

## Chapter 5

# Summary, Conclusions, and Policy Implications

The Philippines, under a succession of administrations since 1986, has been committed to sustained growth of income and employment, stable prices, poverty eradication, and improved distribution of income and wealth in an open-economy setting. In pursuit of these development goals, the national and local governments have ushered in wide-ranging economic and social policy reform programs.

Under these reform programs, real GDP doubled between 1986 and 2006—a growth rate of about 3.5% each year. However, this pace of growth leaves much to be desired when compared with that of many of the Philippines' East and Southeast Asian neighbors. In recent years, growth has picked up and in the first three quarters of 2007 real GDP grew at about 7%. But there is no room for complacency. Private investment remains weak, raising the question of whether the current pace of growth is sustainable. In 2003, about 25% of families and 30% of the population still lived in poverty, a reminder of the difficulties that many individuals are still going through. And inequality in the distribution of household incomes remains high by regional standards.

Moving forward, the challenge for the Philippines is to sustain the current pace of growth or even accelerate it, while making every Filipino a winner in the growth process. To meet this challenge, a key step is to identify the most critical factors that constrain growth and poverty reduction. The diagnostic approach this study adopted to identify the critical constraints is informed by basic insights from recent literature that seeks to account for international differences in the levels and growth rates of per capita income. Once the most critical constraints have been identified and prioritized, targeted efforts at relaxing them may unleash profound spurts of growth and poverty reduction that can be sustained well into the future.

### A. Critical Constraints to Growth and Poverty Reduction

Many factors are at work in the growth and development process, but in the long run, a country's prosperity and the welfare of its people are determined by the accumulation of physical and human capital, their efficient utilization, and equitable access to the opportunities that the growth and development process generates. What factors have been hindering these in the Philippines? Using a variety of evidence—macroeconomic, financial, and social indicators; findings from investment and business surveys; regression analysis; insights from in-depth case studies; and benchmarking with other similarly situated countries—the study determined that the following are critical constraints to growth and poverty reduction in the Philippines during the next 5–8 years:

- Critical constraints to growth are
  - (i) tight fiscal situation;
  - (ii) inadequate infrastructure, particularly in electricity and transport;
  - (iii) weak investor confidence due to governance concerns, in particular, corruption and political instability; and
  - (iv) inability to address market failures leading to a small and narrow industrial base.
- Critical constraints to poverty reduction are
  - (i) lack and slow growth of productive employment opportunities;

- (ii) inequitable access to development opportunities, especially education, health, infrastructure, and productive assets; and
- (iii) inadequate social protection and social safety nets.

Many of these critical constraints are interlinked. Only when the fiscal situation sufficiently improves will the Government be in a position to allocate more resources to infrastructure investment. However, improved infrastructure alone is not enough to lower the cost of doing business and to stimulate private investment. Better infrastructure has to be accompanied by significant improvements in investor confidence, which can be done through the Government adequately addressing governance concerns by implementing initiatives aimed at reducing corruption and improving political stability. Removing these three constraints (e.g., tight fiscal space, inadequate infrastructure, and weak investor confidence) will result in increased private investments from domestic and foreign sources. But, to ensure that growth can be sustained at a high level similar to that achieved by many Southeast and East Asian economies in recent decades, the Government will also need to address the market failures (such as information and coordination externalities) in order to encourage investments in diversifying and expanding the manufacturing sector and exports, and in upgrading the level of technology.

Sustained and high growth, resulting from removing its critical constraints, will create more productive employment opportunities. This is essential because insufficient employment is the most critical constraint to poverty reduction in the Philippines. But expansion in employment opportunities may not lead to significant poverty reduction unless inequalities in access to development opportunities are reduced and removed by instituting good governance and better policies. Removal of constraints due to unequal access will greatly help accelerate the pace of poverty reduction, but they may not suffice to reduce poverty sufficiently unless the inadequacies in the social safety nets are addressed so as to keep the most vulnerable groups, such as the old-aged and destitute, from extreme deprivation. Similarly, people who graduate from poverty may still be vulnerable to natural disasters or economic shocks unless the inadequacies in the social protection are addressed.

Governance concerns not only weaken investor confidence, they underlie most other critical constraints just listed. For instance, corruption undermines tax collection, political instability hinders investment and growth and reduces the tax base, and both contribute to the “tightness of the fiscal space.” Poor conditions of infrastructure are a result of insufficient development spending and of poor governance, which causes leakages and improper appropriation of public funds. Similarly, poor governance hinders the pace of poverty reduction, as it reduces growth of incomes and productive employment opportunities. It is also a major contributing factor to inequalities in access to education, health, infrastructure, and other productive assets, as well as to weaknesses of many poverty reduction programs. Therefore, addressing governance concerns will go a long way toward relaxing the critical constraints to growth and poverty reduction and should be made a top development priority in the Philippines.

The study looked at other possible constraints (such as the level of domestic savings, the efficiency of domestic financial intermediation, the cost of international borrowing, and the stock of human capital) and found them to be less critical than the ones just listed. However, in the longer term, as the Philippine economy reaches a higher growth trajectory, some constraints that are currently less critical could become more so. They include the needs for a higher level of domestic savings and for a higher skill and knowledge base to support the development of new and emerging industries.

## **B. Overcoming the Constraints to Growth and Poverty Reduction**

Some of the constraints identified are well recognized and have been the focus of the Government’s policy and reform agenda in recent years. Thus, this study confirms their continued relevance and points to the need for more concerted efforts to overcome them. Other critical constraints identified have been less well recognized and discussed and, therefore, the study offers some new thinking on and new insights into the development problems the Philippines faces. The following policy priorities are proposed to address the constraints and are for the Government’s consideration.

### (a) Expanding the Fiscal Space

Despite significant Government efforts in fiscal consolidation and tax reform since 1986 (Box 3), the fiscal situation remains very tight. Expanding the fiscal space requires further action on at least two fronts—taxation and government spending. Many measures could be taken on both fronts, but the following are the top priorities.

- **Institute efficient tax collection machinery.** Making the tax collection machinery efficient should be the top priority for improving revenue generation. While the Government has devoted significant efforts to this in recent years, more needs to be done. An important step is an evaluation of what the Lateral Attrition Law, a performance-based incentive scheme, has accomplished. Fundamental to this is the adoption of the implementing rules, the draft of which was for review of the Bureau of Internal Revenue (BIR) as of October 2007.

Equally important is regular monitoring of the status and outcomes of programs for improving tax collection that have been started, such as the RATES or “Run after Tax Evaders” effort. The program was launched by the Department of Finance (DOF) and the BIR, ostensibly to go after the “big fish” among alleged tax evaders, but progress has been limited so far. Under the RATES, the Department of Justice filed 87 tax evasion and estafa cases. To establish the credibility of the program, these cases must be monitored and their outcomes fully disclosed. In addition, the proposal to corporatize the BIR and implement an appropriate compensation and incentive structure for the agency should be revived.

- **Streamline the tax incentive program.** The Government recognizes the importance of rationalizing the special fiscal and investment incentives program in order to reduce huge tax revenues forgone, but the implementation has been held up pending the enactment of a new law to this effect. Thus, coming up with a consensus bill and its expedient enactment should be a top priority.

- **Rationalize the rate structure of the tax system.** The country’s corporate income tax rate is one of the highest in the region. This should be reviewed because the rate is seen as disadvantageous by potential investors. In addition, the personal income tax system could be evaluated to determine whether the rates need to be streamlined. But any reduction in corporate and individual income tax rates must be matched with new tax enhancement measures, including removal of many deductibles. Furthermore, there may be scope for enhancing excise taxes. For instance, the questionable excise tax law on cigarettes enacted in 2005 could be reassessed and amended so that it can deliver the expected increase in tax revenues. The DOF, for example, notes that some cigarette brands continue to be classified based on their net retail price in 1996, which keeps the actual excise tax collection from them below potential while resulting in inequitable tax treatment between old and new brands. All this renders rationalization of the tax structure an immediate concern.

- **Cut losses of and subsidies to Government corporations.** On the expenditure side, there is still significant room for cutting Government spending on net lending or subsidies to some large and loss-making Government corporations, such as the National Food Authority (NFA). Fees and charges for front-end services from these corporations must be regularly reviewed and adjusted, and they must be made to mimic private corporations in the efficiency and quality of their service delivery. The Government may also look into some aspects of their operating activities to find out which of them could be privatized. Savings derived from reducing or removing subsidies to loss-making Government corporations could be reallocated to finance infrastructure and social safety nets that are working effectively. Many evaluations of the NFA, for instance, indicate that much of the benefits expected from the subsidies going to the agency is captured by even high-income individuals and groups. Hence, the NFA should stay out of money-losing grain trading and limit its role to achieving grain security by managing buffer stocks.

- **Strengthen expenditure management.** Efforts to strengthen the links between planning and budgeting and to improve expenditure management should be continued. Most importantly, such efforts help to minimize the possibility of budgetary appropriations for high-priority public investments being underprovided. Meeting past unmet budgetary needs for education, health, and infrastructure, for example, is indicated. In addition, the Organizational Performance Indicator Framework that is being rolled out by the

Department of Budget and Management clarifies what the Government and its instrumentalities ought to be doing, minimizes duplication of functions among agencies, and holds agencies accountable by adopting performance indicators; this is helpful and must flourish fully.

Furthermore, current government procurement reforms should be monitored constantly to determine if they actually deliver a transparent and efficient system of bids and awards. The recent explosion,

### Box 3

#### Major Tax-Related Reforms and Initiatives Since 1985

The following lists reforms and initiatives from 1986 through 2007.

##### A. Tax System

- Tax Reform Package, 1986—Introduced the luxury tax, increased withholding tax rates, rationalized income taxes and excise tax, and abolished the export tax.
- Executive Order (EO) No. 273, 1987—Introduced the value-added tax (VAT) at 10% of gross value of the goods sold and discontinued various sales taxes, compensating tax, and excise tax on some specific products.
- Republic Act (RA) No. 7496, 1992—Introduced the Simplified Net Income Taxation (SNIT) for the self-employed and professionals, including reducing the rate structure to seven brackets.
- RA No. 7716, 1994—Restructured the VAT system to widen the tax base and enhance the tax administration through the expanded VAT law.
- RA No. 7844, 1994—Introduced various tax credits for exporters.
- RA No. 7916, 1995—Introduced preferential tax treatment for special economic zones.
- RA No. 8184, 1996—Simplified the excise tax on petroleum products by adopting product-specific rates.
- RA No. 8240, 1996—Increased the tax on beer and cigarettes by introducing specific tax rates.

- RA No. 8241, 1996—Amended the expanded VAT to exempt six specific items and provide presumptive tax credits to agro-processors and government contractors.
- RA No. 8424, 1997—Rationalized income tax through the Tax Reform Act of 1997 or Comprehensive Tax Reform Program, which reduced the tax rates; broadened the tax base, included measures to better capture "hard-to-tax incomes"; abolished the SNIT; introduced minimum corporate income tax; and exempted taxable income of fixed income earners.
- Corporate income tax rate reduced from 34% to 33% in 1999 and to 32% in 2000.
- RA No. 9334, 2004—Reformed the Excise Tax on Alcohol and Tobacco Products, popularly known as the "sin tax."
- RA No. 9337, 2005—The Reformed Value-Added Tax law imposed a 10% VAT on oil and electricity, increased the corporate income tax rate from 32% to 35% until 2008, and reduced it from 35% to 30% in 2009.
- 2006—Increased the VAT rate from 10% to 12% of gross value of the goods sold after the economic conditions prescribed by RA No. 9337 were achieved.

#### **B. Tax Administration**

- 1994—Tax computerization program initiated to establish an integrated tax system designed to provide a standard processing framework for the functions of the Bureau of Internal Revenue (BIR) related to tax collection and administration.
- 2001—The Large Tax-Payers Unit established in the BIR.
- EO No. 259, 2003—The Revenue Integrity Protection Service created to detect, investigate, and prevent corruption in the revenue generating agencies of Government under the Department of Finance.
- RA No. 9335, 2005—The Lateral Attrition Law (which includes provision of a system of rewards and sanctions, a rewards and incentive fund, and a revenue performance evaluation board) created to improve the collection performance of the BIR and Bureau of Customs.
- 2005—The Run After the Smugglers program created to detect and prosecute smugglers and other types of trade law violators that are not detected and acted upon during initial and secondary reviews and screenings by other components within the Bureau of Customs.
- EO No. 625a, 2007—Initiated the Run After Tax Evaders (RATES) Program, which files tax cases against high profile personalities.

Sources: Aldaba (2006), BIR (2007), and Diokno (2005).

for instance, of controversies about procurement in some projects funded by official development assistance (ODA) clearly highlights the need for looking into and possibly correcting current procedures.

### (b) Accelerating Infrastructure Development

This study has highlighted the high cost of electricity and inadequacy of the road and transport system as critical constraints to growth. The Government recognizes this, as evidenced by the priorities every MTPDP since 1986 has given to infrastructure development and, more recently, the introduction of the Comprehensive Integrated Infrastructure Program 2006–2010, under which the Government has committed to increasing infrastructure spending to 5% of GDP (ADB 2007a). To accelerate infrastructure development and successful implementation of the program, four problem areas urgently need the Government's attention—regulation, competition and incentives, capacity development for the lead agencies, and finance.

- **Catching up with the Electric Power Industry Restructuring Act (EPIRA).** With the electric power industry now being privatized, finance will largely be the concern of the private companies. But to assure creditors that their loans will be serviced, the Government must ensure that loan covenants are observed, rate regulation is enlightened and market-friendly, and the sanctity of contracts is not compromised. All this helps assure continued flow of finance to the electricity and power sector. In other words, creditors' concerns must be adequately addressed.

The Government body in charge of energy regulation must institute a market-friendly regulatory framework with clear implementing rules and regulations. In reviewing petitions for rate increases, the Government must ensure continuous delivery of quality service from the utilities in the sector. Ensuring viability of the firms must be a high priority consideration. At the same time, given that the electricity and power industry is bound to be a natural monopoly or oligopoly, effective

competition policy is critical to help ensure that quality services are uninterrupted and forthcoming at competitive prices.

Capacity development is indispensable for the Government agencies in charge of planning and ensuring reliable electricity and power supply, in particular the Department of Energy. The energy sector is facing new challenges from rising oil prices and the need to diversify energy sources in consideration of climate change. Ensuring energy security over the long term is essential for sustained growth. The technical, legal, economic, and financial expertise of Government agencies in charge of energy infrastructure development must thus be raised to a high level.

The EPIRA is one of the most ambitious public policy reforms undertaken by the Philippine Government. Commensurate to its importance, the reforms in the EPIRA are accorded high priority in the MTPDP for 2004–2010. The sale of power-generating assets has quickened as a result, which is clearly a move in the right direction. It will bring the electric power industry closer to the “open-access” provision of the law and help raise the credibility of price competition in the wholesale spot market, both of which are crucial in achieving the ultimate goal of the EPIRA to make electricity prices affordable and competitive in the region. Once this final goal is reached, the country will have more attractive investment and growth opportunities than it has now.

- **Upgrading and maintaining roads and transport systems.** Reliable sources of finance are critical to road and transport development. Reliable financing can be provided in at least two ways: (i) by increasing government budgetary outlays, and (ii) by increasing reliance on public-private partnership under the build-transfer-operate (BOT) law and its variants. The guarantee and incentive provisions of the BOT law must be unambiguous; they should not be sources of additional uncertainty. Likewise, to ensure the flow of credit to BOT projects, creditors' concerns must be taken care of.

- In terms of maintenance, the Motor Vehicle Users' Charge, or Road Fund, shows great promise. The fund, however, must be properly administered to achieve its intended results, especially in light of the finding that only about 50% of roads are well maintained. Consistent with this, the DOF plans to introduce a scheme funding phase 2 of the National Road Improvement Project by providing financing from the Motor Vehicle Users' Charge. The scheme intends to minimize distortions that may arise from political interference in the allocation of the Road Fund. The plan is laudable and deserves to be tried.

The Government body in charge of regulating the road and transport system, particularly toll ways, must gear its review of petitions for toll rate increases to allow smooth flow of services from the road facilities while also assuring that users are not deterred by unaffordable toll rates, which would impair the viability of the road facilities. With regard to pricing policy, agreed-upon parametric pricing under the loan covenant must be honored. This enables private operators to maintain the facilities, service their loans, and guarantee the delivery of high quality service.

The Government agencies in charge of planning infrastructure development must ensure they have sufficient technical, legal, and financial expertise and capacity to support planning and implementation. The agencies must exercise ownership over the projects they are implementing, whether solely through the national Government budget or through public-private partnership.

As articulated in the latest MTPDP, the Government is conscious of the imperatives of raising not only the quantity but also the quality of the country's transport system, primarily to decongest Metro Manila, while spreading and propagating growth in the lagging regions. The Government envisions physical integration of the three major islands through the construction of a "nautical highway." In line with this, the Development Bank of the Philippines has opened a loan window supportive of roll-

on-roll-off projects of the private sector. This and other budgetary initiatives of the Government are an impetus to public-private partnership in infrastructure development, a strategy that holds a great deal of appeal, and must be made to prosper.

- **Expanding regional and local infrastructure.** The Local Government Codes specify the division of responsibilities in infrastructure development between the national Government and the local government units (LGUs). For example, the national Government is in charge of the national arterial road network, which is about 12–15% of the total road network, while the LGUs take care of local, secondary, and farm-to-market roads. The partnership between national and local governments needs to be enhanced in adequately developing and improving infrastructure all over the country.

The importance of coordination cannot be overlooked. The worst infrastructure is in poor municipalities and rural and remote areas. Infrastructure development in these areas suffers from coordination failures. Infrastructure projects need to be synchronized among national and local governments and across provincial governments to link their infrastructure productively so that markets can be integrated and economies of scale achieved.

Financing of infrastructure programs at the local level is crucial. In this connection, LGUs must be actively enlisted in infrastructure development programs of the national Government and made conscious of their roles therein. Under the Local Government Code, at least 20% of each LGU's internal revenue allotment is intended for development and infrastructure projects. LGUs favor infrastructure development. While it is appropriate for LGUs to share the cost of developing their infrastructure, low income municipalities may still need to be provided meaningful subsidies from the national Government for building infrastructure and raising their capacities for project formulation and implementation.

For additional financing of local infrastructure development, appropriate incentives could be developed for better LGU performance by tapping ODA funds and linking access to such funds to LGU performance in relation to their MDG targets. It may also help to channel grants to LGUs from the national Government in addition to the general grants under the Internal Revenue Allotment scheme to help enhance the capacity for developing and implementing projects.

Institutional strengthening for the Municipal Development Fund Office may assist it to realize the efficiency and equity objectives of infrastructure development at the regional and local levels. Specifically, the need remains urgent for an effective mechanism to raise LGUs' ability to avail of ODA funds that support their infrastructure development programs.

### (c) Instituting Good Governance

Governance concerns not only weaken investor confidence, but also underlie many other critical constraints identified in this study. Instituting good governance should therefore be made a top development priority in the Philippines. Two issues stand out—fighting corruption and addressing political instability.

- **Fighting corruption.** Eliminating corruption rests largely on the existence of well-defined and implementable rules and procedures in transacting with Government; a credible legal and judicial system that efficiently resolves corruption cases brought to it; a professional and nonpolitical career civil service; and a system of sanctions against erring agents, whether public or private. In this regard, the reform of Government procurement procedures through Republic Act (RA) No. 9184 (the Government Procurement Reform Act), along with recent efforts to harmonize these procedures with international standards, is a good start. The creation of the Presidential Anti-Graft Commission also deserves commendation.

Compensation and incentive structures in government could be reviewed for better

performance. The threat of government servants being dismissed when caught engaging in corrupt practices should be credible, and foregone earnings as a result should be of significant value. Furthermore, insulation against political intervention and a deliberate reduction in the scope of political appointments are important for strengthening the career civil service and giving it the leeway to perform professionally.

- **Addressing political instability.** Strong evidence shows that political instability holds back growth in the Philippines. Reforms to restore the credibility of the electoral process are a vital first step to restoring stability. The law mandating the computerization of election returns has been enacted and its implementation should not be delayed. The Government has affirmed its commitment to this reform, and fast-tracking the implementation of election computerization would contribute to political stability.

### (d) Supporting Expansion and Diversification of the Industrial Base

The Philippine Government has long held industrialization to be a major development goal. As agricultural productivity increases and many of the sector's workers are rendered redundant, industry and services must grow fast enough to reach full employment and raise living standards. The economy must learn to “walk on two legs”: industry and services (ADB 2007b). The Philippines needs more efforts to diversify its product range and enhance the value addition of its industry, whether designed for the export or domestic markets.

Growth comes from the emergence of new goods, not only from the increased production of the same ones. In addition, process innovations are important to raise the technological contents of products and achieve sufficient economies of scale. While industrial restructuring, diversification, innovations, and technological upgrades are essentially activities of the private sector and should be driven by market forces, the Government has the responsibility to provide an enabling environment and has a strategic and coordinating role to play. The responsibility involves not only putting in place

physical, institutional, and social infrastructure conducive to business and private investment, but also addressing distortions arising from market failures such as information and learning externalities and coordination failures. These failures could lead to underinvestment in knowledge and innovations, discourage entrepreneurship, and constrain diversification. Thus, some alternative thinking about industrial policies, departing from the traditional approach of picking winners, is useful—see, for example, Rodrik (2004).

During the 1970s and early 1980s, the Philippines tried to implant strong industrial policy but failed because the policy did not target high value-added export sectors and was badly implemented. Performance criteria were not used to make the economic incentives effective and the policy, instead, favored sectors owned by close allies of political figures. More recently, to attract foreign direct investment, the Government has put in place some investment promotion schemes and relied mainly on setting up industrial and export processing zones. To export businesses locating in the zones, the Government provides special fiscal incentives such as tax holidays and exemptions from customs duties for imports of capital equipment, raw materials, and intermediate products, provided the final products are re-exported. Much of the value-added of such schemes is only in employment generation. Links of the big firms in the special zones to local firms and technological spillovers are weak, if not absent. In addition, the Government continues to issue a yearly investment priorities plan along the lines of traditional industrial policy.

Recent literature on industrial policy has shed some light on why the traditional approach to industrial policy often fails, and highlighted the importance of policy design and implementation. Rodrik (2004) listed some general design and implementation principles for the so-called “new industrial policies” that may have high pay-offs:

- Public support and incentives should be provided only for activities and not sectors; moreover, the activities in question should be new ones, including products that are new to the local economy or new technologies for existing products.
- The activities supported should also have the potential to crowd in other complementary investments, generate informational or

technological spillover, encourage R&D, and facilitate industrial restructuring and productivity enhancement.

- Clear benchmarks for success and failures must be adopted to ensure that public support is not abused or wasted. Public support should not be indefinite. Sunset clauses could be used to phase out support. The Government also needs to take some mid-course corrections.
- Agencies that implement industrial policy must be competent, have sound institutional and governance structure in place to prevent “being captured,” have good communication with the private sector, be supported by the highest level of leadership possible, and be effectively monitored by all stakeholders.

Such an approach need not be restricted to industry or manufacturing, whether large corporations or SMEs—the approach also applies to the development of nontraditional activities in agriculture and services. If carefully designed and properly implemented, this new approach has great potential to help the Philippines seize many of the opportunities arising from the new trading, investment, and production arrangements, including “off-shoring” and outsourcing of business processes, which have emerged in the region and globally. At the same time, new policy measures must comply with World Trade Organization rules. The Philippines clearly could learn lessons from the industrial policies of some of the economies in East and Southeast Asia that are regarded as models of successful industrialization—see, for example, Kuchiki (2007), Hernandez (2004), and Rodrik (2004).

Improving access to credit by SMEs by addressing market failures such as information asymmetry will also help to diversify the industrial base. Finally, diversification of the industrial base and promotion of nontraditional manufacturing exports require maintaining a competitive real exchange rate (Lim 2007a).

### (e) Making Access to Opportunities More Equitable

For growth to make a significant dent in poverty, the Government must ensure not only that the growth process generates sufficient productive

employment opportunities, but also that they are within reach of every segment of society, including low income strata. The list of things the Government has to accomplish before this challenging goal could be achieved is long, and attention to the following three policy priorities will help advance the development agenda in the Philippines in a visible way: (i) increasing investment in expanding human capacities, especially of the disadvantaged; (ii) improving the effectiveness and funding of development programs at local levels; and (iii) improving the effectiveness and targeting of social safety nets and disaster relief.

- Expanded and more equitable access to education, training, and health services. Spending for education and health targeted at the poor must be sufficiently large to get visible impacts. Alternative financing modalities, including national Government-LGU counterpart schemes, need to be more aggressively developed to raise the spending levels on basic social services, especially in low income LGUs. The aim should be to raise spending levels close to those of the country's more economically dynamic neighbors.

Innovative approaches in education that have been tried and are known to be working, including vouchers, alternative education systems, and conditional cash transfers, should be scaled up. For example, education vouchers have been used successfully in other countries to increase parent participation in children's schooling and the quality of education services.

The implementation of the Basic Education Sector Reform Agenda, which covers universal access to basic education and effective school-based management, has to be expedited and monitored. The reform must go beyond providing quantity of education inputs to include, even more importantly, quality of education services, especially in rural areas and regions of Mindanao and the Visayas where the chances of achieving the MDG targets for basic education and health are poor.

In health, the Government has developed critical interventions through its FOURmula One for Health (F1) program. The implementation of this program, which aims to achieve better health outcomes, more responsive health systems, and more equitable health financing, has likewise to be hastened. The program has to enhance the Philippine Health Insurance Corporation (PhilHealth) coverage of indigent families (by increasing enrollment numbers and expanding coverage of services), while at the same time ensuring sufficiency of benefits (providing payments for medicines and treatments). The program should include fostering a more competitive drugs industry to reduce the cost of drugs and medicines.

Government should consider bundling specific health and education interventions to enhance their natural complementarities (for example, breakfast feeding programs in schools are needed because cognition is enhanced with proper nutrition and immunization programs in schools will reduce absenteeism). In this regard, the effectiveness of the Early Childhood Development Program should be evaluated.

- More effective and better funded development programs at local levels. Effective and adequate programs to address the development needs at the local level can help the poor benefit from opportunities. In this regard, the Government may consider the following:
  - (i) The national Government may refine its choice of government unit (province, city, municipality, or village) to target for grant and loan support. Proper ranking of the chosen LGUs by development status is critical to designing incentive structures intended to extract proper governance practices from LGUs and to minimizing any leakage from the financial support provided to them.

- (ii) Rural infrastructure development must be launched with a big push, preferably under the auspices of LGUs. The national Government could come in with some form of cost-sharing arrangement or counterpart grant mechanisms.
- (iii) Much progress has been made in microfinance but further expansion is needed, given the large regional income disparities in the Philippines and weak access to credit by SMEs, especially in the lagging regions. SMEs continue to be deprived of credit, as the fixed cost of accessing credit from established commercial banks and other formal financial intermediaries is prohibitive for them. Moreover, microfinance helps households that are victims of temporary economic shocks to smoothen fluctuations in their consumption patterns. Institutionally, the appropriate national Government agency could consider dedicating a desk or bureau to monitoring micro and small businesses, to find out whether they have the capacity to graduate into medium-sized enterprises. Information about factors contributing to growth of SMEs is helpful.
- (iv) Despite the achievements under the Comprehensive Agrarian Reform Program in the last 20 years, more needs to be done. The Government needs to extend the Comprehensive Agrarian Reform Law to allow the acquisition of remaining lands identified for redistribution, their distribution, and provision of support services to the beneficiaries.
- (v) The development of growth areas could be promoted, linking them to depressed areas as this addresses the problem of coordinating industrialization across provinces and regions.

- **More effective and better targeted social safety nets and disaster relief.** Reliable social protection and safety nets promote growth with equity. But they are not very helpful if they are poorly designed and not well-targeted; intended beneficiaries who need the assistance most are missed as a result. The weaknesses of the existing social safety nets include poor targeting; lack of awareness of various programs; and low coverage level in terms of area, depth of support, and number of beneficiaries.

In addition, victims of disasters must be given opportunities to recover. Poor households tend to locate in hazardous areas. When disaster strikes, they are driven deeper into poverty, and even those who have managed to escape poverty may find their improved situations to be fragile and temporary. The social protection schemes must have as components timely and reliable relief and rehabilitation efforts. Disaster prevention is, likewise, crucial. In this connection, partnerships with LGUs, civil society, business, and external funding agencies are essential.

The wide range of pro-poor programs that the Government has instituted is proof of its commitment to equitable development (Box 4). To invigorate the commitment across time and place, impact monitoring and evaluation are crucial, as they help ensure cost-effectiveness and sustainability of safety net programs. The National Anti-Poverty Commission, together with the National Economic Development Authority, must put in place a systematic impact monitoring and evaluation system as part of the Government's good governance program. Such an evaluation system may start with the conditional cash transfer program launched by the Department of Social Work and Development. For instance, the program provides for cash transfers of up to ₱15,000 per family over a period of 5 years if parents keep their school-age children in school and bring them to primary health clinics for full immunization.

**Box 4**  
**Salient Poverty Reduction Programs, 1986–2007**

Since 1986, the overarching objective of the Medium-Term Philippine Development Plans (MTPDPs) has been poverty reduction. In addition to broader initiatives aimed at poverty reduction as the end result, each of the MTPDPs has had focused programs on tackling absolute poverty. The salient programs include the following.

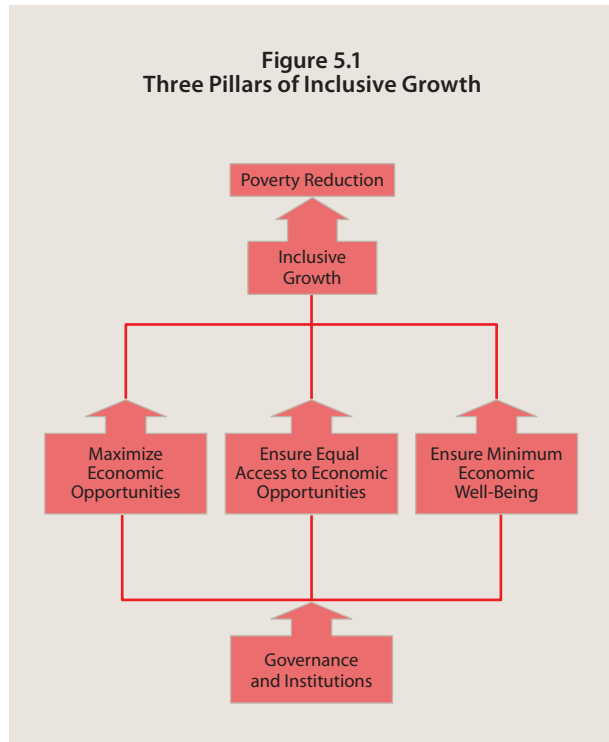
**Tulong sa Tao (MTPDP 1986–1991).** The program was aimed at reducing poverty by creating employment opportunities in low income municipalities. It focused on creating and strengthening self-help groups, raising group savings, and establishing group enterprises.

**Social Reform Agenda (MTPDP 1992–1997).** The agenda emphasized two key areas—poverty reduction and countryside development—and included a package of Government interventions organized around flagship programs of the MTPDP for the country's 20 poorest provinces. Within priority provinces, preference was given to the poorer municipalities and within these, to poorer villages. Within the selected geographic regions, the focus was on disadvantaged economic and social groups. The philosophy was to organize Government thrusts toward securing minimum basic needs before attending to other demands. A flagship initiative under the agenda was the Comprehensive and Integrated Delivery of Social Services (CIDSS), which relied on empowerment to fight poverty. The CIDSS employed an elaborate targeting mechanism based on a set of 33 indicators to monitor basic needs for survival, security, and an enabling environment.

**Lingap Para sa Mahihirap or Lingap (MTPDP 1999–2004).** The program identified the 100 poorest families in every municipality and focused on improving their welfare by providing subsidized food, social services and housing, and livelihood development. The program was financed through the Lingap Para sa Mahihirap (Poverty Alleviation) Fund.

**Kapit-Bisig Laban sa Kahirapan (MTPDP 2001–2004 and 2004–2010).** The initiative encompasses a wide range of activities including asset reforms, provision of human development services, creation of employment and livelihood opportunities, social protection and security against violence, and participation of basic sectors in governance. The interventions are grouped into four programs: (i) the CIDSS, which seeks to empower poor communities through enhanced participation in community governance and involvement in the design, implementation, and management of antipoverty initiatives; (ii) the Agrarian Reform Zone, which focuses on acquiring lands for qualified farmers, improving tenancy, and providing agricultural support services; (iii) KALAYAAN, which aims to address the needs of poor communities in conflict areas; and (iv) Poverty Free Zones, which provides livelihood opportunities for people in targeted areas.

Source: ADB (2005).



### C. Toward Inclusive Growth

The Philippine Government has long been committed to creating prosperity that every citizen can access. Achieving this vision requires a strategy for inclusive growth (Ali and Zhuang 2007, Ali and Son 2007). The strategy rests on maximizing economic opportunities through high and sustainable growth, ensuring equal access to economic opportunities, and guaranteeing a minimum economic well-being for all (Figure 5.1).

Expanding investments in human, physical, and technological capital, together with promoting market access and exports, raises productivity and creates economic opportunities. Such outcomes permit families to increase their investments in education, training, and health. Enhanced human capacities enable all members of the society, especially those from disadvantaged groups, to participate in and benefit from the growth process and to take responsibility for their own well-being. Nonetheless, some disadvantaged individuals will find it difficult to seize opportunities, and their welfare hinges greatly on social protection and safety nets that government provides. All these require an enlightened and active government and good governance.

To sum up, easing the critical constraints identified in this report can trigger a growth process conducive to eradicating poverty and reducing inequality in the Philippines. Improved fiscal space will enable the Government to invest more in infrastructure, human capital, and social programs. Concurrent governance reforms will help to improve investor confidence, promote economic and social justice and level playing fields, and raise the quality of public services and goods delivery. Upgrading the technology and increasing the scale and diversity of manufactured products will help to generate new growth drivers, improve their sustainability, and create more decent and productive jobs. All these will lead to more private investment and entrepreneurship and to high economic growth. Finally, more equitable access to development opportunities will help to ensure that the benefits of growth and development will be widely shared by all members of Philippine society, bringing about a virtuous cycle of inclusive growth.