

2006 PHILIPPINES DEVELOPMENT FORUM
30-31 March 2006, Tagaytay City, Philippines

“Building on Economic and Fiscal Reforms to Achieve Sustainable Economic and Social Progress”

I. BACKGROUND

1. The 27th meeting of the Philippines Development Forum (PDF), chaired by Finance Secretary Margarito Teves and co-chaired by World Bank Country Director, continued arrangements initiated last year for a more inclusive, impact-oriented dialogue. This year’s gathering of about 250 participants was the largest ever and included representatives from the executive, legislative and judicial branches of government, local government, government agencies, business community, civil society, academia, and bilateral and multilateral development partners. Indicative of the importance placed on the Forum by the administration, President Gloria Macapagal-Arroyo gave a keynote address on its first day, and Vice President Noli de Castro spoke on the second¹. Development partners welcomed Government’s willingness to dialogue in such an open way with representatives of all key stakeholder groups. The PDF format, built around working groups, was strongly endorsed. PDF documents are available at the web site: www.pdf.ph.

2. The PDF is the primary mechanism for facilitating substantive policy dialogue on Philippines’ development agenda among an inclusive stakeholder constituency. It is the vehicle through which greater clarity is sought for addressing seven key development areas, which are the basis for the PDF working groups: (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. The agenda was structured around breakout sessions for the seven PDF working groups. During the deliberately briefer plenary sessions, prepared interventions were discouraged; there was no assistance pledging, and details of support programs by development partners were not discussed.

3. The annual event is part of a *comprehensive year-round process*, including regular meetings of the seven working groups. Each working group is chaired by a senior administration official (often at Secretary level), and co-chaired by a development partner. Some of the working groups have found it efficient to un-bundle their deliberations by establishing several sub-groups, which also provides opportunity for more development partners to be involved actively as conveners. ADB co-chairs the governance and anti-corruption working group, and has strong representation on each of the others. The PDF, largely through the working groups, supports the process for developing consensus, and generating commitment among stakeholders to support actionable elements of the Philippine reform agenda.

¹ The presentations emphasized: peace in Mindanao as a major contributor to achieving the Millennium Development Goals; the urgency of winning the war against corruption; and the importance of fiscal consolidation and generation of budget space for spending on infrastructure and social sectors.

4. In accordance with commitments made by Philippines and its development partners under the *Paris Declaration*², harmonization and aid effectiveness is integral to PDF deliberations. On-going work financed by ADB technical assistance (TA)³ that supports implementation of the Philippines' commitments was used to anchor a pre-PDF workshop to assess progress, and to provide a platform for embedding harmonization and effectiveness in the deliberations of the PDF working groups.

II. DISCUSSION HIGHLIGHTS

5. Participants noted that the tone of the 2006 PDF was more positive than last year's, reflecting in large part improvement in prospects for meeting fiscal consolidation targets, and positive assessments of Government's resolve to "stay the course" for reforms. The 2005 PDF focused on the limited window of opportunity to reduce fiscal vulnerability⁴. In 2006, participants acknowledged the "significant progress" during 2005, and agreed the country has "moved away from perceived acute risk of instability to generating a virtuous circle of fiscal reform, concrete progress, and restored market confidence". Progress on fiscal consolidation has emerged as the key metric for judging the administration's commitment and capacity to deliver on its broader economic and social agenda. Significantly, due to the better-than-expected trends, Government has brought forward by 2 years its target for a balanced budget from 2010 to 2008.

6. This summary of discussion is anchored around four challenges posed during the PDF's opening session to focus the proceedings over what proved to be a very broad and challenging agenda⁵.

a. Sustaining and deepening fiscal reforms through increased revenue collection rather than further expenditure compression

7. The PDF considered the Philippines to be broadly on track with the fiscal consolidation program. In view of the serious impact of under-collection of revenues on economic growth and public service delivery, the PDF welcomed the front-loading of fiscal consolidation initiatives, including: (i) implementing the adjusted excise taxes on alcohol and tobacco from January 2005; and (ii) changes to the value added tax (VAT), which increased its coverage from November 2005 and increased its rate from 10% to 12% from February 2006. These revenue initiatives were complemented by a reduction in the aggregate deficit of non-financial government corporations. Increases in wholesale electricity prices helped National Power Corporation (NPC), historically the largest contributor to the consolidated deficit, to break even in 2005⁶.

8. Improved performance of tax agencies is critical to successful fiscal consolidation. Tax administration has been strengthened by: (i) passage of the Lateral

² *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.

³ ADB. November 2005. *Harmonization and Aid Effectiveness*, for \$700,000.

⁴ IN.75-05. April 2005. *2005 Philippines Development Forum*.

⁵ The summary draws on public documentation, including PDF opening and closing statements.

⁶ NPC's deficit was reduced from the equivalence of 1.5% of GDP in 2004 to 0.1% in 2005, the result of tariff adjustments, enhanced operational efficiency, and favorable appreciation of the Peso.

Attrition Law (2005)⁷, which provides for performance-based sanctions (including retraining, redeployment, and removal) and rewards for employees of revenue-collecting agencies who fall short of, or exceed, revenue targets; and (ii) focused programs to strengthen tax compliance, including Bureau of Custom's "run after the smugglers – RATS", and Bureau of Internal Revenue's "run after tax evaders – RATE". For the first time since 1997, the tax/GDP ratio improved, increasing to 13.1% in 2005 from 12.4% in 2004; while the national government debt stock/GDP ratio fell to 72% in 2005 from 79% in 2004. These measures and outcomes resulted in more favorable market sentiment: foreign direct investment almost tripled in 2005 (albeit from a low base); two of the three major credit rating agencies upgraded their outlooks from negative to stable; sovereign borrowing costs fell⁸; and the peso appreciated against the dollar. In turn, these translated to significant debt service savings – an important part of the "virtuous circle".

9. Progress on aggregate fiscal consolidation was characterized as "impressive", with the National Government's budget deficit during 2003-2005 falling by 2 percentage points of GDP. However, the improvement relied disproportionately on expenditure cuts rather than higher revenue collections. The PDF cautioned the authorities against this trend, emphasizing that there is no inconsistency between a lower budget deficit and higher spending on public infrastructure, health and education – all of which have been compressed – as long as revenues are increased, public expenditure efficiency improved, and service delivery of government corporations and agencies enhanced. Improving the overall financial performances of government corporations will complement tax enhancement efforts; reforms and privatization in the power sector are important.

10. The PDF characterized 2005 as "the year of tax legislation" and 2006 as "the year of tax implementation", with the overall tax effort expected to improve by 1.4 percentage points, from 13.1% in 2005 to 14.5% this year. Government is targeting a return to the 1997 tax/GDP ratio of 17% by 2010. In 2006 the National Government and consolidated public sector budget deficits are expected to decline to 2.1% and 2.2% of GDP, respectively, 1.8 and 2.7 percentage points lower than in 2004⁹. The PDF noted that these are ambitious but achievable targets.

b. Increasing transparency and efficiency in public expenditures and controlling corruption

11. The Philippines' development agenda is benefiting from serious attention to nurturing and strengthening governance. Public demand for effective governance systems and practices is strong, and the response from the authorities is positive. The PDF supports this effort, and individual partners are providing support for numerous initiatives, which President Arroyo acknowledged in her remarks. On the economic front, significant contributions to fiscal consolidation can be expected from improved governance and better public resource management, including such things as full implementation of the Government Procurement Reform Act (2003). Nevertheless, the PDF noted Philippines is burdened by low ratings on international corruption perception indexes, and the challenges remain formidable. The PDF suggested perceptions will be

⁷ The Implementing Rules and Regulations of the Law were released on 30 May 2006, allowing the performance-based provisions to be implemented from January 2007.

⁸ For example, borrowing from the international market in January 2006 was secured at 333 basis points over US treasuries compared to about 505 basis points one year earlier.

⁹ In this regard, Philippines meets the CSP's primary macroeconomic performance criteria for ADB's policy-based lending, which is a reduction in the National Government's budget deficit of 0.7 percentage points of GDP against the baseline result for 2004 (CSP, Appendix 3, *CSP Results Framework*).

improved by greater attention to measures of anti-corruption *outcomes* such as number of cases resolved, cost savings, increased transparency, and higher civil society participation.

12. An important part of the efforts of the Governance and Anti-Corruption working group, co-chaired by ADB, was preparation of the framework for the National Anti-Corruption Plan of Action (NACPA). The NACPA aims to make corruption a high risk–low reward activity by streamlining and strengthening the anticorruption commitments of the government and its partners under a comprehensive strategic framework, along the lines of the three actionable “Ps” – prevention, prosecution and promotion. In 2006, the Office of the Ombudsman (OMB) will lead operationalizing the NACPA. It will establish a multi-sectoral advisory board headed by the Ombudsman and with representatives from government agencies, civil society, and private sector, and supported by a secretariat based in OMB. Due to its limited resources, OMB intends to focus on quick, high impact projects. The PDF welcomed progress in fighting corruption in terms of significant strengthening of staff and other resources of OMB, an increase in the conviction rate by the *Sandiganbayan* (anti-corruption court) from 6% in 2002 to 33% in 2005, and implementation of Department of Finance’s highly publicized “revenue integrity protection system – RIPS”, which investigates corruption among public servants through lifestyle checks based on income comparisons. President Arroyo referred to learning from the Hong Kong model of fighting corruption; former Hong Kong anti-corruption czar Tony Kwok has been hired, with development partner financing, to assist implementation of the local program.

13. The PDF welcomed implementation of Executive Order No. 366 (October 2004), which requires all government departments, agencies, bureaus, and corporations to complete strategic reviews to rationalize their functions and staffing. This includes preparing restructuring plans (abolishing, merging, and privatizing functions, and right-sizing staffing), in order to improve core service delivery efficiency. Together with promotion of performance-based budgeting, this will enhance public confidence in government. ADB is supporting the effort in several ways, including technical assistance for reforms of government owned and controlled corporations¹⁰, and strengthening government information systems¹¹.

14. The PDF acknowledged progress made on decentralization under the Local Government Code (1991), which makes local government units (LGUs) accountable for delivery of a wide range of services. However, effective devolution has been hampered by a mismatch between LGU mandates and resources available to deliver them. The PDF encouraged strengthening LGUs’ own-revenue mobilization, broadening their access to alternative financing sources¹², improving their capacities for public resource management and project evaluation¹³, and encouraging public-private partnerships for

¹⁰ The proposed TA for *Government Owned and Controlled Corporations Reform* for \$750,000.

¹¹ ADB. March 2006. Japan Fund for Information and Communication Technology grant for *Supporting Information Sharing and Exchange among Civil Servants*, for \$500,000.

¹² See, for example: ADB. March 2006: TA for *Local Governance and Fiscal Management Project*, for \$1.8 million. Also, during the PDF, President of the League of Provinces indicated strong willingness to take loans directly from ODA partners without sovereign guarantee. To ensure the viability of the proposal, the League is seeking an “internal revenue allotment intercept”, which would act as collateral to lenders, and free LGUs’ other assets from exposure. ADB subsequently held discussions with the League on opportunities for sub-sovereign lending, and is scheduling a workshop for the League on ADB’s Innovation and Efficiency Initiative.

¹³ See, for example: ADB. 2004. TA for *Strengthening Provincial and Local Planning and Expenditure Management*, for \$350,000.

service delivery. The PDF welcomed progress on local government performance monitoring¹⁴. ADB's *Country Strategy and Program 2005-2007* includes intensified support for LGUs as a major pillar of its partnership with Philippines; while ADB's Innovation and Efficiency Initiative provides new opportunities for direct engagement with LGUs, including through sub-sovereign lending products.

15. The PDF regretted the failure of governance associated with the much-delayed passage of the 2006 General Appropriations Act (the budget)¹⁵. The delay requires Government to operate on the re-enacted 2005 budget, reducing the effective use of scarce budget resources in terms of support for current spending priorities. The PDF expressed concern at the erosion of public confidence caused by delayed annual budget approvals by Congress, which has been a frequent occurrence. Related to the budget process, the PDF encouraged Government to be more transparent in reporting on how incremental VAT revenues are being spent.

c. Accelerating and broadening the base of growth to ensure it benefits more Filipinos

16. Recently, President Arroyo stated "... if growth must directly impact the poor, we need to do more"¹⁶. Part of the answer provided by the PDF was to highlight the strong linkage between higher growth and more rapid poverty reduction, the central role of infrastructure in underwriting higher growth, and the importance of improved access by the poor to that infrastructure for them to access markets and participate in the growth process. The PDF identified as key priorities (i) improved government institutional capacity for overall planning and coordination of infrastructure investments, (ii) refocusing national oversight agencies from project-specific concerns to more forward looking strategic and policy frameworks, and (iii) enhancing capacity of LGUs to finance infrastructure or encourage other investors. In view of the tight budget situation, the PDF emphasized the need to strengthen the model for engaging the private sector and to clarify the framework for private participation. Important also is development of clear infrastructure roadmaps, with prioritized project pipelines and time-bound sector reform agendas. Power, transport and water were identified as critical areas, not only in the large cities, but in municipalities and barangays throughout the country.

17. The small and medium enterprise sector is highlighted in the Medium Term Philippine Development Plan as a major generator of employment and income opportunities, and is important for achieving the government's goal of 10 million new jobs by 2010. Facilitating access to capital, and improving the process of business registration¹⁷ were highlighted by the PDF as two priority areas, while reducing "red tape" at the sub-national level can be expected to yield quick results in terms of crowding in private investment. Within this context, the PDF encouraged improved dialogue between national and local governments to increase understanding of the benefits of implementing reforms, and to assist LGUs with their efforts.

¹⁴ See, for example: ADB (forthcoming), *Performance Measurement at the Local Level*.

¹⁵ The Government's fiscal year begins 1 January. At the time of writing, the budget had not been passed by Congress, increasing the likelihood that Government will operate on the re-enacted 2005 budget for all of 2006.

¹⁶ Office of the Press Secretary, Manila. *Statement of the President on First Quarter Result*. 31 May 2006. (www.news.ops.gov.ph)

¹⁷ See, for example: ADB. August 2005. Japan Fund for Information and Communication Technology grant for *Developing the Philippine Business Registry* for \$700,000.

18. On the business climate, the importance of a robust, credible regulatory environment was noted. Strengthening regulatory authorities will reduce the need to seek remedies through the Supreme Court, as has often been the case in major infrastructure sectors¹⁸. The PDF suggested attention be given to rationalizing fiscal incentives among the eight investment promotion agencies. It was noted that there are over 140 independent incentives, which poses a challenge for business. A bill to establish a single, country-wide incentives policy is being sponsored by the Board of Investment.

d. Accelerating progress on the Millennium Development Goals

19. More rapid poverty reduction is the objective of the Medium Term Philippine Development Plan. More needs to be done if the MDG targets are to be achieved. The PDF noted that modest economic growth coupled with high population growth, and high income inequality, pose challenges for achieving the income MDGs. Recently compressed spending in the social sectors and on public infrastructure complicates the task of meeting many of the non-income MDG targets.

20. The PDF acknowledged recent accomplishments, especially intensive advocacy efforts: at the national level, for example, MDG mainstreaming is supported by the Medium Term Philippine Development Plan, and the House of Representatives Special Committee on MDGs (which, among other things, monitors legislation in terms of its contribution to the MDGs); local level initiatives include building awareness of local authorities on the concepts and localizing the MDGs (especially through efforts of the League of Municipalities of Philippines - LMP), and introducing community-based monitoring systems as a tool to measure progress (involving LMP, National Anti-Poverty Commission, and Department of Interior and Local Government). The private sector also is active in its advocacy of embedding MDGs in core business and social investments¹⁹.

21. For more rapid progress toward the MDGs, the PDF emphasized striking a balance between economic growth and equity in social benefits, partly by improving the quantity and quality of social spending, which has been compressed in recent years. Areas identified for special attention include early childhood education, alternative learning systems, private sector participation in social service delivery, children's and women's health services for early childhood interventions, improving women's reproductive health (which continues to be hampered by high population growth), and developing a policy on population.

22. President Arroyo gave special emphasis to the urgency of resolving the three-decades old armed conflict in Mindanao, noting it is here that many of the answers lie to better progress on the MDGs. Partly because of the persistent conflict, seven of Philippines 10 poorest provinces are in Mindanao, and although many development partners have strong interest there, the region receives a disproportionately low amount

¹⁸ ADB's recent support includes: December 2004. *Institutional Strengthening of Energy Regulatory Commission and Privatization of National Power Corporation* for \$1.2million; August 2001. *Capacity Building for the Regulatory Office of Metropolitan Waterworks and Sewerage System* for \$800,000.

¹⁹ See, for example, Philippine Business for Social Progress. December 2004. *Responding to the Millennium Development Challenge: A Roadmap for Philippine Business*. This is a joint effort of National Economic and Development Authority, PBSP, and United Nations.

of total ODA to Philippines²⁰. Nevertheless, Mindanao has high potential for growth, especially if transport links to the rest of the country are strengthened. Prospects for peace have improved. There has been a sharp reduction in the level of armed confrontation, aided by deployment of an International Monitoring Team, led by Malaysia, to ensure compliance with the ceasefire agreement between Government and the Moro Islamic Liberation Front (MILF). Dialogue continues towards forging a peace agreement, which is a condition precedent for implementing the Mindanao Trust Fund, a grant facility to be subscribed to by ODA partners as a dividend to sustain the peace by supporting reconstruction and rehabilitation in post-conflict affected areas.

III. NEXT STEPS

23. Conveners of the seven working groups were encouraged immediately to plan on how they will pursue the agenda identified during the 2006 PDF. All development partners were invited to participate actively in the process.

24. Finance Secretary Teves suggested, and participants agreed, that an interim PDF should be scheduled for the third quarter of 2006²¹ (i) to get updates from the working groups on implementation of the actionable agenda items, and (ii) to review Philippines economic progress based on data for the first half of the year.

²⁰ Conversely, about 40% of ADB's lending to Philippines has been for projects exclusively in Mindanao, or for national projects with Mindanao components.

²¹ Scheduled tentatively for 18 August.