

**2005 PHILIPPINES DEVELOPMENT FORUM**  
**A Meeting of the Philippines Consultative Group and Other Stakeholders**

*“Working Together for Sustainable Economic and Social Progress”*

**SUMMARY OF DISCUSSIONS**

**I. Overview**

1. The 26<sup>th</sup> meeting of the Philippines consultative group, chaired by newly appointed Finance Secretary Cesar Purisima, and co-chaired by World Bank Country Director Joachim von Amsberg, marked a significant break from previous gatherings. Under the new name of Philippines Development Forum (PDF), it was held for the first time in Mindanao, at Davao City during 7- 8 March 2005. There was wider participation from local stakeholders, including representatives from the three branches of government, local government units (LGUs), civil society, private sector, and academe. With about 180 participants, including 12 cabinet secretaries, three representatives of Congress, and 10 ambassadors, it was the largest ever consultative group meeting for the Philippines. President Gloria Macapagal-Arroyo attended the final session, gave the closing address, and held a Cabinet meeting in Davao immediately afterwards to discuss the outcomes. Vice-President Eichenberger led the ADB delegation. Statements made by Vice President Eichenberger at the plenary sessions are in Appendix 1.

2. The format of the PDF was also significantly different, with a focus on interactive dialogue and development issues rather than development partners' prepared statements and operational programs. There was no session for financial pledges. The new format responds to agreement reached during the 25<sup>th</sup> meeting (Cebu City, November 2003) for a more substantive exchange of views, and inclusion of a wider group of stakeholders to provide a broader airing of viewpoints, while providing them with a better understanding of development partners' positions. Preparation for the PDF was also different, being structured around five thematic working groups with wide participation that met several times prior to the PDF to clarify issues, review reform progress, and identify action-oriented agendas. Background papers prepared by the working groups were inputs to a half-day of break-out sessions during the PDF and focused on: (i) Social Progress; (ii) Growth and Investment Climate; (iii) Economic and Fiscal Reform; (iv) Governance; and (v) Decentralization and Local Government. The breakout sessions, comprising 30-35 participants each, were chaired by cabinet secretaries, with resource persons from civil society, private sector, House of Representatives, LGUs, and development partners.

3. The dialogue was dynamic with participants seeking tangible, substantive responses to the country's development needs. As significant as agreement on key corrective measures at the breakout sessions was the inclusion of the wider group of stakeholders—necessary for coalescing support for difficult agendas. The new format was successful, with agreement that the five working groups will meet periodically prior to the next PDF to review progress on reforms, especially fiscal consolidation.

4. The high level of representation from the Executive branch reflected Government's strong commitment to reform. A dominant theme was that the window of opportunity is narrowing for the Philippines to address its major challenges, including the prime concern of the fiscal imbalance. Urgent actions are needed, despite the short-term

political and social costs that will be incurred, which should be seen as investment in larger, long-term gains. One of the main messages given by ADB, echoed by others, was the importance of results-based support: more aggressive progress on fiscal consolidation will enable ADB to consider significantly higher levels of financial support.

## II. Highlights of Discussion<sup>1</sup>

5. The Government's strong resolve and openness to dialogue with stakeholders on the key development issues was appreciated. Government for its part outlined its fiscal, financial, and economic reform agenda for the next six years, as well as recent achievements in terms of economic growth, credit worthiness, legislation, MDG targets, and the Mindanao peace process. Civil society representatives noted the challenge of financing the ambitious targets for public infrastructure and social service delivery; the high rate of population growth was seen as a major constraint on poverty reduction. International development partners supported greater harmonization of official development assistance programs with Government priorities.

6. **The Window of Opportunity.** It was agreed a limited window of opportunity exists for the Philippines to grasp the currently favorable domestic and international circumstances to initiate the difficult measures needed to reduce fiscal vulnerability. In her address, President Arroyo stated: *"I recognize your concern about the narrowing window. I recognize that 2005 is a year of urgent change, but it is also a year of fervent hope."* Political uncertainty greatly reduced after President Arroyo's election in May 2004 to a 6-year term, with solid majority support of pro-administration members in both houses of Congress. Politically, this should make it easier to pursue front-loaded reforms, including measures that are not popular. On the economic front, the relatively robust domestic growth of 2004 and a currently favorable international environment provides a good platform for undertaking initiatives that will have financial and economic short-term costs. However, the environment is likely to become less conducive for tough reforms as international oil prices and interest rates rise, with the prospect for slower global growth, and as the next scheduled Philippine elections approach.

7. **Fiscal Responsibility Program.** Persistent budget deficits have opened a new front of vulnerability—a high level of debt, and increasing debt service commitments. National government debt has increased at an annual rate of 20% over the past six years, and interest payments now account for one-third of budget expenditure. To reduce vulnerability, and remove a potential cause of economic instability, the Government has prioritized fiscal consolidation—its "fiscal responsibility program"—as the cornerstone of its reform agenda.

8. The program targets a reduction in the National Government budget deficit from 3.9% of GDP in 2004 to a balance in 2010, and a reduction in the consolidated public sector deficit from 5.5% of GDP in 2004 to 3% in 2010. The objective is to reduce debt-service demands on the budget, increase fiscal space for high priority spending on infrastructure and social sectors (which has been compressed severely in recent years), and accelerate progress towards the MDGs and poverty reduction.

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<sup>1</sup> Documentation distributed at the PDF is available from the Philippines Country Office.

9. The program includes enhanced revenue mobilization, improved spending efficiency, and an increase in the proportion of official development assistance financing. Enhanced revenue mobilization relies on tax adjustments, especially the consumption-based value-added tax; aggressive measures to improve tax administration and increase the costs to taxpayers for non-compliance; improved cost recovery in revenue-earning Government agencies, especially National Power Corporation; and sale of Government assets. The new Lateral Attrition Act establishes performance-based incentives (including financial remuneration, and job opportunities) to encourage employees of the two major revenue raising agencies (Bureau of Internal Revenue and Bureau of Customs) to meet revenue targets. The Government expects the recently adjusted "sin tax" for alcohol and tobacco products to raise an additional P15 billion (0.3% of 2004 GDP) in a full year. It expects the proposed value-added tax increase (from 10% to 12%) to raise an additional P30 billion (0.6% of GDP); and removal of exemptions from the value-added tax to generate an additional P25 billion (0.5% of GDP). A provisional average tariff increase for National Power Corporation of P0.98/kWh, granted in 2004, is expected to increase revenue by P38 billion (0.8% of GDP) in a full year. A promising start to privatization in the power sector has been made, with sale of several minor hydropower generation plants, and the bid award to a foreign investor for the 600MW coal-fired Masinloc generation plant. Other assets planned for sale are the power transmission grid, public shares in San Miguel Corporation and Philippines National Bank, and real estate. A new undersecretary position for privatization has been created in the Department of Finance. A Fiscal Responsibility Law is proposed to ensure no new expenditure measures are considered without matching incremental funding.

10. Participants agreed a substantial proportion of the incremental revenues from the tax adjustments should be applied to reduce debt, with the balance available for development spending, especially on social programs. Participants also agreed that front-loading the fiscal responsibility program would increase opportunity for development partners to consider higher levels of financial support. ADB noted that strong actions by the Philippines toward fiscal consolidation will provide the opportunity and context for ADB to deepen its partnership with the Philippines.

11. **Mindanao Peace Process.** The appropriateness of holding the PDF in Mindanao was acknowledged as it gave participants the opportunity to see the island's economic dynamism, despite its prolonged conflicts. Many participants noted the adverse impact of the Mindanao conflict on perceptions of security in the country, and the negative effect on investment. In a special plenary session, Secretary Teresita Deles, Presidential Advisor on the Peace Process, noted development partner concerns related to recent hostilities by the breakaway Moro National Liberation Front in Jolo. She advised the hostilities are being contained, humanitarian aid is being delivered, and LGUs are commencing reconstruction activities. More importantly, she emphasized strong evidence of the substantial progress made in the peace process: it was mainly because of improved communication and trust that prevent hostilities from spreading. This reinforces progress being made by the Government and Moro Islamic Liberation Front (MILF) negotiating teams as they prepare for formal peace talks in Malaysia in March or April, in which both sides have indicated willingness to participate. There is optimism with the initial findings of the Joint Needs Assessment undertaken by the Government, Bangsamoro Development Agency (representing the MILF), and development partners (including ADB) in conflict-affected communities.

### III. The Breakout Sessions

12. **Social Progress.** (Co-chaired by Secretaries D. Soliman, Department of Social Welfare and Development; F. Abad, Department of Education, Culture and Science; and M. Dayrit, Department of Health.) Participants agreed some progress has been made towards the MDG targets. However, significant challenges remain to sustain and expand progress on a wider range of issues. The key challenges include (i) wide disparities across regions, especially in terms of reducing poverty and providing basic services; (ii) population management; (iii) corruption; (iv) weak monitoring and implementation; (v) lack of an advocacy plan; and (vi) need to scale up localization campaigns.

13. A major recommendation was to establish a medium-term financing framework for social services and attainment of MDGs. The framework should include a mechanism for additional funding for LGUs receiving low support from the tax-revenue sharing Internal Revenue Allotment; a requirement that members of Congress use their discretionary budget allocations for MDG-oriented activities; fiscal autonomy for government health institutions to increase cost recovery; and LGU spending for education as part of total resources planning and management of education delivery. Other items were the need to conduct poverty mapping in all communities, focus on rural poor, mobilization of women for social services reforms, regulatory reforms in health and education, to link review of MDG targets to annual budget process and incentives for LGU performance, and implementation of “quick wins” or “fast tracking” of programs without detracting from building sound institutional foundations. There was strong support among development partners and other stakeholders for a national population policy, and passage of a reproductive health law.

14. **Growth and Investment Climate.** (Co-chaired by Secretaries J. Santos, Department of Trade and Industry; and R. Neri, National Economic and Development Authority.) With the private sector accounting for some 86% of GDP, and a leading job creator, it plays an important role in reducing poverty, raising living standards, and spurring social development. Participants agreed this role is constrained by the weak investment climate, and welcomed the Government’s progress in implementing the revenue integrity program (“lifestyle checks” on public servants); addressing fairness in existing build-operate-transfer operations, and amending the implementing rules and regulations; progress on the Mindanao peace process; initiating the streamlining of business approvals; creating the Philippine Infrastructure Corporation to jump-start key infrastructure projects; and establishing the Capital Markets Development Council, Fixed Income Exchange, Credit Bureau among others. The Supreme Court’s upholding the mining investment law was noted as a significant event.

15. Constraints to improving the investment climate were identified as corruption, inconsistency of Government policies and contracts, unstable peace and order, large bureaucracy, weak infrastructure, and inefficient financial sector. Participants recommended a set of specific actions such as (i) establishment of private sector-Department of Trade and Industry partnerships for key investment sectors; (ii) Government to commence one or two major infrastructure projects in the next 60 days and complete critical projects by 2006; (iii) develop Subic-to-Batangas growth corridor; (iv) Government to accelerate resolution of contractual dispute on the new Manila international airport; (v) continue judicial reform (e.g., institutionalize private sector briefings of courts on investment climate issues; (vi) central bank to operationalize the Fixed Income Exchange by end 2005, and encourage the formation of credit bureaux;

(vii) improve investment climate for other sectors (human capital, natural resources, foreign exchange earners); and (viii) monitor progress of the actions through semi-annual meetings of the working group.

16. **Economic and Fiscal Reforms.** (Chaired by Finance Secretary Purisima.) The topic was the dominant theme of the PDF. Participants agreed the country's key challenge is for upfront action to raise public sector revenues to achieve a sustainable public debt level, while creating the fiscal space for urgent development priorities. Participants arrived at five major agreements: (i) National Government to frontload fiscal adjustments while sticking to its macroeconomic targets; (ii) tax administration improvements and aggressive privatization to expand fiscal space for infrastructure and social spending to meet growth targets; (iii) complement fiscal reforms with structural reforms in pensions and contingent liabilities, among others; (iv) National Government to seek development partner support for its fiscal responsibility program once it establishes a track record of reducing the consolidated public sector debt/GDP ratio; and (v) continue dialogue among development partners to ensure conversion of ideas into an action agenda and commitments.

17. **Governance and Anti-Corruption.** (Co-chaired by Secretary M. Gutierrez, President's Chief Legal Adviser; and Acting Secretary M. Relampagos, Department of Budget and Management.) Local stakeholders in particular focused on anti-corruption measures rather than the long-term process of instilling good governance in institutions, procedures, the bureaucracy and political process. This reflects the community's concern with "catching the crooks". Some debate arose as to whether keeping the two subjects together would result in too much attention to anti-corruption, to the detriment of the larger governance agenda.

18. However, consensus emerged as to next steps, including: (i) prosecution of tax and graft cases; (ii) disposition of cases in the court system; and (iii) implementation of procurement reforms, especially transparency in the bidding process. Only the first is clearly within the anti-corruption agenda although some of the indicators identified address governance issues. Over the next twelve months these areas (plus others that will be added) and indicators will be monitored. Participants agreed to meet the following week to specify in more detail the optimal monitoring mechanism, both by government and independent civil society groups. ADB serves as the lead convener for the Governance and Anti-Corruption working group.

19. **Decentralization and Local Government.** (Co-chaired by Secretary A. Reyes, Department of Interior and Local Government; and J. Amatong, Senior Advisor, Department of Finance.) Participants recognized the gains of decentralization since implementation of the local government code in 1991, and focused on key issues to promote the partnership between national government and LGUs. First is the absence of a common capacity building framework, with efforts being largely project driven with weak coordination among funders, service providers and beneficiaries. Second is the absence of an institutionalized performance management system and weak capacity to generate appropriate data needed for performance benchmarking. Third is the lack of clear delineation of roles of LGUs and national agencies in basic services delivery, and lack of linkage between local plans and budgets, and national targets and priorities. Other issues are (i) many LGUs are not fully utilizing available local revenue opportunities with real property tax collection efficiency averaging only 60%; (ii) provision of capital grants for devolved activities contrary to established policy, as well as the use

of priority development assistance funds of legislators for devolved activities; and (iii) limited access of LGUs to private capital despite potential support for bond issuances offered by LGU Guarantee Corporation.

20. Participants agreed on an action agenda focusing on three areas: local governance, local finance, and legal framework. It was recommended Department of Interior and Local Government take the lead to harmonize capacity building interventions, institutionalize performance benchmarking systems; and clarify the roles of LGUs and national agencies in basic services delivery. For local finance, Department of Finance will take the lead for accrediting private banks as LGU depository banks; harmonizing Government finance institutions' on-lending terms for official development assistance funds; considering well-targeted and performance-based grants; adopting a consistent financing framework for Government credit and grant programs; considering options for market segmentation and financing project preparation assistance to LGUs; and exploring untapped LGU revenue bases (e.g., centralized land valuation, privatization of assets). Participants called for the conduct of a broad review of the implementation of decentralization and proposed amendments to the 1991 Local Government Code, taking account of already completed studies and using available grant assistance. The working group will meet within six weeks to develop a work program and timetable for activities to be undertaken over the next year.

**Appendix 1**

**2005 PHILIPPINES DEVELOPMENT FORUM**  
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**7-8 March 2005, Davao City, Mindanao, Philippines**

**SESSION I: LAYING OUT THE DEVELOPMENT AGENDA**

**Statement by Joseph Eichenberger, Vice President, Asian Development Bank**

ADB welcomes the very comfortable arrangements made by the Government and World Bank for this gathering. We appreciate the revised format of the PDF, with its wider universe of stakeholders, including members of Congress, and the business, civil society, and academic communities.

**A. Acknowledging the challenges**

The Philippines faces a variety of challenges, many of them urgent, to achieving the targets of the Medium-Term Philippine Development Plan laid out by the Government. The level of representation at this PDF reflects widespread appreciation for the scale of the challenges and a sense of shared engagement and responsibility.

There is a broad consensus on the key issues and constraints, and a widely shared view that the mandate received by the government provides a window of opportunity to move more resolutely on the challenges, even as they involve difficult choices.

The challenge for this PDF is to reach broad agreement on an effective way forward.

**B. Recognizing the need for urgent action**

The scale and urgency of the challenges for the Philippines have both grown. The economy is more vulnerable to negative external developments such as in oil prices and interest rates. There has been erosion of international competitiveness, evidenced by sluggish local investment and low FDI. There has been decline in some important human resource indexes, and achievement of key MDGs is in question.

Given these circumstances, it is clear that the window of opportunity to address the most urgent challenges is not large; and we believe it is narrowing.

Some significant early “wins”, especially in terms of fiscal consolidation, are vitally important. We welcome the Government’s commitment to actions to improve revenues and tax collection efficiency, and to strengthen the incentive framework for compliance by taxpayers (by increasing the risks of tax avoidance). Strengthening the administration of the existing tax system will be essential to improve fiscal performance. Extending and deepening these measures will be important to build greater confidence that the Philippines is positioning itself to confront its challenges.

**C. Accepting the costs of adjustment**

There will be political and social costs associated with implementing the reforms, but these need to be seen as an unavoidable investment in much larger long-term gains.

**D. Strengthening the quality of the ADB-Philippines partnership**

The ADB-Philippines development partnership remains strong. The Philippines can be assured of ADB's steadfast support.

However, the ability of ADB to commit, and effectively deliver the full range of support depends on a macroeconomic and policy framework that provides for sustainability, and strong sector reform agendas. The more quickly concrete actions are taken to advance this process, the more fully and speedily ADB will be able to move ahead. More rapid adjustment progress will reduce the risk of low levels of financial support that is so vital to redressing compressed spending for high priority infrastructure and social projects. Improved circumstances will improve prospects for ADB to maintain the level of financial support that Philippines seeks from ODA sources.

### **SESSION III: DISCUSSION ON BREAKOUT SESSIONS AND COMMITMENTS ON ACTIONS FROM STAKEHOLDERS**

#### **Statement by Joseph Eichenberger, Vice President, Asian Development Bank**

ADB greatly appreciates the candid exchange and genuine dialogue we have had, which has led to a great deal of agreement on key issues, challenges, and the way forward.

We especially appreciate the presence and active engagement of so many members of the executive branch, members of congress, civil society, and the private sector.

Our dialogue has produced broad and important consensus around the challenges that we jointly see as most urgent, and around the necessary elements of an action plan to address these challenges.

In particular, the challenge of reducing poverty that is both persistent and pervasive requires compelling and urgent action. That is the defining challenge for the Government, local stakeholders, and development partners. And that is ultimately why we are here together.

As for the core elements of a solution, we know what they are, and we have covered them at some length over the past day and a half.

Now the challenge, for each of us, is delivery.

For the Government, in particular, it will be vital in the coming months to move forward resolutely towards significant fiscal consolidation and toward reversing the serious erosion of investor sentiment that we have seen. And it will be urgent to ensure an improved flow of services to the poor who depend on them.

As for ADB, our commitment to and partnership with the people of the Philippines remains solid and strong.

Strong actions toward fiscal consolidation will provide ADB with the opportunity and the context to deepen our support, including through possible program support. Delivering the specific steps identified in the fiscal reform breakout session would be very important in this respect.

ADB is also eager, and prepared, to engage more deeply in the power sector, in strengthening the capacity of local governments to deliver services, and in improving the financial sector.

ADB's new country strategy, now under preparation, will be a key vehicle to set out these priorities, and we look forward to working closely on it with the Government and other development partners.

Our conversations here have given us a renewed sense of optimism and commitment. ADB greatly hopes that this will be translated into concrete progress that the people of the Philippines both need and deserve.

You will have our fullest possible cooperation and support in this effort.