concrete progress, and restored market confidence, characterized 2006 as *the year for enhanced tax implementation*. The third PDF⁴ recognized the successful efforts in meeting fiscal consolidation targets and characterized 2007 as *the year for fiscal consolidation*.

3. The full set of PDF documents, including those tabled by ADB, and the PDF monitoring framework, are available at the web site: www.pdf.ph.

II. OPENING PLENARY SESSION

4. This year's PDF, under the theme *Accelerating Inclusive Growth and Deepening Fiscal Stability*, commended Philippines for its robust economic performance in 2007 in terms of: 7.3% growth of gross domestic product (GDP), the highest in three decades, alongside low inflation; substantially lower fiscal deficit of 0.2% of GDP; record high gross international reserves of \$33.8 billion, providing about 6 months of import coverage; and upgraded credit rating by international credit agencies. Participants underscored the imperative of strengthening reforms to sustain growth and progressively build on the dividends from recent economic gains. In view

¹ 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.

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

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

⁴ *2007 Philippines Development Forum*, Board Information Paper, IN.53-07, 2 April 2007.

of reported increasing poverty incidence, the PDF characterized 2008 as the year for deepening reforms to ensure that growth is sustained and more inclusive.

5. In her keynote address, President Arroyo highlighted the “three E” priority thrusts for Government’s budget—economy, education, and environment; and highlighted the need to increase investment by referring to the “three I action plan—investment, investment, and investment”. Vice President de Castro, in his opening remarks, gave a clear assessment of the challenges still facing the Philippines, noting that the country’s development agenda is very much “work-in-progress” with a need to focus on (i) promoting sustainable income generation; (ii) globalization and its impact on food prices; (iii) deepening fiscal reforms; (iv) good governance and sound business process; and (v) efficiency and effectiveness.

6. The private sector, represented at the opening plenary session by Jaime Antonio Zobel de Ayala, highlighted the issue of governance and strengthening the value of trust in private and public institutions. The country must build on a progressive governance standard, fostering clear adherence and enforcement of the rule of law, transparency, respect for the sanctity of contracts, and consistency in policies and regulations. He also noted the imperative of focused public sector investment geared towards raising the productivity of labor and lowering the cost of doing business to ensure competitiveness relative to other investment destinations.

7. Civil society, represented by Fr. Francis Lucas of the Asian NGO Coalition for Agrarian Reform and Rural Development, likewise focused on governance noting that “bad governance leads to exclusive growth”. He noted the importance of rural development in attaining inclusive growth, focusing on the need for creating opportunities for the rural poor through better access to land and basic social services, particularly education and health. The key to inclusive growth is participation and ownership—development becomes inclusive only when the poor are able to participate as able stakeholders and partake in economic gains.

III. ADB’s PARTICIPATION

8. ADB had one of the largest delegations, enabling it to participate actively in each of the three parallel break-out sessions. During the plenary session, ADB attributed the country’s macroeconomic success to (i) a shared sense of responsibility and accountability among Filipinos and development partners; (ii) commitment and competence of the economic management team; and (iii) addressing the right priorities by the right actions, which has created a virtuous cycle of reform, improved economic performance, and stronger buy-in from stakeholders.

9. ADB highlighted that recent economic success is a dividend of sound management and robust partnerships which honor the Paris Declaration of Aid Effectiveness. The Philippines has emerged as a leader in implementing the principles of the Declaration, successfully customizing its global aspirations for the Philippines-specific circumstances. ADB recognized the link between economic success and the ADB-Philippines operational engagement, under which ADB has moved to its high-case lending scenario.

10. ADB concluded by emphasizing that while high growth is good, sustainable high growth is better, and growth that is high, sustained and inclusive is best of all⁵. ADB drew the attention

⁵ For the transcript of ADB’s plenary session intervention, see www.pdf.ph.

of participants to its recently published *Philippines: Critical Development Constraints*⁶, which uses a rigorous analytical framework to undertake a growth diagnosis of the Philippine economy and to identify the key constraints to higher, sustained and more inclusive growth. ADB set up a display at which this study and others publications on the ADB-Philippines partnership, were available to PDF participants⁷.

IV. BREAK-OUT SESSION DISCUSSION HIGHLIGHTS⁸

a. Accelerating Growth through Improved Competitiveness

11. While the Philippines' growth trend has improved to 5.8% during 2002-2007 from about 3% during 1990-2000, growth has been led largely by private consumption spending which in turn is heavily dependent on remittances of overseas workers. Despite strong GDP growth, there has been continued sluggishness in investments and manufacturing. The share of capital formation to GDP has declined from 20% in 2003 to 17% in 2007, while manufacturing growth has decelerated steadily since 2005. The Government noted that the Philippines has not attracted its potential share of foreign investments, notwithstanding overall positive macroeconomic performance. Participants noted key constraints to the country's competitiveness include: (i) inadequate infrastructure; (ii) weak human resource base due to inadequate investment in health and education; (iii) urban-biased policies and public investments resulting in the narrow-based growth; and (iv) lack of competition in some sectors (from oligarchic power structures, regulatory capture, and restrictions on foreign participation).

12. Participants reiterated the importance of increasing investments as they provide a more stable source of growth that boosts the economy's resilience amidst volatile global conditions. Fundamental to improving the investment climate is addressing infrastructure bottlenecks. In line with this, participants noted the several imperatives: (i) higher investments in priority infrastructure projects; (ii) transparency in implementation of projects; (iii) close coordination between the executive branch and judiciary to address technical and legal issues affecting project implementation; (iv) clear competition policies; (v) capacity building for infrastructure planning and development; (vi) enhanced planning-budgeting-funding linkages; (vii) balance between affordability to the poor and industry competitiveness; and (viii) regard for social and environmental sustainability. In this context, the creation of a separate Infrastructure Working Group under the PDF is being considered.

13. Under the Government's updated 2007-2010 Comprehensive Infrastructure Investment Program (CIIP), total investment is estimated at about P2.1 trillion (\$52.5 billion), 59% of which is expected to come from the national government, 28% from the private sector, 7% from government corporations and government financial institutions, and the rest from other sources. Illustrative of the urgency in reducing the infrastructure deficit, Government presented 10 priority infrastructure projects for private financing, mostly involving road and power projects.

14. Participants highlighted the several measures to foster investment and entrepreneurship, and raise labor productivity: (i) completion of the Comprehensive Agrarian Reform Program; (ii) livelihood diversification programs (off-farm employment) for agri-based communities; (iii) strengthening of land use policy; (iv) credit mechanisms responsive to farmers and small and

⁶ ADB. December 2007. *Philippines: Critical Development Constraints*. Manila. The study is the first of a series being managed by the Economics and Research Department under a regional technical assistance project.

⁷ Including: ADB. 2008. *Impact Stories*. Manila. This publication, prepared by PhCO, presents a series of success stories, and the positive impacts of the ADB-Philippines partnership.

⁸ This summary reflects deliberations of the PDF's three parallel break-out sessions.

medium enterprises; (v) streamlined business regulations; and (vi) demand-driven curriculum to match human resource requirements.

b. Creating Opportunities for More Inclusive Growth

15. Participants noted that advancing social inclusion, particularly reducing income poverty, remains a key development challenge. Amidst high economic growth, it is disconcerting that poverty incidence rose to 33% of the population in 2006 from 30% in 2003, while income inequality remains high with the richest 10% of the population capturing more than one third of the country's total income. Participants emphasized that economic growth is insufficient without investing in the social sectors. As such, social growth is not an “add-on” but a pre-condition for inclusive growth.

16. In terms of the Millennium Development Goals (MDG), while there has been progress in some areas (nutrition, gender equality, reducing child mortality, combating HIV/AIDS, malaria and other diseases, access to safe drinking water and sanitary toilet facilities), the Philippines needs to strive harder if it is to reach certain targets, specifically those on poverty and hunger, education, maternal and reproductive health. There are wide disparities in MDG progress across regions, with most lagging locations in Mindanao.

17. While Government was commended on its higher spending on social sectors in recent years, there was consensus that further increases are required. The Philippines' allocation for social services is low in comparison with international benchmarks of 40% share in the national budget, particularly 6% share of GDP in education, 5% for health and 7.8% for social services (current share of social programs is only about 30% of the national budget and 2.4% of GDP). Mobilizing public-private sector partnerships were highlighted as a way to more effectively finance and implement MDG programs.

18. The PDF acknowledged Government's piloting the *Ahon Pamilyang Pilipino (APP) Conditional Cash Transfer* program in 2007. The APP aims to enable the poorest households to spend for education and health. It is a convergent program linked with other government programs such as the Basic Education Sector Reform Agenda and the Health Sector Reform Agenda. Participants recognized the potential of APP to be the backbone of social protection strategy in the Philippines. The program can also provide the basis of a national household poverty targeting system that could be adopted for other programs such as the PhilHealth Indigent subsidy.

19. To address the rapidly deepening implications of rising food prices, ADB proposed establishing an inter-agency task force to examine in a holistic framework various issues relating to the rice subsector (e.g. pricing, strategic reserves, tariffs), as well as assessing medium- to long-term solutions on food security and agricultural productivity. The proposal was endorsed by the PDF partners and accepted by Government.

20. Participants underscored the need for the government and the Moro Islamic Liberation Front to continue negotiations to settle the long-running conflict in Mindanao which has worsened poverty in the area (11 of the 20 poorest provinces of the country are in Mindanao). The ongoing review of the 1996 Peace Agreement with the Moro National Liberation Front was taken positively. Development partners agreed to work on a unified strategy for conflict-affected areas. The need to develop Mindanao's agricultural sector and supporting infrastructure was also emphasized.

c. Deepening Macro-Fiscal Stability and Improving Governance

21. Government's significant progress in fiscal consolidation is commendable but more efforts are required to ensure sustainability and adequate fiscal space for development spending. The low deficit achieved in 2007 was mainly a result of privatization revenues. Efforts to shore up tax revenues faltered with the tax effort declining to 14% of GDP in 2007 (from 14.3% in 2006). This has raised concerns about the Government meeting its tax effort target of 16.6% by 2010, especially in view of structural erosion caused by non-indexation of excise taxes to inflation and the lowering of corporate tax rates as mandated by the EVAT law. Participants reiterated the imperative of strengthening tax administration on a sustainable basis to finance priority infrastructure and social services projects without jeopardizing fiscal stability.

22. Government outlined its major revenue enhancing measures: (i) prioritizing legislative measures through simplified sin taxes, rationalization of fiscal incentives, simplified net income taxation system, and excise tax reforms; (ii) strengthening tax administration through enhancements in tax registry and audit mechanisms, reinforcement of "Run after Tax Evaders" (RATE) and Run after the Smugglers (RATS) programs; (iii) upgrading skills and competencies of revenue agencies; and (iv) adopting technology-based tax administration (e.g. electronic systems).

23. The PDF highlighted the overarching challenge of good governance, particularly addressing corruption. Most governance indicators in the Philippines have deteriorated over the last decade and have fallen below the average of other Asian economies. The representative from business community noted that the Philippines should work towards progressively higher governance standards in both the public and private sectors.

24. Government reported on its efforts to developing a holistic framework for reducing corruption, including the passage and implementation of the omnibus public procurement law and strengthening of the Office of the Ombudsman. Deepening procurement reform remains a priority. While the procurement law provides a robust framework, it is sometimes compromised by slow and inefficient enforcement. Participants expressed support to Government's proposal to bring all ODA within the ambit of the Public Procurement Reform Act. Participants also appreciated Government's proposal for consultations to firm up the Implementing Rules and Regulations (IRR-B) governing procurement for ODA-financed projects.

25. Participants welcomed the establishment of the Procurement Transparency Group which has strong civil society participation, and supported plans for creating a similar body to monitor tax collection and smuggling cases. Government's implementation of the Integrity Development Review, which assesses corruption vulnerabilities of high-risk agencies and projects, likewise gained support.

26. To improve the quality of public spending, Government highlighted several initiatives: deepening results-based budgeting; strengthening internal audit capacities; and harmonizing budget, accounting, audit procedures and reporting requirements by oversight agencies, local government units and development partners.