PRIVATE SECTOR ASSESSMENT
Philippines

Private Sector Assessment - Philippines

This private sector assessment was undertaken to provide essential background for the development of a coherent strategy for private sector development (PSD) in the Philippines. This is for ADB’s country strategies and programs which is developed in partnership with the Republic of the Philippines. The analysis aims to identify ways to promote a strong and dynamic private sector that will contribute to the country’s long-term economic growth and to sustained poverty reduction.

This assessment is organized into five main sections: (i) an overview of the macroeconomic environment and the role of the private sector in the economy; (ii) the framework for and key impediments to PSD; (iii) an analysis of key economic sectors affecting PSD (physical infrastructure, financial sector, social sectors, and agriculture); (iv) an overview of the experience of ADB in funding PSD initiatives in the Philippines; and (v) a proposed PSD strategy for ADB.

About the Asian Development Bank

The Asian Development Bank (ADB)’s work is aimed at improving the welfare of the people of the Asia and Pacific region, particularly for the 1.9 billion who live on less than $2 a day. Despite the success stories, Asia and the Pacific remains home to two thirds of the world’s poor.

ADB is a multilateral development finance institution owned by 63 members, 45 from the region and 18 from other parts of the globe. ADB’s vision is a region free of poverty. Its mission is to help its developing member countries reduce poverty and improve their quality of life.

ADB’s main instruments in providing help to its developing member countries are policy dialogues, loans, technical assistance, grants, guarantees, and equity investments. ADB’s annual lending volume is typically about $6 billion, with technical assistance provided usually totaling about $180 million a year.

ADB’s headquarters is in Manila. It has 26 offices around the world. The organization has more than 2,000 employees from over 50 countries.
Private Sector Assessment

Philippines

Asian Development Bank

May 2005
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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AmCham</td>
<td>American Chamber of Commerce</td>
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<tr>
<td>ATO</td>
<td>Air Transportation Office</td>
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<tr>
<td>BIR</td>
<td>Bureau of Internal Revenue</td>
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<tr>
<td>BOT</td>
<td>build-operate-transfer</td>
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<tr>
<td>BSP</td>
<td>Bangko Sentral ng Pilipinas</td>
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<tr>
<td>CAB</td>
<td>Civil Aeronautics Board</td>
</tr>
<tr>
<td>CAP</td>
<td>college assurance plan</td>
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<tr>
<td>CARP</td>
<td>comprehensive agrarian reform program</td>
</tr>
<tr>
<td>CHED</td>
<td>Commission on Higher Education</td>
</tr>
<tr>
<td>DOH</td>
<td>Department of Health</td>
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<tr>
<td>DOTC</td>
<td>Department of Transportation and Communication</td>
</tr>
<tr>
<td>DPWH</td>
<td>Department of Public Works and Housing</td>
</tr>
<tr>
<td>EPIRA</td>
<td>electric power industry reform act</td>
</tr>
<tr>
<td>ERC</td>
<td>Energy Regulatory Commission</td>
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<td>FDI</td>
<td>foreign direct investment</td>
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<tr>
<td>GASTPE</td>
<td>Government’s Assistance to Students and Teachers in Private Education</td>
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<tr>
<td>GDP</td>
<td>gross domestic product</td>
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<tr>
<td>GOCC</td>
<td>government-owned and government-controlled corporation</td>
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<tr>
<td>IC</td>
<td>Insurance Commission</td>
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<tr>
<td>ICT</td>
<td>information and communication technology</td>
</tr>
<tr>
<td>IPP</td>
<td>independent power producer</td>
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<tr>
<td>LGU</td>
<td>local government unit</td>
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<td>MSMEs</td>
<td>Micro, small and medium-sized enterprises</td>
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<tr>
<td>NAIA</td>
<td>Ninoy Aquino International Airport</td>
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<tr>
<td>NBFIIs</td>
<td>nonbank financial institutions</td>
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<tr>
<td>NFA</td>
<td>National Food Authority</td>
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<tr>
<td>NBFG II</td>
<td>Nonbank Financial Sector Governance Program II</td>
</tr>
<tr>
<td>NHMFC</td>
<td>National Housing Mortgage Finance Corporation</td>
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<tr>
<td>NPA</td>
<td>nonperforming assets</td>
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<td>NPC</td>
<td>National Power Corporation</td>
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<tr>
<td>NPL</td>
<td>nonperforming loan</td>
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<td>PhilHealth</td>
<td>National Health Insurance Corporation</td>
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<tr>
<td>PLDT</td>
<td>Philippine Long Distance Telephone Company</td>
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<td>PNCC</td>
<td>Philippine National Construction Corporation</td>
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<td>PNR</td>
<td>Philippine National Railways</td>
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<td>PPA</td>
<td>Philippine Ports Authority</td>
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<td>PPI</td>
<td>private participation in infrastructure</td>
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<tr>
<td>PSE</td>
<td>Philippine Stock Exchange</td>
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<td>PSD</td>
<td>private sector development</td>
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<tr>
<td>ROPOA</td>
<td>real and other properties owned or acquired</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SME</td>
<td>small and medium-sized enterprises</td>
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<tr>
<td>SPV</td>
<td>special purpose vehicle</td>
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<tr>
<td>SUCs</td>
<td>state universities and colleges</td>
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<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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<tr>
<td>WDs</td>
<td>water districts</td>
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Philippines Private Sector Assessment  V
Foreword

The Philippines’ entrepreneurial culture, skilled workforce, and pro-business economic policies have led to consistently high levels of private sector involvement in the economy. Private firms generate 95% of gross domestic product (GDP) and employ 92% of the workforce. The rapid expansion of new call centers and other outsourcing operations reflects the real competitive strengths of Philippine businesses. This private sector assessment notes many indications of such dynamism.

Economic liberalization in the 1980s and 1990s resulted in large inflows of private investment including foreign participation in previously closed sectors such as retail trade, telecommunications, banking, and infrastructure helping fuel an average real GDP growth rate of 2.5% from 1980 to 1997. Foreign investors became significant players in such industries as banking, life insurance, and manufacturing.

In recent years, private investment has slowed raising concerns that the private sector’s ability to drive sustained high rates of growth is weakening. This report highlights governance issues that are weakening the business environment including the lack of rule-based regulations and the treatment of private firms. Infrastructure weaknesses that add to the cost of doing business, undermine competitiveness, and deter private investment are also assessed. The lack of a vibrant financial sector with financially sound banks and an active capital market is noted as a third core constraint in private sector development (PSD).

A focused effort to overcome these problems can aid significantly in shifting the Philippines to a more rapid and sustainable growth path and can generate income and employment that will reduce poverty. For the Asian Development Bank (ADB) to make a significant contribution to that effort, this assessment proposes a PSD strategy based on the analysis in its opening sections. The proposed PSD strategy is intended to provide broad direction and emphasis to ADB’s PSD interventions in the Philippines. It focuses on strengthening the enabling environment for business through legal, regulatory, and governance reforms as these are the most serious impediments to sustained private sector growth.

This report was based on extensive interviews and workshops with private sector representatives throughout 2003. It also draws on the January 2004 investment climate survey conducted by ADB and the World Bank in which the principal business constraints of many private enterprises were assessed. The views of the private sector are therefore largely reflected in the analysis.

The work was funded by ADB and prepared by a team of consultants including Laure Darcy, Mario B. Lamberte, Florian A. Alburo, and Epictetus E. Patalinghug under the guidance of F. Cleo Kawawaki, Senior Private Sector Development Specialist and Thomas Crouch, Country Director, Philippines Country Office, with close consultation with the Philippines Country Team and other ADB staff.

SHAMSHAD AKHTAR
Director General
Southeast Asia Department
Asian Development Bank
Executive Summary

The Philippines has a long tradition of private sector-led growth, and indeed its entrepreneurial culture, skilled workforce, and pro-business economic policies have led to consistently high levels of private sector involvement in the economy. The efforts of successive administrations to liberalize the economy in the 1980s and 1990s resulted in large inflows of private investment, including foreign participation in previously closed sectors such as retail trade, telecommunications, banking, and infrastructure.

Despite the political upheaval and recession of the mid-1980s, economic liberalization has largely remained on track fueling an average real gross domestic product (GDP) growth rate of 2.5% from 1980 to 1997, and allowing foreign investors to become significant players in such industries as banking, life insurance, and manufacturing. Moreover, the liberalization of the power sector in the early 1990s resulted in over 35 new power projects and the current dominance of the private sector as the owner and/or operator of 70% of the generating capacity in the country.

In other infrastructure sectors, private companies have also taken a leading role such as in the development of the telecommunication network (cellular networks, cable, Internet, and other related services), water supply (e.g., Manila Water Company and Manila Water Services, Inc.), and toll road development. Private investment flows slowed after the 1997 Asian financial crisis, however, and have yet to recover. Gross domestic investment steadily declined from 23.8% of GNP in 1997 to 18.1% in 2002, and foreign direct investment (FDI) dropped from a high of $2.1 billion in 1999 to $0.1 billion in 2003.

The drop in both domestic and foreign investment is largely due to the deteriorating investment climate in the Philippines. Growing fiscal deficits have weakened the economy, vested interests appear to increasingly influence both legislative and judicial proceedings, and the weakness of the public sector in creating and enforcing freely competitive and/or regulated markets acts as a deterrent to prospective investors and as a drag on economic growth. While private enterprises dominate the economy, effective competition does not exist in many sectors.

For foreign investors, the perceived risks of doing business in the Philippines are rising, encouraging them to seek alternative investment destinations such as the People’s Republic of China, the Republic of Korea, and Thailand. Disputes concerning private contracts in the power, water, and airport sectors have highlighted the weakness of the legal and regulatory framework, the limited recourse available to resolve disputes, and the high level of political intervention in the commercial sector. Add to these the high costs of power and labor, and the costs of doing business in the Philippines become comparatively greater than in alternative regional destinations.

Aggravating this loss of competitiveness is the increasingly weak financial position of the central government. Consistently low revenue collection, mounting government-owned and government-controlled corporation (GOCC) losses, and high external debt servicing costs have aggravated its accumulated deficit. Poor tax and customs administration together with poor taxpayer

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3 In 2003, the private sector generated 95% of GDP and employed 92% of the registered workforce.
4 Out of the 44 commercial banks, 17 are foreign branches or subsidiaries of foreign banks, and 19 domestic banks have foreign equity participation.
5 Twelve out of 35 insurance companies are foreign owned.
6 Major players in the car industry (e.g., Toyota, Nissan, Honda, Mitsubishi, and Columbian Motors) have foreign equity participation ranging from 37.5–100%.
7 Of the 70% of total generating capacity operated by private parties, 82% is owned by the National Power Corporation but operated by private parties under independent power producer contracts; the remaining 18% is owned by private parties.

8 FDI has been on the decline for all of Asia since 2000, with only the People’s Republic of China recording a net year-on-year increase.
compliance are largely responsible for a decline in tax revenue which fell to 14% of GDP in 2003. The national debt reached $55 billion in 2003, or 73% of GDP, with interest payments absorbing close to 38% of total government revenues. GOCCs contributed another P97 billion ($1.76 billion) of losses in 2003 with few signs of a turnaround.

Adding to this fiscal burden are substantial contingent liabilities that are estimated at a further P3.1 trillion ($56 billion), representing maximum exposures under pension, risk, debt, and deposit guarantees. With this high level of contingent liabilities, the government has already exceeded its capacity and cannot feasibly contract additional exposure without first reducing that which exists.

In this context, restoring investor confidence to fuel investment needs and economic growth is increasingly urgent. The newly elected Arroyo administration recognizes its unique opportunity to demonstrate its commitment to establishing a rule-based business environment that encourages investment and rewards fair competition. The President’s development agenda has ambitious targets for job creation and fiscal management that are key elements of long-term growth but which are achievable only with governance reforms to remedy key weaknesses in the investment climate.

The government has taken steps towards improvement in governance; this needs to be continued. In the context of investment, governance reform essentially means establishing and enforcing a rule-based business environment that encourages investment and rewards fair competition. In the Philippines, vested interests and systemic corruption will continue to make this process very challenging, but significant progress can be achieved with sustained political commitment.

If a favorable business environment is the most fundamental requirement for sustained private sector development, adequate physical infrastructure and the availability of finance are key supporting factors as they allow businesses to operate, access markets, and finance growth. While it is recognized that the country is in need of immediate private investment to address looming power shortages, deteriorating roads, poor water supply, and rising unemployment, the long-term benefits of these investments, and indeed their impact on poverty reduction, will depend on the implementation of stronger legal, regulatory, and institutional frameworks within each sector as well as in support of the economy as a whole.

Therefore the central tenet of the Asian Development Bank’s sustainable private sector development strategy for the Philippines will be governance reform. The two pillars of assistance will be for development and modernization of the physical infrastructure and financial sectors underpinned by governance reform.

**Development Agenda—July 2004**

“To create a higher economic growth path, we will need to bring investments from 19% of GDP to 28% of GDP, and increase our exports of goods and services from $38 billion to $50 billion within two years.”

“To achieve these objectives, government will provide the policy environment that will reduce the costs and risks of doing business and nurture globally competitive enterprises that will produce goods of high quality in a cost-efficient manner. It will also provide the marketing and logistical support to facilitate domestic and international trade and effect transfer of knowledge that will increase the productivity of our people.”

Introduction

This private sector assessment was undertaken to provide essential background for the development of a coherent strategy for private sector development (PSD) in the Philippines. As with other private sector assessments developed for Asian Development Bank (ADB) member countries, the analysis aims to identify ways to promote a strong and dynamic private sector that will contribute to the country's long-term economic growth and to sustained poverty reduction. Private sector assessments also serve as key inputs to ADB country strategies and programs.

This assessment is organized into five main sections: (i) an overview of the macroeconomic environment and the role of the private sector in the economy; (ii) the framework for and key impediments to PSD; (iii) an analysis of key economic sectors affecting PSD (physical infrastructure, financial sector, social sectors, and agriculture); (iv) an overview of the experience of ADB in funding PSD initiatives in the Philippines; and (v) a proposed PSD strategy for ADB addressing the key impediments identified in the previous analysis and taking into consideration the past experience of ADB in the Philippines and the limited absorptive capacity of the Philippine government, both financial and institutional.
I. THE PRIVATE SECTOR IN THE MACROECONOMIC ENVIRONMENT

A. Macroeconomic Overview

The Philippine economy has proved quite resilient to external shocks and changes in economic policy over the past 5 years. While many of its neighbors suffered deep recessions during the post-Asian crisis years of 1998–2001, the Philippine economy continued to grow at an average pace of 2.5% per annum. Despite these gains, the rapid pace of population growth has led to the lowest overall per capita gross domestic product (GDP) growth rate in the region from 1990 to 2001 (see Figure 1). GDP growth has been largely consumption led, as both national savings and domestic investment rates have fallen since 2000 (Appendix 1). The Philippines has one of the lowest investment to GDP ratios (20%) in East Asia and the lowest capital stock per worker among market economies in the region. The persistent inflows of remittances from overseas Filipino workers (see Figure 2) averaging more than $6.7 billion annually in recent years, has helped boost consumption, but the slow rate of new investment raises questions about the overall sustainability of this growth in the coming years.  

GDP growth has proven to be closely related to poverty reduction in the Philippines where high growth rates from 1986 to 1997 led to a reduction in the official incidence of poverty from 44.2% of the population in 1981 to less than 20% by 2000. 

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1 Average GDP per capita growth rate in 1990–2001 was 0.5% for the Philippines compared with 3% for Bangladesh and Indonesia, 4% for Malaysia and Thailand, 5.5% for Viet Nam, and 8.2% for the People’s Republic of China.

2 Amount flowing through formal channels, according to Bangko Sentral ng Pilipinas (BSP); it is estimated that informal transfers add another 50% to this amount.

3 See more on investment trends in sections C and D.

4 Per-capita gross national product (GNP) growth during 1995–1997 averaged almost 3% per year.
families in 1985 to 31.8% in 1997. Slow GDP growth since 1998 reversed that trend with the incidence of poverty rising to 33.7% of families in 2000. Similarly, the incidence of poverty among individuals decreased from 49.2% in 1985 to 36.9% in 1997 before rising to 39.5% in 2000 (ADB 2004). These trends are illustrated in Figure 3 that shows data taken from the Philippine poverty assessment report prepared by ADB in July 2004.

National figures mask significant geographical disparities. In addition to urban-rural income disparities, regional differences are also marked, particularly among the three major island groups of Luzon, Visayas, and Mindanao (southern Philippines). The highest incidence of poverty is in Mindanao, where GDP is lowest (see Table 1). As will be demonstrated in subsequent sections of this report, the southern Philippines also has the poorest physical infrastructure and fewest nonfarm employment opportunities, further dampening efforts to stimulate economic growth.

The newly elected government of President Arroyo is acutely aware of the need to foster broad-based economic growth to reduce the levels of poverty in the country. In her July 2004 development agenda, she declared, “Our objective is to improve our economic growth from the current rate of less than 5% and move it up to 7% per annum, or even more, on a sustained basis, up to the year 2010. Through this we will be able to bring the poverty rate from 34% down to a more manageable 17% by the end of the President’s term.”

![Figure 3: Income Poverty in Philippines 1985–2000](image)

Source: National Statistical Coordination Board, various years

<table>
<thead>
<tr>
<th>Table 1: Gross Domestic Product and Poverty Incidence by Region</th>
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<tr>
<td><strong>Region</strong></td>
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<tr>
<td>PHILIPPINES</td>
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<tr>
<td>NCR</td>
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<tr>
<td>CAR</td>
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<td>ARMM</td>
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<td>XIII</td>
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</table>

* Provinces comprising of (CARAGA) region are included in Region X and XI based on the old regional groupings.
**Provinces comprising of (CAR) region are included in Region X and XI based on the old regional groupings.

Source: National Statistical Coordination Board, various years

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5 Per-capita GNP growth in 1998-2000 averaged 0.8% per year while population growth remained at 2.2% per year during 1995-2000.
The economy is dominated by the services sector which contributed approximately 50% of GDP in recent years, followed by industry/manufacturing at 32% and agriculture, fishing, and forestry at 15–17%. The services sector has also had the fastest growth rate in recent years, reflecting the fast pace of consumption and demand for telecommunications and food services.

One of the most salient characteristics of the Philippine economy is its rising budget deficit brought on by a combination of poor revenue collection and the rapidly accumulating liabilities of its government-owned and government-controlled corporations (GOCCs), in particular the National Power Corporation (NPC). The budget deficit grew from 1.8% of GDP in 1998 to an estimated 4.5% in 2003 (see Figure 4). Weak tax and customs administration together with poor taxpayer compliance are largely responsible for the decline in tax revenue which fell from 16% of GDP in 1997 to 14% in 2003. The potential for improvements in tax collection is significant given that a change in management at the Bureau of Internal Revenue (BIR) in 2002 succeeded in increasing revenue collection by 13% year-on-year in 2003. Ongoing administrative reforms and computerization will be important steps in further improving the performance of both customs and internal revenue collection. Particular emphasis must be placed on implementing BIR’s large taxpayer service that targets those taxpayers whose collective liabilities contribute more than 70% of total income tax revenue.

The persistent deficits in the operations of its GOCCs further weaken the financial position of the government. NPC alone is expected to contribute P73 billion to the consolidated public sector deficit in 2003, largely due to further mandated reductions in the tariffs in 2003, inadequate capitalization, and onerous offtake obligations with its independent power producers (IPPs). Restructuring the power sector and addressing the issue of tariff levels is therefore essential in restoring a manageable fiscal balance (see Table 2).

<table>
<thead>
<tr>
<th>Table 2: Consolidated Public Sector</th>
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<tbody>
<tr>
<td>Billion pesos</td>
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<tr>
<td>National Government</td>
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<tr>
<td>Capitl Bank Restructuring</td>
</tr>
<tr>
<td>Monitored GOCCs</td>
</tr>
<tr>
<td>NPC (share of)</td>
</tr>
<tr>
<td>NFA (share of)</td>
</tr>
<tr>
<td>SSS/GSIS</td>
</tr>
<tr>
<td>BSP</td>
</tr>
<tr>
<td>GFIs</td>
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<tr>
<td>LGUs</td>
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</tbody>
</table>

GOCCs= Government Owned or Controlled Company, NPC= National Power Corporation, NFA= National Food Authority, SSS= Social Security System, GSIS= Government Service Insurance System, LGUs= Local Government Unit

Source: Department of Finance, 2004

The government also faces a ballooning national debt that reached $55 billion in 2003, or 73% of GDP. Approximately 50% of this amount was denominated in foreign currencies. Interest payments were close to 38% of total government revenues in 2003, up from only 17% in 1997. Rising levels of debt service are crowding out other important government expenditures such as much-needed transfers to local governments (LGUs) to support their public service obligations and expenditures in health, education, and physical infrastructure.

Contingent liabilities of the government are estimated at a further P3.1 trillion ($56 billion), representing maximum exposures under obligations such as (i) unfunded liabilities of pension programs (P1.8 trillion), (ii) direct guarantees on loans to GOCCs (P66 billion), (iii) risk guarantees for build-operate-transfer (BOT) contracts (P45 billion), and (iv) deposit insurance (P352 billion) (ADB/World Bank 2003). With this high level, the government has already maximized its capacity and it would not be able to borrow.

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A more detailed discussion of NPC’s financial position and the power sector in general is provided in Chapter III.

Philippines Private Sector Assessment
prudent to contract additional exposure without first reducing existing liabilities. Although the risks associated with these guarantees may not materialize, it is imperative for the government to develop a mechanism to accurately account for them and to create corresponding provisions.

In summary, the Philippine government is in a very weak financial position. As it looks to support measures for fostering economic growth and private sector development, it will be very limited in the financial investments that it can make. This may actually be fortuitous. As will be demonstrated throughout this paper, the most important contribution that the national government can make to private sector development is creating better conditions for private investment including more competitive markets, credible regulatory oversight, better administrative performance from supporting government agencies, and a reliable mechanism for dispute resolution.

**B. Profile of the Private Sector**

**1. Contribution to the Economy**

The private sector dominates the Philippine economy generating on average 95% of GDP and accounting for 85% of total expenditure during 1991–2002 (see Figure 5). The private sector also contributes on average 65–75% of total investment, although its share dropped to 66% after the Asian financial crisis as the economy contracted and the government intervened to revive growth.

Private enterprises employ 92% of the registered workforce but have not been able to keep pace with the growing number of job seekers since the Asian financial crisis. Unemployment rose from 7.9% in 1997 to 10.2% in 2002. The inability of the domestic economy to absorb a large portion of the growing number of new entrants into the labor market and the relatively large differential in pay between local and foreign employment have encouraged many Filipinos to seek employment abroad.

The overall productivity of the private sector is low and declining (see Figure 6). Rising real wages due to successive rounds of minimum wage increases have not been matched by concurrent rises in productivity, such that unit labor cost rose from 1.0 in 1978 to 1.3 in 2000. In contrast, the unit labor cost of Malaysia and Thailand were close to or less than 1 for most of the same period (Jurado 2000). Business efficiency in the Philippines, i.e., the extent to which enterprises are performing in an innovative, profitable, and responsible manner, was found to be one of the lowest among 49 industrialized and emerging economies (Macaranas and Silva 2002).

The key factors causing this poor competitiveness relate to the enabling environment for business (e.g., high labor and energy costs, poor infrastructure, weak governance and regulation) and are explored in detail in Chapter III.

In spite of its lack of competitiveness, the Philippines has managed to leverage some of its key resources (educated and English-speaking workforce,
modern information and communication technology [ICT], strategic location) to foster the growth of some new industries. The proliferation of call centers and business process outsourcing activities in recent years has demonstrated the Philippines’ competitiveness in these sectors (even in the face of intense competition from India), and the country’s location has made it a hub for major air courier companies such as Federal Express. The recognition that these and other industries are attractive to foreign investors as well as the changing manufacturing landscape fostered by the growing weight of the People’s Republic of China as an export market should serve to orient the government’s efforts to further promote investment.

2. Types of Business Organizations

There are approximately 825,000 registered private enterprises operating in the Philippines: 91% are microenterprises, 8.5% are small and medium-sized enterprises (SMEs), and 0.5% are large companies. It would follow that the largest employers in the economy are microenterprises and SMEs, accounting for 41% and 30% of total employment, respectively (see Figure 7).

Micro, small and medium-sized enterprises (MSMEs) are predominately engaged in wholesale/retail trade and light manufacturing. These types of enterprises also provide the majority of social and personal services, agriculture, real estate, and construction in the country. Employment numbers in these industry sectors show that micros account for 67% and 57% of employment in the trade and the restaurant sectors while large firms employ almost half (48%) of all employees in the manufacturing sector and 42% of those in the real estate sector (see Table 3).

Despite their predominance in the economy, the contribution of MSMEs to total value added remains low relative to other middle-income Asian countries. In 2002, MSMEs contributed 32% to total value added compared with 46% and 60% in the Republic of Korea and the People’s Republic of China, respectively.

3. Shareholding and Market Concentration

The corporate sector is still relatively small accounting for only 26–29% of GDP during 1990–2001, but it is highly concentrated. The sector is

<table>
<thead>
<tr>
<th>INDUSTRY SECTOR</th>
<th>Micro</th>
<th>%</th>
<th>Small</th>
<th>%</th>
<th>Medium</th>
<th>%</th>
<th>Large</th>
<th>%</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale and Retail Trade</td>
<td>1,109</td>
<td>67</td>
<td>350</td>
<td>21</td>
<td>55</td>
<td>3</td>
<td>138</td>
<td>8</td>
<td>1,653</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>353</td>
<td>23</td>
<td>310</td>
<td>20</td>
<td>137</td>
<td>9</td>
<td>734</td>
<td>48</td>
<td>1,534</td>
</tr>
<tr>
<td>Hotels and Restaurants</td>
<td>267</td>
<td>57</td>
<td>152</td>
<td>32</td>
<td>19</td>
<td>4</td>
<td>33</td>
<td>7</td>
<td>470</td>
</tr>
<tr>
<td>Real Estate and Renting Services</td>
<td>103</td>
<td>25</td>
<td>93</td>
<td>23</td>
<td>41</td>
<td>10</td>
<td>174</td>
<td>42</td>
<td>411</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>40</td>
<td>13</td>
<td>79</td>
<td>26</td>
<td>23</td>
<td>8</td>
<td>159</td>
<td>53</td>
<td>301</td>
</tr>
<tr>
<td>Education</td>
<td>21</td>
<td>8</td>
<td>104</td>
<td>38</td>
<td>42</td>
<td>15</td>
<td>104</td>
<td>38</td>
<td>271</td>
</tr>
<tr>
<td>Financial Intermediation</td>
<td>74</td>
<td>29</td>
<td>98</td>
<td>39</td>
<td>11</td>
<td>4</td>
<td>70</td>
<td>28</td>
<td>254</td>
</tr>
<tr>
<td>Community and Personal Services</td>
<td>105</td>
<td>56</td>
<td>45</td>
<td>24</td>
<td>9</td>
<td>5</td>
<td>26</td>
<td>14</td>
<td>186</td>
</tr>
<tr>
<td>Health and Social Work</td>
<td>56</td>
<td>36</td>
<td>34</td>
<td>20</td>
<td>16</td>
<td>10</td>
<td>58</td>
<td>35</td>
<td>168</td>
</tr>
<tr>
<td>Total</td>
<td>2,132</td>
<td>41</td>
<td>1,265</td>
<td>24</td>
<td>353</td>
<td>7</td>
<td>1,496</td>
<td>29</td>
<td>5,248</td>
</tr>
</tbody>
</table>

% may not total to 100 due to rounding. 
dominated by large, family-owned businesses operating in diversified sectors (Saldaña 2000). At the end of 2003, 62% of the market capitalization of the Philippine Stock Exchange (PSE) was composed of 23 family-controlled groups (Philippine Center for Investigative Journalism 2004). These companies are typically closely held with the top five shareholders owning more than 50% of the total outstanding shares (Saldaña 2000). If one considers that less than 20% of the largest 1,000 corporations are listed on the PSE and that this pattern of ownership concentration is common throughout the corporate sector, then it would follow that significant portions of the wealth and GDP of the country are in the hands of a few business owners.9

Although high levels of ownership concentration are common in East Asia, what is notable in the case of the Philippines (as well as in Indonesia and Thailand) is the degree of concentration across firms (see Figure 8). It can be argued that Philippine conglomerates exhibit many characteristics similar to pre-crisis Korean chaebols and Japanese zaibatsus: they are family owned; have diversified interests; include a bank among their component firms (or ICT firm, in the case of chaebols); very few are publicly traded on the stock exchange; and — according to some researchers — they receive preferential treatment from the government due to the political influence of their directors (Tan 1993).

Although improving, the Philippine corporate governance regime remains weak which helps to perpetuate ownership concentration in the corporate sector. Practices such as cross-holdings of equity, interlocking directorates of banks and corporations, and pyramid holding structures—quite common in the Philippines—are effective barriers to hostile takeovers and help to prevent productive assets from coming into the hands of those best positioned to manage them efficiently. By limiting the scope for external corporate control, these weaknesses also limit the capacity of (and raise the cost to) firms to raise external finance and to expand in areas where they can compete (World Bank 2002).

The corporate sector has a high degree of market concentration, with the four largest firms in 18 major sectors of the economy comprising 74% of the total value added of the sector (Aldaba 2002). The effects of this market structure on competition and private sector development are discussed in more detail in Chapter III.

The private sector is also composed of a large segment of informal service providers, i.e., those “businesses” that do not register with the Department of Trade and Industry, do not report income to the BIR, and do not participate in the financial sector. While estimates of the size of this informal economy vary from 20–40% of the formal economy, there is little debate about its importance. A detailed study by the International Labour Organisation, to be published in June 2004, will provide a detailed analysis of the structure of the informal sector.

C. Investment and Sources of Finance

Since 1997, overall investment rates in the Philippines have slowed gradually as a percentage of GDP (see Figure 9). The decline from 2000 to 2003 mirrored the decline in interest rates indicating that investment contraction was not precipitated by high interest rates. The general economic downturn and the decline in the value of the peso are more important factors slowing investment.

One of the constraints to private sector growth in the Philippines is the low level of local debt and equity financing available (see Box 1). It is limited not only by borrowers’ capacity and the shortage of
collateral assets but also by the preference of commercial banks for short-term loans, the thin capital market, the absence of venture capital, and the relatively undeveloped leasing subsector. Despite a downward trend in interest rates, over 75% of Philippine companies participating in the 2003 ADB-World-Bank investment climate survey and 2000 world business environment survey reported high interest rates\(^\text{10}\) as a significant deterrent to obtaining bank financing, followed by onerous collateral and paperwork requirements.\(^\text{11}\) In general, these companies reported high interest rates as a more significant deterrent than access. As a result, it is estimated that 50% of Philippine companies finance their operations through retained earnings.\(^\text{12}\) It should be noted that this low level of bank financing is also common to neighboring Asian economies reflecting their equally dissuasive credit policies (see Figure 10).

**Box 1: Microfinance Sector**

While commercial banks tend to cater to larger corporate customers, the 93 thrift and 772 rural banks service small and medium-sized enterprises, essentially with working capital loans. There is also a growing microfinance market (loans under P150,000) that includes formal institutions such as thrift, rural, and cooperative banks and semi-formal institutions, such as credit unions and credit-granting nongovernment organizations (NGOs). A survey conducted by the Microfinance Council of the Philippines in late 2001 indicated that 88 institutions were providing microfinance loans: 41 rural/cooperative banks, 23 NGOs, and 24 cooperatives. The total loans outstanding of these microfinance institutions as of June 2001 amounted to P1,690 million distributed among 397,225 borrowers.

It is estimated that fewer than 20% of the microenterprises in the Philippines contract external financing, and financial institutions are reluctant to enter the market due to high-perceived risks and comparatively high cost of credit analysis. The United States Agency for International Development Microenterprise Access to Banking Service Project has demonstrated that rural microfinance banks that practice effective credit analysis can not only generate profits from this market segment but can also maintain nonperforming loans at below 10%. Given the small share of microfinance loans in the total assets of the sector, these institutions do not pose a systemic risk and could therefore benefit from a more liberal regulatory approach. Relaxing collateral and provisioning requirements, if accompanied by technical assistance to hone credit analysis skills and the establishment of a microcredit information bureau, should help more financial institutions expand into microlending.

The equity market in the Philippines is very small and is not liquid. In 2002, only five new issues were listed raising a total of $3.5 million. While there is an SME board, it has only five listings and is also not very liquid. The weak equity market deters the development of a venture capital industry, further reducing the sources of finance available to small firms. (See Chapter IV for a discussion of the financial sector.)

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\(^\text{10}\) Short-term lending rates varied between 13–20% for SMEs from 1999 to 2002.

\(^\text{11}\) These paperwork requirements appear onerous to companies undertaking them for the first time and do not necessarily imply a high level of due diligence and disclosure requirements by the banks.

\(^\text{12}\) Despite the mandated allocation of 25% of every bank’s net loanable funds for agriculture lending (as per Presidential Decree 717, also known as Agho-Agho Law) and 8% for SMEs, many companies still go without financing as banks prefer to satisfy the requirement with an alternative purchase of government bonds (where possible), as lending to smaller companies entails higher processing costs and risks.
D. Foreign Direct Investment

The Philippines has one of the lowest rates of foreign direct investment (FDI) in the region, an indicator of the perceived risks of doing business in the country and its unattractiveness relative to its neighboring economies. While the country benefited from high levels of FDI during the 1990s with its push to attract investment into the infrastructure sectors, net FDI dropped to just $0.1 billion in 2003, or 0.1% of GDP (see Figure 11).

![Figure 11: Net Foreign Direct Investment](source)

The perceived risks of doing business in the Philippines are rising, deterring foreign investors and encouraging them to seek alternative investment destinations such as People’s Republic of China, Republic of Korea, and Thailand. Moreover, the high costs of energy and labor, together with the general inefficiency of the public sector, add to the overall costs of doing business in the country and further depress its competitiveness. Given the high level of competition for FDI in the region, it is unlikely that the Philippines will see a marked increase of FDI inflows without substantial improvements in its investment climate (see Table 4).

The foreign capital that is invested in the Philippines is relatively diversified. Shares of foreign equity in the agriculture, industry, and service sectors were estimated at 19.3%, 50.8%, and 34.3%, respectively, in 2000. Increases in the shares of foreign equity are highly notable in sectors that have been substantially liberalized, such as manufacturing and electricity, gas and water, wholesale and retail trade, transport, storage, communications, financial intermediation, and real estate.

Foreign investors even dominate selected sectors of the economy such as cement where almost all firms are foreign owned. Nearly 40% or 17 of the 44 commercial banks are foreign branches or subsidiaries of foreign banks, while 19 domestic banks have foreign equity participation ranging from 13–42%. In the life insurance industry, 12 out of 35 insurance companies are foreign owned. Major players in the car industry—such as Toyota, Nissan, Honda, Mitsubishi, and Columbian Motors—have foreign equity participation ranging from 37.5–100%. Two of the three major oil firms are subsidiaries of foreign oil companies and the remaining one has 40% foreign equity participation.

This said, there remain restrictions to foreign ownership of Philippine companies in some sectors designated by the constitution or special laws (e.g., operation and management of public utilities, advertising, and small-scale mining). In these sectors, foreign equity participation is limited to 25–60%. Non-Filipinos are also restricted from owning land. As will be discussed in subsequent chapters, the restrictions on ownership of utilities and land are deterring needed investment in the power sector and slowing the process of resolving non-performing loans, respectively.

Table 4: Comparative Cost of Doing Business

<table>
<thead>
<tr>
<th>Country</th>
<th>Business Registration (days)</th>
<th>Contract Enforcement (days)</th>
<th>Insolvency (years)</th>
<th>Labor Flexibility Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Philippines</td>
<td>59</td>
<td>164</td>
<td>5.7</td>
<td>39</td>
</tr>
<tr>
<td>Indonesia</td>
<td>168</td>
<td>225</td>
<td>6</td>
<td>43</td>
</tr>
<tr>
<td>Malaysia</td>
<td>31</td>
<td>270</td>
<td>2.2</td>
<td>15</td>
</tr>
<tr>
<td>PRC</td>
<td>48</td>
<td>180</td>
<td>2.6</td>
<td>57</td>
</tr>
<tr>
<td>Thailand</td>
<td>42</td>
<td>575</td>
<td>2.5</td>
<td>30</td>
</tr>
<tr>
<td>Singapore</td>
<td>8</td>
<td>50</td>
<td>0.7</td>
<td>1</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>11</td>
<td>180</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>China</td>
<td>88</td>
<td>225</td>
<td>11.3</td>
<td>45</td>
</tr>
<tr>
<td>India</td>
<td>88</td>
<td>225</td>
<td>11.3</td>
<td>45</td>
</tr>
</tbody>
</table>


II. FRAMEWORK AND KEY IMPEDIMENTS TO PRIVATE SECTOR DEVELOPMENT

The enabling environment for private sector development in any economy is a combination of physical and financial infrastructure, government policies, legal and regulatory frameworks, and the institutional capacities for their implementation. The following discussion focuses on those aspects of the enabling environment that continue to inhibit private sector development to highlight needed reforms. It is instructive to briefly note efforts by the Philippine government to date to improve the environment for private enterprise. These have included the outright privatization of 50 GOCCs since 1987 and the sale of minority stakes in a further 29, passage of the BOT law facilitating private sector participation in the infrastructure sector, price liberalization measures, and elimination of interest rate caps and import tariffs on most nonagricultural goods. The government has also introduced measures to encourage investment and to promote the growth of MSMEs and allowed the establishment of export processing zones.

While progress is being made to liberalize trade, much remains to be done to fully open up markets to foreign investment, to create a level playing field for participants within the markets, and to reduce the market distortions created by government intervention. As the following section will demonstrate, sustained investment and economic growth will depend on effectively addressing these structural impediments to private sector growth.

Chief among these impediments is the weakness of the government in establishing a rule-based business environment that fosters fair competition. Creating such an environment requires not only effective legislation but also the institutional capacity to monitor and enforce it. In the Philippines, institutional weaknesses exist in all three branches of the government: executive, legislative, and judiciary. Vested interests (in particular the close relationships between members of government and business owners) serve to encourage monopolies and deter the establishment of a more objective, market-based competitive environment. While rules and regulations addressing various micro impediments to private sector growth can be developed, these measures will not have lasting effects if the fundamental, structural weaknesses in the ability of the government to create and maintain a rule-based business environment are not addressed.

Second, the physical infrastructure of the Philippines is one of the poorest in the region. Despite an estimated $4 billion of private investment in infrastructure in 1993–1997, investment contracted to $1 billion in 1997–2001 and has yet to recover. It is estimated that 20% of the population lacks access to power, 17% to safe drinking water,
and 14% to adequate sanitation services. The poor condition of roads and rural transport infrastructure adds to the cost of doing business, as does the price of electricity, which is the highest in the region. Here again, attracting private investment into the capital-intensive infrastructure sector will require the definition and enforcement of fair and predictable rules of engagement.

Third, the weak financial sector has inhibited the efficient flow of investment resources to the private sector. High levels of nonperforming loans in the banking sector and the underdevelopment of capital markets have meant that access to external finance remains restricted for most enterprises. The presence of banking arms in most large business conglomerates allows them to access funds with relative ease while smaller enterprises have to rely largely on retained earnings. While improving, the poor corporate governance practices among both banks and businesses combined with the limited supervisory capacity of the Bangko Sentral ng Pilipinas (BSP) and the Securities and Exchange Commission (SEC) have inhibited the development of the financial sector as an efficient source of business funding.

The following paragraphs detail the three major categories of impediments to private sector development presented in their relative order of importance. In each category, suggestions for reforms are made which in the case of the infrastructure and financial sectors are further elaborated in Chapter IV.

A. Absence of a Rule-Based Business Environment

1. Weak Framework for Competition

The high degree of market concentration that exists in many sectors of the economy deters both new entrants and the growth of existing, smaller competitors. The four largest firms in 18 major sectors of the economy generate 74% of the total value added of the sector (Aldaba 2002). It is widely believed that these groups obtain and maintain protected market access through collusion with regulatory authorities, legislators, and other licensing authorities (Philippine Center for Investigative Journalism 2004). These practices not only limit growth opportunities for smaller firms but also remove the incentives for efficiency in freely competitive markets.19

While the effectiveness of business groups in allocating resources and fostering growth has been well documented historically (World Bank 2002), these groups serve the public interest most in lower-income economies with underdeveloped financial and executive labor markets and restricted foreign investment. In the Philippines, it is argued that the economy is open and developed enough to support free competition and that implicit or explicit market protection afforded to large business groups should be removed.

The roots of this market structure may be found in the government’s historical policy of fostering economic development through import substitution leading to highly protected markets with significant sector inefficiencies. Investment incentives for domestic industries and price fixing20 of selected outputs have further deterred foreign investment and have contributed to the development of the oligarchic structure of the Philippine manufacturing industry. While these trade and investment restrictions are slowly being dismantled, the dominant industry players that they created still largely retain their market shares.

It would appear that most Philippine corporations view dominant market share as the most desirable competitive advantage. Where market share can be protected by regulations, as was the case with the telecommunication and domestic airline industries before the introduction of limited competition in the 1990s, monopoly rents can be extracted. A recent Philippine study found that concentration ratios in most sectors were positively correlated with the price-cost margin, which serves as an indicator of profitability, suggesting that monopoly rents were indeed being exploited by incumbent firms (Aldaba 2000). The degree of relationship between these two variables has weakened over the years,21 however, suggesting that the increasing concentration in some industries is due to the exit of inefficient firms. Despite this progress, there are several major indus-

19 Collusionary practices have been noted to occur in the cement, shipping, sugar, and flour-milling industries (Aldaba 2002).
20 In sugar and cement, for example.
21 From 0.42 in 1988 to 0.27 in 1994 and then to 0.14 in 1995.
tries, such as shipping, tobacco, glass, upstream telecommunications and cement, among others, where-in effective competition still remains weak.

The Philippine Institute of Development Studies and the United States Agency for International Development (USAID) have conducted studies since 1995 to assess the effects of market concentration and to identify collusion (Medalla 2002 and Aldaba 2002). These studies have concluded that despite reforms undertaken by the government to increase access to markets by removing trade and other barriers to entry, a high degree of concentration still exists particularly in the manufacturing sector. This finding suggests that barriers to competition continue to exist and prevent the sector from maximizing gains from trade liberalization (Aldaba 2002). It can further be argued that the structure of family-dominated conglomerates, which often include major banking arms, leads to unfair competition for finance and adds another impediment to the growth of smaller firms.

The existing legal framework for managing competition includes various laws addressing anticompetitive behavior as well as the regulatory and contractual parameters for managing monopolies (e.g., utilities, telecommunications). This legal framework has proved to be largely inefficient as the antitrust provisions that are found in separate laws have not been codified and are inadequate to address various forms of anticompetitive behavior such as restrictive vertical and horizontal agreements, abuse of a dominant position, and cross-subsidization. Moreover, the responsibility for enforcing the laws is unclear as a number of government agencies are ostensibly involved and strict accountability is lacking (Foundation for Economic Freedom, Inc. 1999). Lastly, the requirements of some of the laws make them difficult to prosecute, as the amount of evidence required for the case to prosper—"proof beyond reasonable doubt"—is difficult to obtain (Lamberte et al. 1992). Knowing the long and costly legal processes involved, aggrieved parties typically settle for an injunction or for a cease and desist order rather than fully prosecuting violators.

In sum, while the Philippines has undertaken major reforms to introduce competition through trade liberalization and deregulation, this has not proved sufficient to create a level playing field in many sectors. Further measures need to be undertaken to facilitate the identification and prosecution of anticompetitive behavior. One such measure could be establishing practical, nonpenal antitrust legislation with clearly stated enforcement responsibilities of government agencies. While the government could also consider establishing a centralized antitrust commission or enforcement agency such as those created in the Republic of Korea and more recently in Indonesia, it should be recognized that such agencies are charged with highly complex legal analyses that require input from experienced professionals. Moreover, the decisions of such a body often have a substantial economic impact on the firms and sectors involved which makes the body highly susceptible to outside influence. Protecting the independence and integrity of these bodies (both in their decisions and in setting their agendas) is critical to their effectiveness in defending the public interest. Lastly, it should also be noted that the functioning of such a commission or agency is further complicated when, as in the case of the Philippines, the legislation that it is intended to enforce lacks clarity. It is therefore recommended that careful consideration be given to all these parameters before proceeding with the creation of a new body in the context of the current Philippine institutional framework.

2. Systemic Corruption

The Philippine government suffers from widespread corruption that weakens its institutional capacity and significantly raises the costs of doing business for private enterprises. Worldwide surveys consistently rank the Philippines among the lowest in the world in terms of transparency and adherence to the rule of law.

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22 See Appendix 6 for an illustrative list of market liberalization reforms.
23 RA 3815 (Revised Penal Code of 1930), RA 3247, and RA 386 are the major pieces of legislation addressing anticompetitive behavior.
24 To date, there have been only two cases defining monopoly decided by the Supreme Court.
• In a survey of 49 developed and developing countries, the Philippines, together with Colombia, Indonesia, and Peru ranked lowest in terms of adherence to the rule of law.25

• In a 2000 global competitiveness report, the Philippines ranked 74th out of 75 countries in terms of frequency of irregular tax payments (behind all Asian countries except Bangladesh).


• The Gallup survey commissioned by the American Chamber of Commerce (AmCham) and AmCham’s follow-up survey found that corruption is the “most negative problem” in the country (AmCham 2003).

• Transparency International ranked the Philippines 92nd out of 133 in its 2003 corruption perception index.

• The Economist Intelligence Unit gave the Philippines a score of 53 out of a lowest possible score of 100 in terms of overall risk and 35 out of 60 globally in terms of business risk.

The investment climate survey completed in January 2004 by ADB and the World Bank further underscored the costs of doing business in a corrupt environment. Participating firms listed irregular payments in taxes, customs, and licensing as systemic. Most firms agree to irregular payments to facilitate processing goods through customs or to secure needed licenses. In addition to the added costs of doing business, these practices have resulted in substantial losses of revenue to the Philippine government. Indeed, the Office of the Ombudsman estimated the losses over the last 20 years at $48 billion (Office of the Ombudsman 1997).

Payment of bribes is also common in government procurement. The Global Competitiveness Report 2001–2002 rates the Philippines as worse than Indonesia, Malaysia, and Thailand in terms of irregular payments in the securing of public contracts (see Figure 12). The apparent high level of discretion in the award of public contracts also affects their security as reported in a recent advocacy paper by AmCham indicating that some public sector contracts are renegotiated or become controversial after a change in administration, further increasing the risk of doing business (AmCham 2002). Indeed, the ongoing dispute over the Philippine International Air Terminals Company contract is a highly visible example of poor practices in awarding concessions. In the specific area of procurement, a study by Procurement Watch, Inc. estimated the potential loss due to procurement corruption at P95 billion in 2001.

The Medium-Term Philippine Development Plan, 2001–2004, has pointed out that the country’s recent economic crisis was partly caused by crony capitalism and by graft and corruption. Several initiatives have been launched to address these problems, including the enactment of a procurement reform act in late 2002,27 phasing in of a new government accounting system, the introduction of lifestyle or asset consistency checks for government employees, and increased computerization among government agencies. Pursuing these reforms in earnest, while embarking on fundamental civil service reforms as

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25 See La Porta et al. (1998). The study uses the assessment of the law and order tradition in the country produced by the country-risk rating agency International Country Risk. The index was constructed using the average of the months of April and October monthly index between 1982 and 1995. The scale ranges from 0 to 10, with lower scores for less tradition for law and order.

26 This index covers contracts/laws (i.e., independence of the judiciary, fair bidding on public contracts, and the impact of organized crime on business) and corruption (i.e., perception of bribes paid for import and export permits, connections to public utilities, or in connection with tax payments).

27 Rules and regulations for implementation were issued in September 2003.
proposed in the new civil service code (e.g., recruitment policies, merit-based pay schemes, strengthening accountability) will be components in a serious effort to eradicate corruption.

3. Inadequate Dispute Resolution Mechanisms

The cost of dispute resolution in the Philippines is one of the highest in the world (World Bank 2004). The inadequacies of the judicial system present a significant obstacle and disincentive to doing business in the Philippines. These inadequacies concern issues of efficiency, integrity, and competence. As shown in Table 5, the number of pending cases in the court system is very high and is rising as more cases are filed each year than are resolved. The backlog of cases can be attributed to several factors: the lack of judges, shortage of courtrooms, complicated legal procedures that allow protracted delays, and the propensity of citizens and banks to use the courts as collection agents for unpaid checks. Indeed many cases clogging court dockets are small money claims involving violation of Batas Pambansa blg 22 (otherwise known as the bouncing checks law).

More fundamental weaknesses in the judicial system involve its integrity and competence. Perceptions of judicial corruption are widespread.28 The Supreme Court’s decision to dismiss or sanction 230 judges during 1998–2001 for graft or corruption, representing 10% of the judges working in the system, indicates that the perception may have a basis in fact. The low compensation levels of the judges increase their susceptibility to graft. The judiciary receives only 0.8% of the national budget in 2003–2005 although it represents the third branch of government and employs 25,000 court personnel in addition to its 2,300 judges.

The excessive numbers of temporary restraining orders issued by the judiciary is seen by many as another indicator of corruption. Moreover, despite a law (LRA 8795) prohibiting issuing temporary restraining orders against government projects and programs, trial and appellate courts have continued to issue injunctive writs effectively discouraging both local and foreign investors from partnering with the government in development projects (ADB 2005).

Through a series of diagnostic studies from 1998 to 2000, the Supreme Court identified major challenges that it is now proposing to address through an action program for judicial reform:

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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Supreme Court</td>
<td>4,124</td>
<td>4,453</td>
<td>5,066</td>
<td>7,021</td>
<td>5,526</td>
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<td>2,752</td>
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<td>3,272</td>
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<tr>
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<td>485</td>
<td>426</td>
<td>391</td>
<td>350</td>
<td>285</td>
<td>359</td>
<td>410</td>
<td>394</td>
</tr>
<tr>
<td>Regional Trial Court</td>
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<td>216,607</td>
<td>194,939</td>
<td>199,501</td>
<td>214,453</td>
<td>225,188</td>
<td>251,351</td>
<td>265,957</td>
<td>279,241</td>
</tr>
<tr>
<td>Metropolitan Trial Court</td>
<td>21,749</td>
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<td>82,148</td>
<td>134,085</td>
<td>185,242</td>
<td>183,024</td>
<td>186,799</td>
<td>185,192</td>
<td>200,271</td>
</tr>
<tr>
<td>Municipal Trial Court in Cities</td>
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<td>56,475</td>
<td>83,878</td>
<td>131,031</td>
<td>165,194</td>
<td>177,310</td>
<td>180,456</td>
<td>157,199</td>
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<td>Municipal Trial Court</td>
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<td>77,133</td>
<td>102,109</td>
<td>134,861</td>
<td>121,214</td>
<td>118,255</td>
<td>117,010</td>
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<td>43,011</td>
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<td>Shari’a District Court</td>
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<td>135</td>
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<tr>
<td>Shari’a Circuit Court</td>
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<td>236</td>
<td>227</td>
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<td>Total</td>
<td>370,473</td>
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<td>635,991</td>
<td>776,020</td>
<td>795,808</td>
<td>830,795</td>
<td>821,020</td>
<td>827,676</td>
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</tbody>
</table>


28 The recent investment climate survey conducted by ADB and the World Bank revealed that more than 50% of the firms surveyed had confidence in the judiciary’s ability to uphold contract and property rights.
• case congestion and delay;
• severe judicial budget deficiencies;
• politicized system for judicial appointments;
• lack of judicial autonomy;
• inadequate human resource development;
• dysfunctional administrative and financial structures;
• deficient court technology and facilities;
• inadequate public information and collaboration with civil society.

The action program seeks to address these issues and to achieve judicial autonomy; speedy and fair dispensation of justice for all; improved access to judicial and legal services; improved quality of external inputs to the judicial process; and efficient, effective, continuous improvement to judicial institutions. Its mission is to develop a judiciary that conducts its business with dignity, integrity, accountability, and transparency and that is worthy of public trust and confidence.

These reforms are being implemented with the support from ADB,30 the World Bank, USAID, and other funding agencies. Parallel to these reforms, measures will need to be taken to upgrade the technical capacity of judges to review cases involving complex commercial and economic issues as an increasing number of cases will be brought involving matters of recent legislation, e.g., asset securitization, anti-money laundering, electronic commerce, and special-purpose vehicles.

As implementation proceeds, it is recommended that alternative dispute resolution mechanisms be further encouraged to address the case backlog and to provide a viable and expeditious alternative to the court system. Some government agencies have launched mediation projects with encouraging results (Abaya 2003),31 and over 300 mediators have been trained by the Supreme Court. Moreover, the bill institutionalizing alternative mechanisms has been passed by Congress, and the Supreme Court has recently passed rules requiring the use of mediation prior to any hearing on a civil case. These important advances can now be leveraged to further decongest the court system.

In rural areas, there is a barangay justice system that allows barangay officials to amicably settle disputes among family members and residents before bringing them to regular courts. As the competence of barangay officials in dispute resolution is often in question, training will be required to encourage petitioners to use this alternative system.

4. Weak Creditor and Property Rights

Security of credit and property is essential for private sector development. Weak protection of these rights significantly increases the risks of doing business and often makes required compensation prohibitive. The three types of security liens under Philippine law are the real estate mortgage, chattel mortgage, and pledge. When formally perfected, these liens bind specific property, and the world, in accordance with their terms.

Real estate and chattel mortgages may be foreclosed by selling the collateral at public auction. This may be done judicially (with court intervention) or extra-judicially (through a sheriff or notary public). Because of the inconvenience, time, and expense involved in judicial foreclosures, almost all mortgage deeds contain a clause authorizing extra-judicial foreclosures. In either case, the proceeds of the foreclosure sale are used to settle the obligations secured by the mortgage. The creditor may bring an action against the debtor for any deficiency in case the proceeds of the foreclosure sale are insufficient to cover the secured obligations.

In the case of a pledge, personal property (or the document evidencing the incorporeal right) is delivered to the creditor or to a third party trustee. The pledge may be foreclosed by having the property sold at a public auction through a notary public. If the proceeds of sale are less than the secured obligation, the creditor is not entitled to recover the deficiency and the obligation is deemed to have extinguished.

Any creditor that does not benefit from any of these security liens is an unsecured creditor. In case the debtor defaults, the unsecured creditor has to file an action for specific performance and may ask the court to grant the provisional remedy of

30 ADB TA 3693-PHI: Strengthening the Independence and Accountability of the Judiciary
31 Smallest local government unit in the Philippines and is very similar to a village. Municipalities and cities are composed of barangays.

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preliminary attachment. The debtor’s property will then be attached or garnished to secure satisfaction of whatever judgment might be obtained.

While these rights appear clear and well defined, their enforcement through judicial proceedings have become problematic. Trial court proceedings may last up to 4 years. If the judgment is appealed all the way to the Supreme Court, the entire proceeding may take 8 to 10 years. Extra-judicial foreclosures, on the other hand, are sometimes hampered by temporary restraining orders or writs of injunction.

Rights of creditors are treated differently in case of insolvency or rehabilitation. After a debtor is declared insolvent by a court, credits are paid in the order of preference set forth in the civil code. As a rule, secured creditors enjoy preference over unsecured creditors, but taxes and assessments on specific property enjoy absolute preference. Other liens on specific property enjoy no priority among themselves but must be paid concurrently and pro rata. On the other hand, the pro rata rule for other liens does not apply to judicial attachments and executions annotated in the registry of property. These are generally preferred over later credits.

In the case of corporate rehabilitation, all claims against the corporation, whether secured or unsecured, are suspended upon the appointment of a rehabilitation receiver. Secured creditors retain their preference, but enforcement of such preference is stayed. It is only when the petition is dismissed (i.e. petition is found to be defective or no rehabilitation plan is approved within 180 days from the date of initial hearing) that the secured creditor can foreclose on the mortgaged or pledged property.

The absence of a modern insolvency law makes debt relief proceedings in the country inefficient. The current Philippine insolvency regime is still a cacophony of laws, jurisprudence, and rules of procedures. The first basic law is the 96-year-old Insolvency Act that vested the courts with jurisdiction over petitions for insolvency and suspension of payment. Presidential Decree No. 902-A was then issued in 1976 (and amended in 1981). It vested SEC with jurisdiction over corporate rehabilitation petitions and transferred to SEC jurisdiction the petitions for suspension of payment. In August 2000, a code for regulating securities transactions transferred corporate rehabilitation and returned suspension of payments to the regular courts. Interim rules on corporate rehabilitation that attempt to hew closely to international standards have been issued by the Supreme Court to govern these debt relief proceedings. However, because of the absence of a comprehensive legislative framework, some gaps cannot be and have not been addressed by the interim rules.

Tedious and protracted court proceedings have proved to be major deterrents to effective rehabilitation and insolvency proceedings. While certain branches of the regional trial court were designated as commercial courts to hear debt relief cases, their heavy case loads from other types of cases, and the piecemeal trial system in the country make it difficult for the rehabilitation court to grant speedy remedies. This imperils the preservation of value, of both the enterprise and stakeholder claims. Commercial court judges likewise did not initially have the requisite expertise or “feel” for the complexities of the various hierarchical, proprietary, and valuation claims of the various stakeholders.32

Recognizing the need to address this weakness in its insolvency legal framework, the Philippine government drafted a corporate recovery and insolvency law. This draft law, prepared under the previous Arroyo administration but not yet passed, will now have to be resubmitted to the new legislature. In its current form, the proposed law is much closer to international standards.33

Beyond the context of corporate recovery, the Philippine collateral system requires strengthening on additional fronts. As noted above, only three mechanisms exist today to secure credit. Expansion of the forms of security is needed. In today’s global economy with cross-border transactions, there is a need for other security options. Legislation along this line should be pursued. The passage of the Securitization Bill, for example, is a step in this direction. With the Securitization Act, it is envisioned that the secondary market can be developed, particularly residential mortgage-backed securities and other housing-related financial instruments. This could contribute to generating investment and accelerating growth in the housing finance sector.

There is also need for a modern registration system for secured transactions. At present, there is

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32 The Philippine Judicial Academy (PHILJA) has since then conducted a number of training seminars on corporate rehabilitation for commercial court judges.
33 Criticisms of the draft law center on its lack of clarity regarding the condition of exit of nonviable firms and rehabilitation of viable ones.
no central registry for mortgages; the registries for chattel mortgages in particular are almost impossible to search. The current system for registering land titles on which the real estate mortgage registry is based is inadequate. Large tracts of land remain untitled. In addition, although searching the land registry is easier than searching the chattel mortgage registry, it is still not easy. Even where computers are used for registering secured transactions, the data are not centrally filed nor are they fully accessible by the public online.

Shareholders’ rights, in particular those of minority shareholders, are not effectively protected in the Philippines. While existing laws contain standard provisions for protecting minority shareholders, the presence of dominant shareholders in so many Filipino companies makes these provisions more difficult to uphold. Saldaña (2000) found that minority shareholders were often vulnerable to expropriation of their interests by controlling shareholders and management. For example, a few who exercised their appraisal rights were offered below-market values for their shares. Minority shareholders were often not able to participate actively in annual meetings due to the dominance of controlling shareholders in shaping the agenda and the discussions.

Loopholes in the corporation code allow a company to waive the preemptive rights of shareholders in the articles of incorporation upon registration or in a subsequent amendment. The code also does not require disclosure of transactions involving potential conflicts of interests. SEC has attempted to address these governance deficiencies with the 2002 code of corporate governance that aims to protect the following for shareholders: voting rights, pre-emptive rights, rights to dividends, rights to obtain relevant information on the corporation on a timely and regular basis, and appraisal rights. The securities regulation code also empowers the SEC to compel the officers of any registered corporation under its supervision to call meetings of stockholders. (See Box 2 for a summary of recent corporate governance reforms.)

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**Box 2: Recent Corporate Governance Reforms**

The important role of corporate governance in enhancing a country’s investment climate is increasingly recognized in the Philippines. The government has therefore initiated a number of reforms designed to strengthen corporate governance including the following:

- Passage of securities regulation code (2001)
- Passage of the general banking act (2000)
- Promulgation of code of corporate governance (SEC Memo Circular 2 - 2003).
- Adoption of Philippine standards on auditing (SEC Memo Circular 10 - 2003).
- Clarification of extent of SEC supervision over all registered corporations (SEC Memo Circular 11 - 2003).
- Requiring corporations to rotate external auditors (SEC Memo Circular 8 - 2003).
- Adoption of code of corporate governance for banks
- Adoption of code of corporate governance for insurance companies and intermediaries
- Adoption of general disclosure of corporate governance practices form for insurance companies, professional re-insurers and insurance intermediaries.
- Strengthened prudential regulations for banks
- Strengthened financial sector supervision
- Other notable efforts to strengthen the corporate governance regime include the pending corporate reform act that seeks to regulate corporate abuses by, among other things: (1) banning accounting firms from providing most consulting services to companies they are auditing; (2) prohibiting any issuer from extending or maintaining credit in the form of a personal loan to or for any director or executive officer of publicly listed companies.
Property rights include both intellectual and physical property. In the case of intellectual property, a modern legal framework exists\(^34\) but poor enforcement has led to one of the highest rates of software piracy in the region. In 2001, an estimated 63% of software in use was pirated.\(^35\) Patents and trademarks are also protected under the law, but suffer from the same deficiencies in implementation. The Philippines remains on the United States’ watch list of intellectual property rights violators.

The Philippines adheres to the Torrens system of titling land. A Torrens title is generally conclusive evidence of ownership of the land referred to therein as well as any interest annotated therein (e.g., a real estate mortgage, or a lease contract). A strong presumption exists that a Torrens title was regularly issued and valid. However, the absence of reliable cadastral surveys leaves much land without enforceable title. Where title does exist, legislation protecting squatters\(^36\) often makes the land difficult to sell or to mobilize for efficient use. Squatting is in fact widespread on public and private lands. As is discussed in Chapter IV, policies and procedures surrounding resettlement have significantly complicated the development of infrastructure projects.

Under the comprehensive agrarian reform law that is designed to redistribute approximately 55% of existing agricultural land, farmers will gain ownership of land but will not be able to transfer it for 10 years. This in effect strips lands transferred to farmers of their collateral value and consequently further limits farmer-beneficiaries’ access to credit from formal financial markets. There are now bills in both houses of Congress proposing to restore the collateral value of agrarian reform land, but they are expected to encounter significant resistance.

Lastly, it should be noted that foreigners are not allowed to own land in the Philippines though they may lease property for 50 years renewable for an additional 25. This ownership restriction further complicates nonperforming loan (NPL) recovery. Consideration should be given to relaxing these restrictions for asset restructuring.

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\(^{34}\) RA 8293 (1997) and international conventions such as the World Trade Organization’s agreement on trade-related aspects of intellectual property rights; \(^{35}\) Business Software Alliance estimate. \(^{36}\) Thelina law obligates landowners to find relocation areas for squatters before evicting them.

5. Government Obstruction of Markets

The Philippine government intervenes in commercial markets on several notable levels: setting trade tariffs; regulating utility and physical infrastructure tariffs; setting the price of selected commodities; and operating over 100 GOCCs, many of which operate in commercial markets and compete against private companies. Many of these interventions effectively inhibit private sector development.

The trade liberalization that began in the 1980s significantly reduced tariff and nontariff import barriers resulting in a fall in the average effective protection rate from 38% in 1985 to 14.4% in 2004. A reversal of these measures has been under way since November 2003, however, with import tariffs on cement, petrochemicals, glass, and vegetables returning to their 1998 levels. Pressure to increase public revenues is said to be driving this movement, although its effect in protecting domestic markets (and their dominant market players) from foreign competition is also evident.

The government, through its sector regulators, is tasked with ensuring that utilities and infrastructure are delivered and priced in a manner that balances the interests of both providers and users. While these regulators are intended to be entirely independent from political influence and free of conflicts of interests, none has fiscal autonomy, and—in the case of the toll road, port, and airport sectors—some have commercial as well as regulatory responsibilities. Given the high investment capital demands of the infrastructure and utility sectors, it is imperative to strengthen the regulatory bodies so they can impartially implement regulations.\(^37\)

In the area of price fixing, the government has removed mandated prices on all commodities except rice. The government in effect controls the distribution of rice through the monopoly of the National Food Authority (NFA). The price of NFA rice is more than twice as high as rice from exporting countries like Thailand and Viet Nam thereby making rice smuggling a very lucrative business (Tolentino 2001). This approach to rice price stabilization has proved very costly without

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\(^{37}\) More on these issues in Chapter IV.
achieving its objectives of lowering food prices to consumers, raising producer prices, and providing market stability (David 2002). The actual effect is that rice consumers are paying more while producers receive less due to inefficiencies and noncompetitive elements in rice marketing (David 2002). NFA has incurred huge losses annually (P4.3 billion in 2000). Roumasset (2000) estimated that the total cost to the economy in 1999 was approximately P48.8 billion broken down as follows: foregone tariff revenue (P3.7 billion); foregone consumer tax revenue (P18.5 billion); foregone producer tax revenue (P7.9 billion); tax friction (P9.0 billion); excess burden for consumers (P6.4 billion); and excess burden for producers (P3.3 billion).

With the concurrence of the government, USAID and ADB have engaged significant technical assistance resources over the past 5 years to help restructure and privatize NFA. While progress was made in defining workable restructuring scenarios, privatization was not deemed feasible by the government and has since been sidelined.

The government still operates over 100 GOCCs, many of which are fully commercial enterprises that compete with the private sector. Others have dual functions as operators and regulators, for example, the Air Transportation Office (ATO), Philippine Ports Authority (PPA), and the Transport Regulatory Authority; that inhibits potential market efficiencies. While the government made significant progress in privatizing GOCCs in the 1990s, efforts have slowed of late. A renewed push to carve out the commercial functions of government agencies and regulators and renew the timetable for GOCC privatization is recommended.

B. Poor Physical Infrastructure

The Philippines has one of the poorest infrastructure sectors in the region. Despite government efforts to enhance the quality of infrastructure in the poorest regions of the southern Philippines, the 2003 World Competitive Yearbook ranked the Philippines last among 30 countries in terms of basic infrastructure quality.\footnote{Regional comparisons (see Table 6) also place the Philippines among the lowest scorers. Notable geographic disparities exist with urban areas benefiting from relatively better access to infrastructure than rural populations.} The dismal state of infrastructure is largely due to poor sector management and inadequate maintenance over the years, but recent deterioration is due to the decline in public funding for capital investment and maintenance that has not been offset by increases in private participation. Indeed, private investment in infrastructure totaled less than $1 billion during 1997–2001, compared with an estimated $4 billion in 1993–1997.

The close correlation between the quality of physical infrastructure, economic growth, and poverty reduction is well documented. Poor infrastructure adds to the cost of doing business as is underscored in the 2004 ADB-World Bank investment climate survey that identified the inadequacy of the road network as one of the major obstacles to efficient business operations. Philippine businesses also pay the highest commercial power rates in the region,\footnote{This situation is especially true in the transport and water sectors where LGUs are responsible for operation and maintenance yet have very limited resources.} more than three times higher than those in Indonesia and Thailand.\footnote{This is partly due to the government’s policy of selling power at the same rates to both consumers and commercial users, allowing the higher margins in commercial distribution to offset the losses in retail.} In addition, it is estimated that 40% of companies operate their

### Table 6: Infrastructure Regional Comparison

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<th>Country</th>
<th>2000</th>
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<th>2002</th>
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<tr>
<td>Philippines</td>
<td>41</td>
<td>41</td>
<td>44</td>
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</table>

Note: Infrastructure includes five subfactors: (i) basic infrastructure, which includes roads and railroads, air transportation, water systems, arable land, energy infrastructure including indigenous energy and self-sufficiency in non-energy raw materials; (ii) technological infrastructure; (iii) scientific infrastructure; (iv) health and environment; and (v) value system. Lower score means better infrastructure system. For basic infrastructure alone, the Philippines scored 49 out of all 49 countries in 2002.

Source: Macaranas and Silva, 2002.
own generators and have their own back-up water supplies in case of outages; maintenance of that equipment further adds to the cost of doing business.  

It is estimated that about $35–45 billion is needed to rehabilitate and modernize the infrastructure sector over the next 10 years (World Bank 2002). Given the weak fiscal position of the government, private sector participation in the sector is imperative. The recent experience of the Philippines with this is mixed. While private investors have brought much-needed capital to the power sector in particular, the lack of an adequate institutional, legal, and regulatory framework for these investments has led to significant market distortions, waste, and the possibility of a renewed power shortage. In transport infrastructure, lack of coordinated planning and the presence of government entities serving dual roles of regulators and operators have deterred both rational investment and private sector participation. In the water sector, the recent experience of one of the Manila Water concessionaires has highlighted the need for better contingency planning, supervision, and tariff management.

Disputes involving large infrastructure contracts, such as the Ninoy Aquino International Airport (NAIA) Terminal 3 concession and the Meralco distribution contract, have highlighted the risks of doing business in the Philippines and have effectively deterred much-needed future investment (see Box 3). Restoring confidence in the sector (and the country) will require a credible demonstration of reforms to strengthen the institutional, legal, and regulatory framework for investment (see Chapter IV for a more detailed discussion of the infrastructure sector).

### C. Weak Financial Sector

The weak financial sector has inhibited the efficient flow of investment resources to the private sector. High levels of NPLs in the banking sector and the underdevelopment of capital markets have meant that access to external finance remains restricted for most enterprises. It is estimated that less than half of Philippine SMEs contract external finance from the banking sector, and only five do so from equity markets. While this can be partly explained by the deterrent effect of high interest rates (13–20% during 1995–2002), it is also due in part to the difficulty of smaller companies in securing credit. Poor accounting and disclosure practices, high collateral requirements, and limited capacity of the banks to assess SME risks have limited the amount of funding available.

Beyond bank credit, few formal alternative sources of funding exist. The PSE is very small (238 listed companies, total market capitalization of 24% of GDP) and thinly traded. Most listed companies float only 10–20% of their shares on the exchange.
The corporate debt market is virtually nonexistent, but the volume of government debt is substantial, equal to twice the value of PSE market capitalization in 2003. Investors in debt and equity markets are predominately corporations with strategic holdings and institutional investors including pension funds, banks, and insurance companies. An SME board exists but counts only five companies.

Growth in banking credit has been contracting over the past 5 years due to reduced demand and to mounting levels of NPLs. Banks are now rationing credit, despite relatively high levels of liquidity. The steady stream of risk-free government securities has given banks an alternative source of investment to offset the decline in corporate lending.

NPL ratios in the banking sector remain one of the highest among the crisis-hit Asian economies and were estimated at 15% of outstanding bank loans at the end of 2003, or 53% of capital (see Figure 13). If real and other properties owned or acquired (ROPOA) are factored in, total net nonperforming assets (NPAs) are estimated at 14% of total banking assets, or 64% of capital and 12% of GDP. Efforts to resolve NPLs have been stifled by a general reluctance of bank owners to recognize the inherent losses and by an unfavorable legal regime.

The passage of the special purpose vehicle (SPV) act in 2002 provides a new legal framework for the establishment of privately owned asset management companies that will purchase, hold, and sell NPAs to interested parties. To date this vehicle has not been used, but some NPL transactions have been completed outside of the SPV law. Weaknesses in the insolvency regime (as stated in Chapter III, A4) continue to limit the ability of banks to restructure potentially viable debts.

Funds that are available from the banking sector are predominantly short term, i.e. of 90 days or less. Long-term, fixed-interest-rate loans are rare given the absence of long-term peso-denominated sources of funds for the banks and high tax rates on secondary market trading of debt securities. Enterprises needing long-term funds, particularly for project finance, have contracted them in foreign currency, exposing them to severe exchange rate risks if their future revenues are to be in pesos.

The absence of long-term funding from the banking sector has not been compensated by alternative funding sources in capital markets. The small size of the stock market, relatively onerous listing requirements, and poor corporate governance practices have deterred potential new listings and investment. The corporate bond market remains virtually nonexistent and will require substantial improvement of the trading infrastructure, the establishment of a long-term benchmark rate, and improved disclosure and corporate governance practices before more institutional investors take part. Major efforts to modernize the capital market and non-bank financial sector institutions are under way and should be encouraged so that long-term funds available within the non-bank financial institutions (e.g., pension funds, insurance companies) can be channeled to productive use in the business sector and thereby facilitate growth.

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45 The proposed establishment of the fixed income exchange in 2004 will provide some of this infrastructure.

46 The tax disincentives on corporate bonds will also need to be addressed if corporations are to favor bond issues over 5-year commercial paper.
III. SELECTED SECTORS

A. Physical Infrastructure

The Philippines suffers from one of the poorest infrastructure sectors in Southeast Asia, severely dampening its regional competitiveness. With limited public resource upgrades, the government has actively solicited private sector input since 1993 with the adoption of the BOT framework. More than $28 billion in investment has followed, helping expand total power capacity,\(^{47}\) road network quality,\(^{48}\) and transport linkages.

Regional disparities are significant, with the highest levels of electrification, access to water, and paved road ratios in Luzon and the National Capital Region in particular, in contrast to the poorest rates in Mindanao, particularly Muslim Mindanao, which consistently ranks below the national average (see Figure 14). Given the proven links between economic growth and infrastructure quality, it is not surprising that Muslim Mindanao also has the lowest contribution to GDP in the country and the highest incidence of poverty.\(^{49}\) Much more investment is required if the Philippines is to sustain economic growth and reduce poverty. Indeed it is estimated that an additional $35–45 billion is needed over the next 10 years to raise the quality of the Philippines’ physical infrastructure to regionally competitive standards.

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47 Independent power producers have augmented total capacity by 5,533 megawatts and private distributors have added another 518 megawatts of capacity.

48 More than 630 kilometers of new roads have been built outside of Manila.

49 See table in section IA above, the government has identified infrastructure investment in Mindanao as a development priority.

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Attracting this new investment will require fundamental changes to the framework for private participation in infrastructure (PPI) and regulations for industry. Disputes concerning private contracts in the power, water, and airport sectors have highlighted the weakness of the legal and regulatory framework, the limited recourses available to resolve disputes, and the high level of political intervention in the commercial sector. Creating an investment environment that maximizes scarce resources and in which public and private players assume an acceptable level of risk will require specific improvements in the following areas:

- coherent sector investment planning and implementation by government agencies;
- the credibility, competence, and independence of industry regulators;
- clarifying rules and regulations for the solicitation and evaluation of PPI proposals;

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Figure 14: Regional Access to Infrastructure

• tariff regimes based on cost recovery;
• efficient mechanisms for dispute resolution.

As will be demonstrated in the following sections, these key enabling requirements are common to most infrastructure subsectors (power, transport, water, and telecommunications). Sustainable improvements in infrastructure quality will largely depend on the ability of the Philippine government to meet these requirements.

1. Power

At approximately 80%, the Philippines has a high rate of electrification by regional standards, but the quality of the electrical supply (measured by number of interruptions) is low and transmission/distribution losses remain among the highest in the region at about 14%. Industrial users already pay the highest prices in the region, and many maintain their own backup sources of power to mitigate the risks of outages (ADB/WB 2004) (see Table 7 and Figure 15). Installed generating capacity is currently at 15 gigawatts with 79% in Luzon, 10% in Visayas, and 11% in Mindanao. According to the Department of Energy’s latest power development program (2005–2014), about 9,225 megawatts in new capacity will have to be added in the next 10 years to meet the growing demand for electricity and thereby avoid power shortages by 2005 in Mindanao and 2008 in Luzon and the Visayas.

The power sector has struggled to recover from the economic crisis that hit in 1997. The reduction in economic growth and the devaluation of the peso reduced the demand for electricity and increased the price of generation to the highest levels in the region, as many contracts have take-or-pay provisions and high levels of foreign-denominated debt service drive up the cost per kilowatt hour.

The private sector currently participates in both generating and distributing electricity. It is estimated that approximately 70% of installed capacity is generated by IPPs. Distribution is split between Meralco (60% of the total and concentrated in Manila) and 139 smaller utilities, most of which are cooperatives (40% of total distribution). The state still plays a dominant role in the industry through the NPC which generates 30% of the power while the National Transmission Corporation manages all of the transmission (see Box 4).

NPC has signed over 40 power purchase agreements with IPPs to date. These contracts had take-or-pay provisions and required NPC to carry fuel price and foreign exchange risk. While the

<table>
<thead>
<tr>
<th>Table 7: Electricity Costs for Business</th>
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<td>City</td>
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</tr>
<tr>
<td>Manila</td>
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<tr>
<td>Bangkok</td>
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<tr>
<td>Kuala Lumpur</td>
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<tr>
<td>Jakarta</td>
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<tr>
<td>Shanghai</td>
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<tr>
<td>Singapore</td>
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<tr>
<td>Hanoi</td>
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<tr>
<td>Phnom Penh</td>
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<td>Vientiane</td>
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program was very successful in addressing the power shortage, it has been a significant cause of the deterioration of NPC’s financial position, largely because of a lower than forecast electricity demand and a substantial deterioration of the peso against foreign currencies. At the end of 2002, NPC had in place power purchase agreements for over 8,100 megawatts of IPP capacity.54

Recognizing the need to improve efficiencies in the sector, to reduce debt levels, and to attract further private sector investment, the government restructured the sector in 2001 with the passage of an electric power industry reform act (EPIRA). It provides for the unbundling, privatization, and commercialization of the sector through (i) the creation of the Power Sector Assets and Liabilities Management Corporation to assume NPC liabilities and manage the orderly privatization of NPC’s generation and transmission assets (except those used for off-grid missionary electrification); (ii) the creation of a wholesale electricity spot market to allow competition; (iii) abolition of the Energy Regulatory Board and creation of an independent Energy Regulatory Commission (ERC) with the power to set tariffs in the noncompetitive transmission and distribution subsectors and with wide powers to regulate the behavior of participants in all sectors of the industry; and (iv) the development of competition in the retail supply of electricity, starting with large electricity users and eventually extending to the supply of electricity at the household level.

Implementation of the EPIRA is running significantly behind schedule, due in part to the limited capacity of ERC to drive the reforms but most importantly due to a lack of investor interest. Investor risk assessments of the sector are very high due largely to (i) regulated generating rates that are well below the potential cost of new generation,55 (ii) the uncertain political climate, (iii) the weak financial condition of the utilities, including Meralco56 that raises doubts about their ability to distribute power in the future, (iv) the lack of credibility of ERC which has been subject to political interference57 and has no financial autonomy, (v) renegotiation of legacy IPP contracts, and (vi) the absence of Congressional approval for the franchise bill specifying the terms of operation of transmission assets.

With the delays in implementing the EPIRA, the government is facing a financial crisis in the sector with ballooning deficits and liabilities at NPC, increasingly weak utilities, and tariff rates that do not allow full cost recovery. NPC’s losses have been increasing and accumulating (see Figure 16). In 2003, NPC suffered a net loss of P113 billion ($2.0 billion), and even its operating loss amounted to P21 billion ($375 million). Out of the net loss, P77 billion was attributable to a major change in foreign exchange loss accounting (the entire loss on loans and lease obligations to IPPs must be recognized in the same

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54 Including NPC owned plants under long-term operating contracts and IPP plants still to be commissioned.
55 President Arroyo ordered the further lowering of consumer power rates in 2002.
56 The Supreme Court decision to impose tariff reimbursements on Meralco has resulted in a downgrading of its Standard & Poor’s credit rating from BB+ to CC.
57 The head of ERC is a presidential appointee.
year rather than amortized over the remaining loan or lease contract life). NPC’s liabilities totaled almost P1.3 trillion (over $22 billion) as of 31 December 2003, with P757 billion ($13.5 billion), resulting from IPP obligations and P475 billion ($8.5 billion) from foreign loans and bond issues. Additional loans obtained in 2004 of about $1.5 billion have raised NPC’s indebtedness by P84 billion.

Given the rapidly deteriorating financial condition of NPC and the looming power crisis, it is imperative that action be taken immediately. Now that a new government is in place, it must make every effort to stabilize the market and to present a credible plan for restoring investment opportunities. A broad-based reform plan addressing the policy, institutional, regulatory and operational constraints to private sector investment is needed including a serious effort to address the tariff issue. Full and successful implementation of the EPIRA will require raising the tariff before longer-term efficiencies can force it back down. The impact of tariff liberalization on commercial/industrial users will likely be positive as it will eliminate the surcharge that they pay today to offset losses of utilities in the retail market.

In sum, implementation of the EPIRA should remove the government from service provision so that it can focus on planning and regulation including the definition of targeted subsidies where required for rural electrification. Specific measures to support EPIRA implementation should include the following:

- strengthening the capacity and independence of ERC to effectively serve as a market-based regulator;
- supporting the establishment of the wholesale electricity spot market that will allow generating and supply rates to be determined by the market;
- ensuring the economic viability of the sector with the establishment of a revised generating tariff schedule based on cost recovery and its integration into the sales contracts of existing NPC generating assets;
- modernizing transmission assets to ensure their ability to handle the increased generating capacity needed beyond 2006;
- strengthening the financial and management capacity of the distributors.

While implementation of the first three of these reforms essentially requires regulatory and legislative input, the remaining two require financial resources that should ideally be mobilized by private investors. Under the terms of the EPIRA, the government should not be making further investments in the sector, and transmission assets are to be privatized. While the most appropriate form of privatization is by concession, the right to operate the NPC franchise has yet to be granted by Congress. If such approval is not forthcoming, the burden of adding additional capacity to the transmission network will fall on the government, further aggravating its already weak fiscal position.

To address the financial weaknesses of the distributors, both operational and financial measures should be taken. Consolidations in the sector would help strengthen underlying financial weaknesses, but consideration should also be given to modifying the terms under which cooperatives operate in the market. Revisions to the tariff regime will be an important mechanism for improving their financial viability. In all cases, however, the institutional

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58 As per ERC decision of May 2003, utilities must charge industrial users 60% of residential charges, even though actual costs are lower.

59 In its initial phase, generating rates will be determined by the market, then once 70% of the NPC generating assets are sold, open access to distribution assets will be allowed introducing full competition in retail supply rates.

60 Moreover, there is a restriction on foreign ownership of utilities or utility concessions that is further deterring potential investors.
capacity of the target utilities and cooperatives must be strengthened before financial assistance is provided.

2. Transport

Transport infrastructure—composed of roads, highways, rail networks, airports, and ports—plays a vital role in supporting economic growth. Private sector enterprises in the Philippines consistently cite poor transport infrastructure (especially roads) as a key impediment to their competitiveness and growth (ADB/World Bank 2004 and AmCham in the Philippines/Gallup Poll 2003). Looking forward, investment requirements in road, rail, port, and airport infrastructure are significant with an estimated $200 million per year needed to develop, operate, and maintain the road network alone (World Bank 2003).

While the private sector provides virtually all transport services (bus, air, sea) in the Philippines, the public sector develops, regulates and operates the infrastructure. The deregulation of the sector launched in the 1990s is partially complete with the government still exercising many commercial functions. Private participation in the development and operation of infrastructure to date has been focused on toll roads and light rail, with the notable exception of the BOT contract for the NAIA terminal 3. The scope for increased private participation in transport infrastructure remains large and includes the following:

- BOTs for toll roads and light rail;
- management or concession contracts for airports and ports;
- maintenance services for roads, ports, and airports;
- airport and port terminal services.

As is the case with all physical infrastructure subsectors in the Philippines, expanding private sector participation through provision of transport infrastructure will require an improvement in the enabling legal and regulatory environment, including a strengthening of the development and implementation procedures for PPI. In the particular case of transport infrastructure, with its multimodal dimensions, reforming the institutional framework for the sector is also critically important. The 16 agencies involved in the operations and management of the transport network cannot effectively coordinate their activities and are often subject to conflict. This makes intermodal planning impossible, so that even the best efforts to identify investment priorities based on the economic and geographic development targets of the country often fail. Indeed several proposals (ADB 1996 and 1999) have been made over the years to strengthen intermodal planning, yet lack of data, resources, and institutional resistance have obstructed their implementation.

Without the authority to direct expenditures according to identified priorities, planning agencies cannot be effective. Infrastructure projects have repeatedly been cancelled, postponed, or replaced through the legislative process for reasons of political expediency. The existence of country development funds allows further interference in defining infrastructure priorities. While ostensibly designed to encourage funding of local priorities, they effectively distort those priorities by allowing a high degree of discretionary power by the legislators. A sector-wide institutional review and strengthening of the planning, budgeting, and expenditure processes would be an important step in (i) proactively communicating priorities to private investors, (ii) facilitating the review of investment proposals and their alignment with regional and national infrastructure plans, and (iii) maximizing scarce investment dollars.

In addition to these sector-wide institutional needs, each transport subsector has specific issues and constraints relating to private sector participation. Brief overviews of each subsector and suggested reforms to facilitate private sector participation follow.

a. Roads and Highways

Empirical evidence has shown the important role played by road links in promoting economic growth and reducing poverty. A good road network integrated with other modes of transport reduces the costs of doing business and makes Philippine companies more competitive. While the road density...
of the Philippines is the highest in Southeast Asia, its overall quality is one of the poorest (see Table 8). Paved roads represent only 53% of national secondary roads, 21% of provincial roads, 34% of municipal roads, and less than 7% of barangay roads. About 33% of local roads are not surfaced and are highly vulnerable to bad weather conditions.

Table 8: Road Densities and Paved Road Ratios
Philippines and Other ASEAN Developing Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Road Density (km./sq. km.)</th>
<th>Paved Road Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Philippines</td>
<td>0.67</td>
<td>0.21</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.19</td>
<td>0.47</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.20</td>
<td>0.74</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.42</td>
<td>0.82</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0.46</td>
<td>0.35</td>
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</table>

Source: Department of Public Works and Highways.

Significant investment targets national arterial roads and farm-to-market roads, but the secondary network, including national secondary roads and provincial roads, is the most neglected segment of the network. The medium-term infrastructure program (1999–2004) targets needed road investments of approximately P38 billion per annum, with P11 billion allocated to maintenance alone. Given budget constraints, the government has only been able to allocate an average of P22 billion per year from 1997 to 2003. In addition, these allocations have been disproportionately focused on developed regions and biased against regions where agricultural production is concentrated. For example, northern and southern Mindanao have the highest grain outputs in the country but have the lowest paved road ratios. These regions also have high incidences of poverty.

Deficiencies in design and construction, inadequate maintenance, and damage from overloaded vehicles are key reasons for the current state of the network. Despite the passage of a motor vehicle user charge act in 2000 and the establishment of a special road maintenance fund in the same year, funds from these sources have been insufficient to prevent the deterioration of the network.

Although management and maintenance of local roads has devolved to LGUs since 1991, investment in local roads is mostly funded by national government agencies—Department of Public Works and Housing (DPWH), Department of Agriculture, Department of Agrarian Reform, Department of Environment and Natural Resources, and the National Irrigation Authority—as part of broader national government projects aimed at improving agriculture, environment, irrigation, or other sectors. Due to this project-by-project approach with fragmented administrative responsibilities, the selection of road sections for improvement is largely decided in an ad hoc manner without due consideration for the integration of the local road network. Many roads have been arbitrarily classified on the basis of administrative, funding, or political decisions, and the road classification system established in 1955 has become inadequate.

Annual needs for maintenance and rehabilitation of local roads are estimated at P14.4 billion, but available resources are only P4.5 billion. A reliable funding mechanism for maintenance and rehabilitation of local roads based on cost recovery from road users must be designed. In addition, efficient incentives, including financial incentives, must be put in place to strengthen the commitment of LGU decision makers to maintain their roads. Lastly, responsibilities need to be clarified for the maintenance of the 122,000 kilometers (km) of barangay roads that is often carried out by provinces and municipalities in the absence of adequate barangay resources.

For LGUs from poor rural areas that have insufficient resources to cover even the maintenance requirements of their networks, access to affordable funding sources for road development is problematic. Under the present financing scheme, LGUs have to borrow at high interest rates to access funds, and only better-off LGUs in developed regions have

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63 Farm-to-market roads are often improved under integrated rural development programs.

64 Despite the intention to use these funds for preventative maintenance, most have been diverted instead to routine maintenance and repairs.

65 TA 1412-PHI: Road Classification Study, for $760,000, approved on 8 November 1990, recommended the establishment of a functional road classification system. However, the issue of funding requirements for rehabilitation and maintenance of roads to be reclassified from national to local roads, unresolved since the study was completed in 1994, has remained an obstacle to the implementation of the new classification.

66 The present lending rate of the Municipal Development Fund Office is 14%.
sufficient debt-servicing capacity to improve their roads. To enable low-income LGUs in poor rural areas to improve their roads, a financing framework needs to be formulated that will set priorities for national government support for local roads, the role of official development assistance resources in rural road development must be defined, and more attractive financial terms for LGUs must be provided.

The scarce funds that exist for maintenance are not used efficiently. While DPWH has largely shifted from maintenance by administration to maintenance by contract for national roads, it still employs an estimated 6,000 regional maintenance workers. Some provincial and municipal LGUs also operate maintenance equipment pools and employ maintenance workforces, but many contract such services to the private sector and resist pressure to use DPWH pools. A mechanism needs to be developed to liberalize maintenance and to introduce more incentives for efficiency in public pools. A shift toward maintenance by contract could be a useful mechanism for evolving public sector maintenance groups into cooperatives or private companies that could bid for maintenance contracts against private sector competitors.

A final key constraint to improving the road network is the complicated process of land acquisition and development. The absence of reliable cadastral surveys and land registries in the Philippines complicates the identification of land titles. Once the rightful owner has been identified, a legal framework exists for exercising eminent domain (RA 8974), but DPWH has resisted adopting market-based compensation for lands acquired. This is in contrast with other agencies such as the Department of Transport and Communications (DOTC) and even LGUs that have more systematically used market-based values. Disputes about rates of compensation have resulted in protracted project delays as has the difficulty of finding suitable resettlement locations for squatters.

Going forward, improving the road network will require (i) significant institutional reforms to coordinate planning and budgeting among national agencies and in relation to LGUs, (ii) institutionalization of a process to fund maintenance, (iii) clarification of compensation mechanisms and procedures for exercising eminent domain (including sources of funding), and (iv) more private sector participation and full competition in output-based maintenance and rehabilitation contracts.

b. Toll Roads

Over the past 10 years, five toll road projects have been developed in the Philippines: southern Tagalog arterial road, Manila-Cavite toll expressway, north Luzon expressway, and Skyway phases II and III. While the involvement of the private sector in toll roads is a central tenet of the government’s policy, implementation to date has been reactive with the government fielding unsolicited bids rather than setting out a detailed development strategy for the road sector. Without the reference point of a strategic plan, key road links are still lacking, and the government’s development objectives are not being met.

Much of the risk in existing BOT contracts is borne by the government either explicitly or through contingent guarantees, yet transferring risk should be one of the central purposes of private sector participation. Further distorting the framework for effective private sector participation is the presence of the state-owned Philippine National Construction Corporation (PNCC) which holds the exclusive franchise to develop, operate, and extend expressways/toll roads. Private investors wanting to develop a toll road must do so either as a joint venture with PNCC or must use PNCC to operate a BOT. To date only two such collaborations have been completed, the Skyway extension of the south Luzon expressway and the rehabilitation of the north Luzon expressway.

The toll regulatory board serves as the sector regulator, with the authority to review tariffs, but it is questionable whether tariffs need to be fixed for toll roads when alternative side roads exist. Allowing market forces to determine the appropriate toll may be a more effective and certainly a more regulatory mechanism. For toll roads to have an effective monopoly, tariff levels can be determined with agreed formulas included in BOT or joint venture contracts.

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67 The government agreed to adopt maintenance by contract as a national policy under ADB Loans 1046-PHI (SF) and 1047-PHI: Road and Road Transport Sector Program, for $50 million each, approved on 8 November 1990.

68 It should be noted that the north Luzon expressway and Skyway contracts present generally market-based risk allocations.

69 With ADB participation as a lender.
Investors in the sector have raised concerns over the (i) ability to maintain toll rates that allow acceptable rates of return; (ii) slow and cumbersome land acquisition, right-of-way determination, and resettlement; and (iii) high currency exchange risks. Indeed two additional BOT projects are currently stalled by a combination of land acquisition and financial issues: the Manila-Cavite toll expressway and the southern Tagalog arterial road.

Any approach to restore private sector interest in the sector must therefore include the following:

- strengthened sector planning in the context of other transport modes and the government’s development objectives;
- strengthened project planning addressing land acquisition, resettlement, and right-of-way issues in advance of project implementation;
- clarification of RA 8974 so that landowners can obtain market value for their property and so land acquisition can be facilitated;
- strengthened ability of DOTC and DPWH to evaluate and assess the economic impacts of private sector participation in infrastructure proposals for roads, especially where usage forecasts and target tariff levels can be objectively tested and where realistic risk-sharing scenarios can be developed;
- clarification of the role of the toll regulatory board particularly its role in regulating tariff levels;
- ending the monopoly of PNCC on the toll road franchise so that private consortia can organize construction and operation to maximize efficiencies;
- expanding the range of private sector participation modalities available as in effect only the joint venture and BOT models have been used to date when other modalities exist that could be used under existing regulations and may reduce the risk exposure of both contracting parties. e.g.,
  - operate and maintain—private sector maintains existing roads to defined standard and collects tolls;
  - rehabilitate, operate, transfer—upgrading existing roads to toll roads.

### c. Rail

The rail subsector is dominated by the national carrier, Philippine National Railways (PNR) which acts as owner, operator, and regulator of 1,296 km of track, less than 50% of which is operational. Indeed only two routes are currently operating: the 479 km between Manila and Legazpi and 15 km between Manila and Meycauayan. The loss of market share to road transport over the years has led to chronic underutilization of track and rolling stock and to operating losses of approximately P200 million per year. When non-operating expenses (depreciation, financing charges) are factored in, PNR is losing close to P500 million per year for transporting only 300,000 passengers, or P1,666 per passenger.

The poor state of the national rail network has resulted in its increasing irrelevance as a mode of transport. Old equipment, lack of preventive maintenance, and absence of right-of-way management have meant that PNR no longer offers dedicated freight service, and most passengers opt for faster road transport. Its charter-mandated obligation to maintain low fares, however, keeps its commuter fares well below those of its light rail competitors.\(^70\)

While it may still be possible to attract private investors to rehabilitate and operate selected PNR corridors, experience to date has not been promising. What is needed in the case of PNR is substantial restructuring to reduce operating costs and the fiscal drain on the government. This recommendation has been made repeatedly over the past 5–7 years, but the estimated 60,000 squatters that would have to be moved to rehabilitate the PNR track coupled with the high number of layoffs in the case of organizational restructuring (PNR has approximately 2,000 employees) have made implementation of these recommendations politically difficult. Indeed the extent of rehabilitation needed to improve the financial performance of PNR is daunting and the cost/benefit has yet to be firmly established.

In the commuter light rail sector, scope does exist for increased private sector participation. Indeed, one light rail project (MRT3) was completed with private partners,\(^71\) albeit with mixed results for

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\(^70\) P6.6 for PNR compared with P12.4 for mass rail transit and light rail transit.

\(^71\) Under a build-lease-transfer arrangement.
the government. In this case the passenger levels projected by the private initiators of the project proved to be far in excess of actual numbers forcing the government to incur significant losses on operations. The government is now considering adding additional light rail projects in Manila to further decongest the city.

In structuring these new light rail projects, allocating risks will need to be more carefully managed with improved planning and demand forecasting. An objective framework for determining and adjusting tariffs will also be required.

d. Maritime Ports

With so much dependence on sea transportation for the movement of domestic and international cargo, the efficiency and productivity of port operations have important economic impacts. The current structure of the sector, however, does not favor either. Apart from a selected number of independently operated ports,72 the PPA directly manages 114 ports and serves as the regulatory authority for all. There has been private participation in various container terminals, but scope remains for greater private sector participation in port management and services, provided that the PPA redefines its mandate and a rational program of port development and subsidization is adopted.

Worldwide experience shows that the commercialization and privatization of port operations can introduce significant efficiencies. Private participation can be limited to selected services within a port, or it can be as comprehensive as a concession to manage all port operations. In defining the right level of private participation, the government will need to determine the most efficient means of financing the network of smaller ports that are not financially self-sustaining but that are nonetheless deemed necessary for social/developmental reasons. These could either be directly subsidized or packaged with other more profitable ports in a management contract. In making these determinations, direct reference to intermodal transport development plans is essential as the viability of ports is closely linked to the quality of their supporting transport links (e.g., road, rail).

Increasing private sector participation will require several reforms: (i) separation of the regulatory and operating roles of the PPA so that it can continue to regulate the sector without direct conflict of interest; (ii) incorporation of all ports and creation of management companies to operate them; (iii) privatization of port services and port management where feasible; and (iv) devolution of tariff setting to port managers who can best determine the rates necessary to cover costs without deterring traffic. The successful experiences of Subic Bay and Cebu in incorporating port management and introducing more private sector participation should serve as useful references.

e. Airports

The Philippines has a total of 90 operational airports run by public authorities in addition to an estimated 87 private airstrips. Civil aviation plays a key role in the country’s economic development and is essential to supporting many forms of private enterprise. While the country has sufficient coverage in terms of number and location of airports, most are in disrepair and do not meet minimum international standards for flight operations and for safety. This is particularly true in Mindanao. As with roads and ports, lack of adequate funding for maintenance and of incentives for efficiency has led to the severe deterioration of infrastructure.

The sector is under the general policy and planning oversight of DOTC. ATO, an office of DOTC, is the most active government body in the sector and is responsible for (i) ensuring air safety, (ii) providing air traffic control services, (iii) determining airport fees and tariffs, and (iv) managing 86 of the 90 public airports.73 The Civil Aeronautics Board (CAB) is responsible for the economic regulation of the sector and determines routes and frequencies allocated to airlines.

The current structure is less than optimal as it obstructs potential incentives for efficiency, builds in conflicts of interest for participants, and deters private sector participation. None of the existing public airports has been fully incorporated, so they

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72 Subic Bay, San Fernando, Port Irene, Mindanao container, and 14 ports operated by the Cebu Port Authority.

73 The remaining four major airports are managed by GOCCs: Manila International Airport Authority for the Ninoy Aquino International Airport, Metro Cebu International Airport Authority for the Cebu International Airport, Subic Bay International Airport Authority for the Subic Bay International Airport, and Clark International Airport Authority for the Clark International Airport.
continue to operate on simple operation and maintenance budgets and to remit all revenues to the Treasury. This structure effectively removes incentives to cut costs and to increase operating margins. Even the four airport authorities that have been created to operate on more commercial principles do not have this necessary financial autonomy and accountability. Second, ATO sets fees for all airports, including those that it manages, thereby creating an inherent conflict of interest that would need to be resolved in any attempt to attract private airport management. Lastly, there is little coherence in the charges and fees levied by various airports, and in general they are substantially below the actual costs of the services provided.

Attracting private sector participation will therefore require a general restructuring of the institutional and regulatory framework to favor a more commercial orientation. There is scope for private participation in the management of airport concessions as a whole or in the provision of selected services to a public airport authority. The government embraced this commercial vision for the sector in its 1997 commercial aviation master plan which calls for (i) incorporating ATO, (ii) creating an independent regulator to assume the regulatory responsibilities of ATO and CAB, (iii) implementing cost recovery principles in determining airport charges, (iv) introducing commercially oriented airport management, (v) deregulating domestic and international air services, (v) promoting private sector participation in air transport infrastructure and services, and (vi) developing human resources in an incorporated ATO.

In sum, the government intends to focus on providing air safety aids and equipment and will leave development and operation of airport facilities to the private sector. To date, however, little progress has been made in implementing the action plan, as there has been institutional and political resistance. The reallocation of regulatory responsibilities requires new legislation, and this has not been forthcoming. Incorporating existing airports to introduce more financial accountability and to give managers the authority to contract out concession space to private entrepreneurs has still not begun in earnest.

As in most countries, many of the smaller regional airports are not likely to be financially self-sustainable so will continue to require some form of budget support. This should not prohibit them from adopting a more commercial orientation and management structure, however, as increased financial and performance accountability should create incentives for efficiency. Private management contracts could be considered for these airports either as concessions (packaged with more profitable airports) or stand-alone management contracts for a fee. The recent experience in Indonesia in developing such contracts should prove instructive.

In general, commercializing airport infrastructure management should introduce cost savings and should allow greater financial transparency so that the government can determine the costs/benefits of those airports that it sustains with direct subsidies. As with all of the transport subsectors, such subsidy and investment decisions should be made in the context of integrated transport plans as airports need road (and sometimes port/rail) links to fully serve their local constituencies.

3. Water

Water supply in the Philippines is managed by a diversified range of national and local institutions with some private sector participation. Service provision is allocated geographically as follows: (i) the Metro Manila area is serviced by the Metropolitan Waterworks and Sewerage System now with two private concessionaires, Manila Water Co., and Maynilad Water Services, Inc.; (ii) provincial urban areas are serviced by water districts (WDs), LGUs, and private utilities; and (iii) provincial rural areas are serviced by rural waterworks and sanitation associations, barangay waterworks and sanitation associations, a few WDs, and LGUs (see Figure 17). While an estimated 80–83% of the population has access to drinking water, the quality of this water remains problematic with more than 500,000 morbidity and 4,200 mortality cases per year due to contaminated drinking water and waterborne diseases.

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74 Prepared with the assistance of ADB TA 2559-PHI.

75 Only 29 of the 90 public airports have regular traffic.
Financing is provided by a combination of government subsidies, local government contributions, user charges, and foreign grants and loan assistance. While the government has identified improved water supply as an important development goal, its funding is barely sufficient to cover operations and management leaving little to nothing for capital investment. Private sector investment has also been limited to date with the notable exception of the Manila and Subic water concessions and a large number of small-scale independent providers. WDs are essentially local GOCCs.

Expansion and modernization of the water system is impeded by the weak financial condition of most LGUs and WDs responsible for water supply and by the absence of coordinated investment planning among municipal, regional, and national authorities. While subsidy schemes exist to help LGUs and WDs address the gap between revenues and costs, these have traditionally been input-based and as such have provided few incentives for service providers to increase efficiency.

Coordinated investment planning is complicated by the many agencies involved in the sector and by the absence of mechanisms to integrate investment proposals (see Table 9).

The poor economics of the water sector have meant that most service providers cannot access commercial funding and therefore rely on concessionary financing provided by the Local Water Utilities Administration which itself receives funds from the national government and from external assistance. Going forward, the economics of the sector must be improved through a combination of greater efficiency in service provision (including reductions in nonrevenue water), the evolution of subsidy schemes from input to output based, a review of tariffs and tariff setting to ensure better cost recovery and to adequately reflect the user’s ability to pay, and the development of a tighter, more simplified regulatory framework.

Private participation in the sector, apart from the Manila concession, has been limited to date. A few systems are managed by private operators, but LGUs have not managed to sign any contracts with private operators despite attempts. Ultimately, potential contracting parties have not been able to agree to a...
satisfactory allocation of risks associated with (i) the unknown operating conditions of the systems, (ii) high nonrevenue water levels, and (iii) uncertainty regarding tariff levels. Other notable issues have centered on the lack of clarity of the proposed contracts in addressing taxation, performance bonds, and impacts of change orders during construction (see Box 5).

The ongoing attempt to structure a concession for the San Fernando City water system in La Union Province, which so far has attracted several bidders, will provide valuable lessons. This concession agreement is based on explicit, output-based subsidy payments to the operator to provide connections to low-income households and on defined investment commitments by the operator.

Both the government and the private sector have learned valuable lessons from the Manila water concessions. They are being applied in San Fernando and will need to be applied going forward. They are: (i) the financial and technical capability of the proposed operator must be objectively assessed, (ii) credible feasibility studies must be conducted to assess the current state of the operating systems, (iii) contracts must assign risks to the parties best able to manage them, and (iv) bidding must be completely transparent. These factors, though seemingly self-evident, have proved challenging in previous bidding attempts, particularly at the LGU level.

4. Telecommunications

The Philippines has a well functioning ICT infrastructure with one of the highest telephone densities in Asia.81 The liberalization of the sector in 199382 brought a substantial increase in investment83 and led to a sharp increase in service providers (see Table 10). Service quality also markedly improved, cutting the time required to get a fixed telephone line from 5–6 years to only 1–3 days. Mobile telephone use also expanded rapidly with the number of cellular mobile providers increasing from 2 in 1992 to 5 in 2000. Parallel increases in Internet service providers and Internet terminals (e.g., the proliferation of privately-run Internet cafes) have also led to an increase in Internet penetration and number of hosts.

Among telecommunications service providers, 10 were vertically integrated, multi-service firms offering all four or some of the services mentioned above. However, recent mergers and acquisitions have decreased the number to 7. Philippine Long Distance Telephone Company (PLDT) still remains the dominant operator in the most lucrative areas in the country including Metro Manila. In 2001, PLDT’s total number of subscribers represented 62.6% of the total for the industry. New operators are gaining market share in selected regions, however. For example, Digitel is fast becoming a major

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81 Four main lines and 22 subscribers per 100 people in 2003.
82 Executive Order 212 required mandatory interconnection of other firms with the Philippine Long Distance Telephone Company’s fixed land lines.
83 Investment in the sector grew at an average annual rate of 28% between 1993 and 1999.
operator in Luzon, serving 11.7% of the total number of subscribers with fixed telephone lines. Competition in the cellular market has also become stiffer, with the two largest firms (Smart-PLDT and Globe) holding market shares of 39.8% and 38.4%, respectively.

Despite this market liberalization, certain segments of the market remain difficult to penetrate. PLDT still dominates the provision of backbone, international gateway facilities and leased lines, and despite Executive Order 212 mandating interconnection, both private sector land lines and cellular lines complain of difficulties. With the continuing rise in demand for broadband, it may be useful to consider how to further liberalize the upstream market. A review of selected market policies and regulations is therefore recommended, including the current delineation of the country into service areas that may unduly segment the market and allow some amount of market power and the reduction of consumer choices.

### B. Financial Sector

The Philippine financial sector is dominated by banks with an estimated P3,758 billion of assets as of January 2004, compared with only P1,292 billion of total PSE market capitalization and P847 billion of assets held by nonbank financial institutions (NBFIs) (see Figure 18). Despite recent reforms designed to strengthen the financial sector, it remains weak and relatively underdeveloped. Although strong capital positions and manageable foreign exchange exposure largely protected the sector from the systemic crises that affected neighboring economies in 1997–1998, the ensuing slowdown in economic activity has led to deteriorating asset quality and a general weakening of the banking sector.

![Figure 18: Financial Sector Assets January 2004](image)

**Source:** GMA Capital Markets Ltd. 2003; Banko Sentral ng Pilipinas, 2004

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84 With about 6.5 million subscribers.

85 For the purposes of this discussion, NBFIs are considered separately from PSE, and include insurance companies, finance companies, securities brokers/dealers, fund managers, pension funds, and pawnshops.
Sector supervision and regulation are fragmented, with the BSP, SEC and the Insurance Commission (IC) serving as the main supervisory bodies tasked with implementing various regulations pertaining to each financial instrument and institution. The central banking act of 1993 and the general banking law of 2000 provide the legal framework for regulating banks and financial institutions that have quasi-banking functions. BSP and SEC share in supervising and regulating nonbank financial institutions with BSP overseeing those that have quasi-banking functions and/or whose charters specify that BSP is the supervisory agency. SEC supervises and regulates the rest. IC is tasked to supervise and regulate the private insurance industry, and NFBIs are governed by their respective charters.

About 50% of Philippine companies finance their working capital needs with internal sources of funds. Those companies that seek external financing contract short- and medium-term funds from the banking sector (see Figure 19). Long-term investment capital is not available from the banking sector or from the capital markets as the small and non-liquid profile of the equities market makes it unattractive to new issues, and the domestic corporate bond and asset-backed securities markets are virtually nonexistent. The commercial paper market provides an alternative source of short-term (i.e., 1 year or less) and medium-term (i.e., ranging from 1 to 5 years) funds to the private sector but also remains very small with less than P1 billion of commercial paper issued in 2000.

There are several reasons for the underdevelopment of the financial sector, chief among them (i) the concentrated nature of the banking sector and propensity of banks to channel funding to their preferred (and often related) customers, (ii) high interest rates, (iii) weak corporate governance practices, (iv) the ineffective insolvency regime, and (v) weak implementation of the regulatory framework. These factors are explored in more detail below and echoed in the earlier discussion on impediments to private sector development.

1. Banking

The Philippine banking sector is composed of commercial banks, thrift banks, and rural banks. Commercial banks dominate the sector with an estimated 90% of total assets as of January 2004. A high degree of concentration exists with the seven largest commercial banks (out of a total of 43) holding an estimated 60% of total assets. Two of these seven large commercial banks are government-owned, the Land Bank of the Philippines and the Development Bank of the Philippines, while the remaining five are private. The top four private banks have a 40% market share and are each owned by a separate, larger commercial conglomerate.
Owning banks is a characteristic feature of Philippine corporations and reduces their need to seek external financing from the capital markets (ADB 2003). Indeed, the reliance of corporations on intra-group finance allows owners to maintain tight control and to avoid the disclosure requirements of listed companies.

While there are no published estimates of the value of intra-group lending in the banking sector, the general banking act of 2000 has adopted new guidelines for reporting and monitoring related party lending. Sector analysts report that the effectiveness of BSP in enforcing these new prudential regulations remains limited, although recent agreements among BSP, SEC, and IC to allow on-site examination, the sharing of information, and the reorganization of the BSP’s supervisory functions according to the conglomerate structure should strengthen the ability of these institutions to monitor connected lending.

The six largest banks in the sector own trust, investment, securities, insurance, foreign currency deposit and thrift subsidiaries as well as business and real estate development projects. This structure facilitates risk arbitrage within the conglomerate and increases the difficulty of supervision without close coordination among regulatory bodies. The need for improved corporate governance practices in the banking sector has been recognized by BSP which has adopted measures including the requirement of all banks, quasi-banks, and trusts to have at least two independent directors.

Further pressing corporate governance reforms are needed in the accounting and auditing practices of both financial institutions and corporate entities. While the Philippines has the most certified public accountants per capita in Asia and statutory accounting guidelines are sound, there is little capacity to enforce these guidelines or disclosure requirements. The Board of Accountancy has never suspended or revoked accountancy charters, despite numerous cases of malpractice. Furthermore, companies often prepare different financial statements for different end-users, although the recent SEC ruling setting the international accounting standards as the standard by 2005 should help eliminate this practice. In the financial sector in particular, BSP should actively pursue its program of accrediting external auditors and imposing penalties on bank auditors who do not alert BSP to events that materially affect the financial condition of banks.

Real credit growth of the banking system has been contracting since 1998 as the general economic downturn reduced the demand for loans and the deteriorating quality of the loan portfolio led banks to practice credit rationing despite relatively high levels of liquidity (see Figure 20). The steady stream of risk-free government securities has given banks an alternative source of investment to offset the decline in corporate lending and has helped the government maintain a low interest rate regime despite ballooning budget deficits (ADB 2003).

Interest rate spreads have historically been high relative to other Asian countries due to a combination of limited competition, higher intermediation costs generated by high reserve and directed lending requirements, and the high interest rates set by monetary authorities on which bank lending rates were based. The availability of low-cost funds on international markets allowed banks to rely less on domestic deposits thereby keeping deposit rates low. Both lending and deposit rates have been falling since 1997, as the general decline in funding demand and...
The NPL ratios of the banking sector remain one of the highest among the Asian crisis economies and were estimated at 15% of outstanding bank loans at end 2003, or 53% of capital (see Figure 22). If ROPOA are factored in, total net NPAs are estimated at 14% of total banking assets, or 64% of capital and 12% of GDP. Although reserves for NPAs ostensibly cover one third of those in the system, foreign market analysts believe that they are unlikely to be sufficient to absorb the losses resulting from the resolutions.100

The highest concentration of NPAs lies in the commercial banking sector, where 42 banks hold 88% of them. The remaining 12% are held by thrift and rural banks. The passage of the SPV law (RA 9182) in December 2002 has done little to entice banks to resolve their NPAs. Issues of valuation and appraisal persist, and banks are generally unwilling to recognize the current market values of their NPAs.101

The steady decline in the profitability of banks102 is putting more pressure on them to restructure, although controlling shareholders have demonstrated continued resistance. A notable exception is the recent agreement reached by the National Housing Mortgage Finance Corporation (NHMFC) to sell an estimated P13.4 billion103 of its NPLs to Deutsche Bank Real Estate for a reported P5.123 billion, or 38.08% of outstanding principal balance. Deutsche Bank and NHMFC agreed on a 51/49% equity split in an SPV to be set up to resolve the loan portfolio, with Deutsche Bank as controlling shareholder. Deutsche Bank’s bid assumes third-party financing of 50% of the purchase price.104 This transaction represents the first major effort to resolve a large NPL portfolio in the Philippines.

Going forward, strengthening the banking sector will require resolving the NPA overhang and implementing the provisions of the general banking law, particularly those concerning disclosure of related-party lending, risk-based capital adequacy,105 and corporate governance and accounting practices.

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100 There is a disincentive to dispose of ROPOAs as they can be retained and counted toward capital; disposing of them would force banks to recognize the losses immediately.
101 Return on assets and return on equity have dropped from 2.2% and 15.9% in 1996 to 0.6% and 4.3% in 2001, respectively.
102 Book value of outstanding principal balance.
103 ADB provided a letter of support and a term sheet for a financing package that would be available to the winning bidder in the auction. These two documents were made available to all registered bidders to allow them to structure their bids. ADB and Deutsche Bank are currently in negotiations for a debt-financing package. ADB Board approval has not been obtained as yet.
104 BSP Circular No. 389 (25 June 2003) sets the guidelines for the granting of loans and other credit accommodations, and BSP Circular No. 360 (3 December 2002) provides guidelines for incorporating market risk in the risk-based capital adequacy framework for universal banks and commercial banks.
Positive steps have already been taken by BSP in adopting a financial sector reform program aimed at strengthening the prudential and regulatory framework and encouraging market-based consolidation in the banking sector. With the adoption of most of the core principles for effective banking supervision of the Bank for International Settlements, BSP has tightened prudential norms regarding industry sector limits, credit concentration, real estate exposure, income recognition, and restrictions on speculative trading and foreign currency activity.

To ensure the effective implementation of these tightened regulations, the authority and capacity of BSP to prosecute violations must be enhanced. This will require some form of protection for BSP examiners from prosecution and more discipline from BSP in implementing regulations uniformly, i.e., avoiding regulatory forbearance and the use of liquidity support to prop up failing institutions. Weak banking institutions with limited prospects for market-based recovery should be allowed to fail.

2. Nonbank Financial Institutions

The nonbank financial sector (NBFS) remains small, representing only 14% of the total assets of the financial sector. It is composed of financing companies (with and without quasi-banking functions), mutual funds, pre-need funds, insurance companies, pension funds, security brokers, and pawnshops. The largest share of assets among NBFs is with the two pension funds that represent 52% of the total.

The Government Service Insurance System and the Social Security System are funded pension schemes. Market analysts express serious doubts about the long-term solvency of both funds. While they should play important roles as institutional investors and providers of long-term finance to the housing sector, their relatively small size and the prevailing government policies regarding their investments have limited their presence in the market. Both funds allocate a significant portion of their portfolios to low-cost mortgage funding and loans to members, which further limits their profitability. Investments in the equity market typically represent 30–40% of their portfolios and government bonds another 10–20%. Further growth and rehabilitation of the pension funds will require a review of subsidized lending requirements as well as improved perception on the part of individual savers that the funds will pay out in the future. Prevailing sentiments today indicate a lack of confidence in the viability of the pension schemes and a consequent propensity to withdraw savings as early as possible.

Beyond pension funds, the pre-need industry also contains numerous memorial and education plans, one of the largest of which is the college assurance plan (CAP). This plan, which recently posted an estimated P17 billion shortfall in its trust fund, is under intense scrutiny as a test for the solvency of the sector as a whole. As with other pre-need plans, CAP has largely escaped the tight regulation afforded to the insurance sector by IC, falling instead under the supervision of a department of SEC. While the tightened regulations issued by SEC in 2001 have largely served to strengthen the disclosure and prudential management practices of the industry, the absence of close regulatory oversight in previous years coupled with poor management has led to the weak financial condition of several plans, most notably CAP. Given the size of this plan, it is feared that its failure could precipitate a general run on pre-need plans; efforts are being undertaken by the industry to improve its financial outlook.

There are over 150 licensed insurance companies in the Philippines although three companies dominate the sector with 72% of the assets. Filipinos

GSIS is required to invest at least 40% of its resources in housing loans and loans to members; in 2001 the actual allocation was 49.4%.

In 2005, an audited financial statement submitted by the company's external auditor to the Philippine SEC stated that CAP's trust funds managed by trustee banks was only P8.49 billion against its liabilities of P25.6 billion.

CAP's trust fund assets are managed by some of the Philippines' biggest and most stable banks, namely the Bank of the Philippine Islands, Metropolitan Bank and Trust Company, Allied Banking Corporation, Bank of Commerce, Equitable-PCI Bank, Philippine Veterans Bank, Union Bank of the Philippines, and East West Banking Corp.
remain modest buyers of insurance with annual per capita expenditure of only P336 in 2001 (ADB 2003). Insurance companies are active in the capital market investing on average 40% of their portfolios in government bonds and another 30% in equities and promissory notes.

The mutual fund industry is the smallest in the Association of Southeast Asian Nations region representing only 0.1% of the size of the industry in the Republic of Korea and 1.8% in Thailand. A history of scandals and poor information dissemination has left investors very wary of the industry. A lack of distribution infrastructure and competition from banks that prefer to market their own common trust funds to investors have left the mutual fund industry with few participants.

Because of their long-term liabilities, contractual savings institutions, mutual funds, and insurance companies can play a key role in developing the domestic capital market. However, investment restrictions and required security deposits imposed on these institutions have created a situation in which a large share of their assets consists of short-term investment instruments and government securities. Addressing the key impediments to NBFI development requires a holistic approach taking into consideration the needs of all stakeholders: investors (e.g., information, ease of access), providers (e.g., distribution infrastructure, corporate governance) and regulators (e.g., disclosure, enforcement powers and immunity from harassment). SEC and the Capital Markets Development Council have recently adopted such an approach in issuing their “blueprint” for developing the nonbank financial sector (NBFS). This approach, which anchors NBFS development to national economic objectives and involves the private sector in defining measures to be taken, should be actively encouraged.

3. Debt and Equity Markets

Active capital markets play a key role in channeling finance and diversifying risk allowing a broad base of investors to finance economic growth. The Philippine equity market is still very small relative to its economy and is by far the thinnest in Asia. The total number of companies listed on the PSE is only 238, and 5 of those are listed on the smaller board reserved for SMEs. Initial public offerings average 4 per year and raised only $3.3 million in 2003. The top 20 equities represent 80% of trading volume on average. It is further estimated that between 500 and 1,000 additional companies qualify for listing but choose not to, preferring to source funding from the banking sector or from retained earnings.

The slow growth of the market can be attributed to four key factors: (i) lack of interest by many qualified companies who prefer to self-finance their operations, (ii) poor corporate governance practices (e.g., disclosure, minority shareholder protection), (iii) relatively high transaction costs, and (iv) restrictions on foreign ownership. Given these market limitations, it is not surprising that the participation of retail and foreign investors in PSE is low at only 16% and 10%, respectively (see Figure 23).

The private debt market is also very small, with few corporate bond issues and little liquidity. The largest corporate issuers, such as Meralco, prefer to

![Figure 23: Philippines Stock Exchange Participants (% of total equity)](image)

Source: GMA Capital Markets Limited estimate

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114 These restrictions include limits on investments in stocks, bonds, and other certificates of indebtedness, real estate investments, investment in a single enterprise, and investments in foreign currency.

115 Total market capitalization of PSE was 23.6% of GDP in 2002 compared to 36% for Thailand and 46% for the Republic of Korea.

116 Documentary stamp taxes (DST) and stock transaction taxes added 1.25% to each transaction, giving PSE the second highest transaction costs in Asia; DST on secondary trading has recently been eliminated.

117 In practice nearly all listed companies have ownership limitations.

118 The California Public Employees' Retirement System put the Philippines on its blacklist in 2002 due to poor standards of disclosure, regulation, and governance, but this rating was then removed following lobbying efforts on behalf of the Philippine government.
list debt on foreign markets given their higher liquidity and better pricing mechanisms. Trading has historically been conducted on an over-the-counter basis, although the planned establishment of a new fixed income exchange in 2004 will automate this process and allow real time pricing. The mortgage market also remains small as current laws weaken the ability of lenders to foreclose on defaulting loans, and until very recently no legal mechanisms existed for secondary trading through portfolio securitization. The generally unstable macroeconomic environment, poor protection offered to creditors, high tax regime,\(^{119}\) and absence of a long-term benchmark rate\(^{120}\) have hampered the development of the market.

The volume of government debt, on the other hand, remains quite large, and at P2.3 trillion is almost double PSE market capitalization.\(^{121}\) Major buyers of government debt are institutional investors (banks, insurance companies, and pension funds) as retail customers have only limited access. The growing fiscal deficit of the government ensures a steady supply of bonds, and their corresponding interest rates will have to steadily increase to match the risks associated with the increasing level of public debt. This phenomenon may have the effect of crowding out future issues of corporate bonds.

SEC has attempted to increase the supply of equities into the market by encouraging PSE to enforce the free-float rule,\(^{122}\) by encouraging the top 5,000 corporations to list, by circulating its draft rules and regulations to govern alternative trading systems, and by redrafting the rules to govern the trading of commodity futures.\(^{123}\) In reality, however, it is SEC’s and the Capital Markets Development Council’s holistic approach to addressing the impediments to NBFS development (as embodied in the “blueprint”) that is more likely to be effective. Confidence in the market must be restored to make it an effective tool for channeling investment. A notable step in this direction was taken in 2003 with the demutualization of PSE and the initial listing of 20% of its shares.

Further improvements in corporate governance practices will be central to restoring confidence in the capital markets. Efforts by SEC to date have included issuing the Code of Corporate Governance, Memorandum Circular Number 5 on the accreditation of external auditors of public companies, and amendments to accounting and auditing rules to incorporate international standards and to increase the responsibility of management for accurate and complete disclosure. In addition, SEC has promulgated guidelines on the nomination and election of independent directors and has developed a corporate governance self-rating process. Other initiatives are under way with the Institute of Corporate Directors.\(^{124}\) On the whole, corporate governance is new to the Philippines and a departure from the tradition of opaque, closely held conglomerates with limited need for external finance. Given the closed nature of many corporate groups, corporate governance reforms will not necessarily be implemented voluntarily and will therefore need careful and competent oversight from a combination of SEC, BSP, IC and encouragement from such private organizations as Institute of Corporate Directors.

4. Housing Finance

Housing finance is currently provided by most private banking institutions, although they tend to focus on the highest tier of the market. Lower income groups receive subsidized mortgage loans from the Government Service Insurance System and Social Security System both of which are obligated to provide these loans at rates that barely cover administrative costs. The experience of NHMFC,\(^{125}\) created to channel subsidized housing finance from the pension funds, showed how these programs can

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\(^{118}\) Interest income on bonds is subject to a 20% final tax withheld at source; capital gains derived from the sale of bonds are considered as ordinary income and taxed accordingly.

\(^{119}\) Of the P2.3 billion in outstanding treasury bonds at the end of 2003, 9% had a 20-year maturity which should begin to lengthen the benchmark yield curve.

\(^{120}\) Figures as of December 31, 2003.

\(^{121}\) The free-float rule requires listed companies to maintain a minimum public float of 10–33% depending on size and market capitalization. This rule was suspended from 1998 until 2004.

\(^{122}\) According to the draft rules, alternative trading system refers to any organization, association, person, or group of persons, or system that constitutes, maintains, or provides an electronic market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a recognized exchange or clearinghouse. Among others, this alternative trading system will provide smaller companies with a more cost-efficient source of corporate financing and offer investors investment products that are not currently offered by traditional investment outlets.

\(^{123}\) Examples of the proposals are the following: corporations must institute the “commitment to corporate governance,” which involves setting up an operative system of accountability, checks and balances, and performance evaluation and adherence to “transparency” which involves, among others, the regular release of financial and nonfinancial information to regulators and to the general public (ICD 2000).

\(^{124}\) Launched under the national shelter program of 1986.
fail as it has proved unable to service and recover the portfolio of 200,000 loans that it built up nationwide leading to the insolvency of the corporation.

It has been demonstrated that lower income groups can pay market rates for housing finance and generally have a low default rate. With the passage of the foreclosure and asset-backed securities laws, the risks of lending to lower income groups should be reduced and modes of risk diversification should be expanded making the market more attractive to lenders and bringing down interest rates.

It is therefore recommended that commercialization of the mortgage market be pursued letting both supply (including pension funds and other contractual savings institutions) and demand (including from commercial banks) meet freely in unsegmented markets. Ensuring affordability for the poor could be achieved through a carefully targeted and transparently budgeted up-front subsidy program.

C. Social Sectors

1. Education

The Philippine educational system reaches most of its eligible students with enrollment rates of 97% in elementary schools, 73.4% in secondary schools, and 25% in universities. While these numbers compare favorably with other countries in the region, the overall quality of education has been declining in recent years with budget allocations unable to keep pace with the growing population.\(^\text{126}\) Real per capita expenditure on education declined 12% from P493 in 1997 to P433 in 2001 while the population of eligible students grew by more than 2% per year during the same period.

The private sector has historically played a significant role in providing secondary\(^\text{127}\) education with over 40% of total enrollments in the mid-1980s. With the government’s introduction of free public secondary schools in 1987,\(^\text{128}\) private school enrollments declined rapidly to 24% of the total in 2000. With few exceptions, private schools are not able to retain enough students to be financially viable even with the modicum of scholarship assistance available under the Government’s Assistance to Students and Teachers in Private Education (GASTPE) program.\(^\text{129}\) Total allocations to GASTPE in 2000–2001 were 2% of total government spending on secondary and higher education.

The crowding out of the private sector is also occurring in the university system with market share of private tertiary institutions dropping from 85% of enrollments in 1987 to 73% in 2000. Contributing to this phenomenon is the proliferation of state universities and colleges (SUCs) throughout the country which increased from 78 in 1987 to 115 in 2003. These SUCs charge on average less than 10% of unit cost, allot minimal budgets for scholarship, and admit mostly the nonpoor.\(^\text{130}\) They are often created at the behest of a congressman within his constituency, and once created must be funded by the Department of Budget and Management.\(^\text{131}\) The role of the Commission on Higher Education (CHED), the planning and regulatory authority for the sector, is minimal as only the president can veto the request.

The role of the government in the sector should be to ensure access to quality education services to all who seek them. The current policy environment fails to do this effectively relying too heavily on public provision of services rather than on a considered policy framework that enables both public and private providers to compete equally, thereby allowing market pressures to induce efficiencies. To reduce the overall cost to the government of providing education, several measures must be considered: (i) strengthening the planning process of the Department of Education and CHED so that

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\(^\text{126}\) The Philippine education system is plagued with teacher, textbook, classroom, and armchair shortages as approximately 90% of the Department of Education’s budget goes to teachers’ salaries.

\(^\text{127}\) Secondary schools cover grades 7–10 with universities covering grades 11–14.

\(^\text{128}\) “Free” elementary and secondary education was mandated by the 1987 Constitution.

\(^\text{129}\) The program provides tuition fee supplements for students, subsidies to private high schools purchasing approved textbooks, subsidies paid to private high schools that enroll students in areas where there is either no public high school or where there is insufficient space in public high schools to meet demand, scholarships to underprivileged first-year college and university students, tuition fee supplements to nonfreshmen students in private colleges and universities enrolled in priority courses and programs, educational loans to college students, low-interest loans to private educational institutions, and scholarships for graduate degrees and nondegree workshops or seminars for faculty members in private colleges and universities.

\(^\text{130}\) An estimated 25% of SUC students are below the poverty line, suggesting that the remaining 75% could afford to contribute to tuition fees (Tan 2002).

\(^\text{131}\) In 2001, SUCs absorbed 13% of the total government budget for the education sector.
licensing of schools can be done according to need;\textsuperscript{132} (ii) elimination of the discretionary authority of congressmen to create SUCs without CHED approval; (iii) broadening CHED mandate to include supervision/regulation of SUCs; (iv) improved targeting of sector subsidies to the poor so that students who can afford to contribute to tuition fees are obligated to do so;\textsuperscript{133} and (v) expansion of the GATSPE program to allow more students to select schools based solely on the quality of education rather than cost.

2. Health

With the steady growth of total health expenditures from 0.78\% of GNP in 1995 to 1.04\% in 2003,\textsuperscript{134} key indicators have also improved with increases in overall life expectancy and a decline in infant mortality rates.\textsuperscript{135} There is a high disparity among provinces and regions. Mindanao, Eastern Visayas, and Ifugao, for example, still have much higher infant mortality rates than the national average; this is directly related to the highly unequal distribution of health services among classes and regions.

The private sector provides a large portion of health services—66\% of the hospitals and 42\% of the hospital beds—reflecting a high level of investment.\textsuperscript{136} Private providers typically focus on personal care services while the public sector provides both public health care and personal care. Despite the significant presence of private sector health care providers, their presence has done little to reduce the fiscal burden on the government due to poor planning, public-private coordination, and licensing and accreditation practices in the sector (see Box 6).

The Department of Health (DOH) is responsible for licensing health care facilities, as well as for the operation of 78 hospitals.\textsuperscript{137} Accreditation is done by the National Health Insurance Corporation (PhilHealth). In licensing private facilities for the sector, DOH is not empowered to consider their proposed location and therefore cannot manage the ratio of facilities per capita which results in suboptimal coverage throughout the country.

Box 6: Opportunities for Local Public-Private Partnerships

At the local level, with devolution, the private sector has an opportunity to partner with the public sector in developing interlocal health zones where expensive medical equipment and emergency services can be shared.

With the passage of the National Health Insurance Act of 1995 and the creation of PhilHealth, the government took an initial step in formally integrating private health care providers into the universal health care system. PhilHealth now reimburses both private and public accredited facilities for their health care services. The evolution of the sector should see the government focus its role on planning, licensing, and accreditation leaving health care service provision to the private sector, particularly in the urban areas. This can be achieved by strengthening the planning and budgeting capabilities of DOH\textsuperscript{138} to introduce professional management and accounting practices, and strengthening the accreditation capabilities of PhilHealth. The planned incorporation of two DOH hospitals\textsuperscript{139} and similar reforms launched by LGUs to create financial autonomy in provincial hospitals should be actively pursued as initial reforms to strengthen the performance of the sector.

\textsuperscript{132} A step in this direction is CHED’s current program mapping for all higher educational institutions to identify institutions per region offering duplicate, oversubscribed, and undersubscribed programs.

\textsuperscript{133} Equal subsidization of public and private schools could be facilitated with the use of vouchers to allow students to choose their schools.

\textsuperscript{134} This is below the 5\% of GNP standard set by the World Health Organization.

\textsuperscript{135} Life expectancy increased from 64.5 years in 1991 to 67.6 years in 1999; infant mortality fell from 55/100,000 in 1991 to 29 in 1999.

\textsuperscript{136} Of the total expenditures for the sector, 54\% are paid by users for services provided by the private sector.

\textsuperscript{137} The devolution of health care services to LGUs in 1991 has meant that public hospitals are now run by LGUs, and only 78 tertiary and highly specialized hospitals remain under DOH management.

\textsuperscript{138} Only 4 of the more than 600 existing public hospitals are incorporated today.

\textsuperscript{139} DOH has four hospitals nominally set up as corporations (heart center, kidney institute, lung center, and children’s medical center).
D. Agriculture

The agriculture sector still contributes a sizeable share of employment and income accounting for nearly half of the total labor force and contributing close to 15% of GDP in 2003. Recent agricultural growth slowed, however, from 6% per year in 1999 to 4% in 2003 (see Figure 24). Contributing factors include drops in world commodity prices and public expenditures for irrigation combined with a sharp increase in the cost of constructing new irrigation systems. Agricultural research and development continues to suffer from underfunding that contributes to low productivity growth as few technological changes have been introduced over the past several years.

The Philippines has one of the lowest arable land per capita ratios in Asia. Given the high population growth (2.1% annually), there is increasing pressure on land and natural resource availability. Landownership, moreover, is highly concentrated. Two percent of all landowners control 36% of farmland, while 86% own only 35% of agricultural land consisting of farms of less than 7 hectares. To address this inequality and to help reduce rural poverty, the government launched the comprehensive agrarian reform program (CARP) in 1988. CARP is conceptually the most comprehensive agrarian reform program ever attempted in the Philippines because it covers all public and private agricultural lands regardless of products produced or tenure arrangements of the farmer. CARP has identified 7.8 million hectares of agricultural land for redistribution to 3.9 million rural producers, farmers, and workers. As of 30 June 2003, 6.01 million hectares had been redistributed, most of which was public land. Addressing the redistribution of private land is a much more sensitive matter and has therefore been delayed, with the target completion date of CARP extended to 2008 from its initial target of 1998.

In addition to the difficulties encountered with implementation due to the lack of documentation (cadastral maps of the entire territory, except for high-value real estate, are either nonexistent or obsolete), poor interagency coordination, to the weak legal framework for the exercise of eminent domain, and to the lack of funds for land acquisition, CARP has fallen short of its stated goals as almost no private land has been redistributed. Resistance from large landowners remains predictably strong and effective. Moreover, land redistributed under CARP is not transferable for 10 years which prohibits beneficiaries from pledging the land as collateral for bank financing. This has significantly reduced the ability of beneficiaries to develop their land.

Fostering continued output and productivity growth in agriculture would require improvements in irrigation facilities, farm-to-market roads, postharvest facilities, credit support, and research and extension. Incentives and support services should be extended to landowners who invest in viable agricultural industries. Farmers’ organizations and cooperatives can be strengthened to enhance their institutional capabilities to serve their members through effective utilization of support services extended by the government, by nongovernment organizations, and by the private sector. Lastly, the transferability feature of CARP lands must be addressed so that it does not impede the functioning of the land market and long-term investments in agriculture.

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140 About 0.4% of gross value added of the sector.
141 Based on the 1998 comprehensive law on agrarian reform.
IV. ADB EXPERIENCE WITH PRIVATE SECTOR DEVELOPMENT INITIATIVES IN THE PHILIPPINES

A. Overview

ADB has been one of the most important development partners in the Philippines since its inception in 1966. As of the end of 2001, ADB had approved $7.9 billion in loans and $120.0 million in technical assistance. In terms of public sector lending, the Philippines is ADB’s fifth largest borrower. In terms of private sector operations, it ranks first among the developing member countries of ADB. During 1986–2001, ADB approved 86 projects and programs for the Philippines involving 109 loans with a total value of $5.9 billion. Project loans accounted for 79% of total lending and program loans accounted for 21%. The share of program loans has been increasing in parallel with ADB’s evolving role as a broad-based development institution with its emphasis on policy reforms. While program loans represented only 4% of lending during 1990–1997, they rose to 56% during 1998–2003. About 16 projects/programs involving 41% of loans went to the energy and transport and communication sectors, while 24 projects/programs involving 22% of loans went to the agriculture and natural resources sector (ADB 2003).

Average lending levels have steadily declined since the Asian financial crisis, from $504 million during 1996–1998 to $110 million during 2001–2003. This is explained by a combination of (i) lower absorptive capacity (especially the government’s budget constraints), (ii) the pace of policy reforms, and (iii) portfolio issues (the overhang of implementation problems with active loans affecting timing of new loans). Nontraditional support modalities have also been used in recent years such as credit enhancements (e.g., a partial credit guarantee of $500 million in 2002), and mechanisms to mitigate foreign exchange risk for private borrowers (peso swap and financing project approved in 2004). While the specific classification of private sector development as it relates to ADB interventions is relatively recent (2001), one can nevertheless review the broad portfolio and identify those ADB interventions that have (i) helped establish an enabling environment for the private sector, (ii) generated business opportunities in which the private sector can participate, and (iii) catalyzed private investments (ADB 2001) by mobilizing additional resources through cofinancing and guarantee operations. The first two have been pursued through ADB’s public sector window with program loans and technical assistance operations and the third by direct investments in and loans to private individual companies. Broadly speaking, ADB’s interventions in support of private sector development have focused on the infrastructure (transport, energy, water) and financial (capital markets, NBFS) sectors.143

143 Judicial reform, critical for reducing the risks of doing business and therefore facilitating private sector development, has also recently been added to ADB’s Philippine assistance program, with the implementation of a $1.2 million technical assistance project approved in 2001 to strengthen the independence of the judiciary.
B. Public Sector Operations: Program Loans and Technical Assistance Operations

From 1986 to 2001, ADB implemented nine program loans totaling $1.5 billion, three of which were sector development programs with policy components. In each case, the policy components were intended to place the sectors on a positive growth footing allowing broad-based participation and, where necessary, strengthened regulatory oversight. ADB also implemented selected infrastructure projects that had policy components and a total of 210 technical assistance projects with a total value of $104 million. The principal beneficiaries of technical assistance activities were the agriculture and natural resource sector (34%), social infrastructure (27%), and transport and communications sector (12%).

In the agriculture and natural resource sector, technical assistance was mostly for institutional strengthening and capacity building and for technology and transfer of “best practices.” The former focused on agricultural policy analysis and national and regional project and program formulation, implementation, monitoring and evaluation; on financial management, management information systems, and benefit monitoring and evaluation; and development of plans, guidelines, and consultation procedures for optimal use of natural resources and conservation of the environment. In the industry and nonfuel mineral sector, technical assistance sought to examine the effectiveness and adequacy of government policies—and of the existing legal and regulatory framework—for developing the mineral sector. In the social infrastructure sector, technical assistance was mostly for institutional strengthening and capacity building as well as for promoting private sector participation in social sector operations.

1. Infrastructure

Two program loans and one project loan in the infrastructure sector have included policy reforms to create conditions for increased private sector participation: (i) the $300 million power sector restructuring program, (ii) the $40 million electricity market transmission project, and (iii) the $100 million road and road transport sector program. The power sector restructuring program, approved in 1998, supported the development of a wholesale restructuring plan for the sector, including the preparation of a new legal framework for competitive power markets, with the unbundling of the national power utility and preparation for privatization. The electricity market transmission project, approved in 2002, supports the establishment of the wholesale electricity spot market. The road and road transport sector program, completed in 1992, included provisions for policy reforms in deregulation, taxation, and importation and resulted in the privatization of road maintenance operations and in the liberalization of imports. In this way both programs created business opportunities for the private sector (privatization) and improved the enabling environment for private sector development (opening up markets, clarifying regulation, and revising tax policy).

Looking forward, preparations are under way for a new power sector development program intended to take a broad view of the issues affecting the fiscal sustainability of the sector. The program, still under definition, would seek to further strengthen the legal and regulatory framework in the power sector, to establish cost-recovering tariffs, to strengthen the distribution utilities, and to facilitate implementation of EPIRA, including the privatization of the remaining NPC assets.

In addition to program loans, 40 technical assistance projects with a value totaling $21.8 million were implemented in the infrastructure sector from 1986 to 2001. These include 17 in the energy sector and 20 in the transport sector, all generally in support of policy reforms, institutional strengthening, and capacity building. In the water supply and sanitation sector, ADB has funded 3 technical assistance projects to support increased private sector participation.

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144 This project also includes a loan for implementation of upgrades to the transmission system, but these have encountered major start-up delays due to land acquisition and right-of-way problems.
2. Financial Sector

In the financial sector, two program loans have been implemented since 1986, and a third is ongoing. The $150 million capital market development program completed in 1997 supported the development of basic capital market infrastructure, while the $75 million Nonbank Financial Sector Governance Program I completed in 2002 addressed a set of second generation challenges: (i) strengthening the governance of SEC; (ii) modernizing the governance and regulatory structure of PSE; (iii) strengthening market oversight, compliance, and enforcement; and (iv) facilitating diversification and innovation in corporate financing. Both programs laid important groundwork for strengthening capital markets as an essential instrument for sourcing funding and for diversifying risk for private investors.

In 2003, the follow-on $150 million Nonbank Financial Sector Governance Program II (NBFG II) was approved leading to significant achievements in the functioning of capital markets, most notably the adoption of risk-based capital as a regulatory principal. The second and final tranche of the NBFG II was approved for early release in November 2004 following the government’s compliance with all second tranche conditions. Overall, the NBFG II focuses on four areas of weakness that need further attention to pave the way for the recovery of the NBFS: (i) the weak and fragmented regulatory structure and policy, (ii) the supervisory and surveillance capacities of SEC, (iii) financial information and disclosure and prudential standards for NBFIs, and (iv) the excessive reliance on banks to mobilize savings.

In addition to these program loans, 22 technical assistance projects were implemented for a total value of $8.3 million. They covered a wide range of issues including feasibility studies for the development of a corporate bond market, venture capital, leasing and mutual fund products, institutional strengthening within financial intermediaries, regulatory bodies (SEC, Insurance Commission, Deposit Insurance Corporation) and local government units, and development of modern rules and regulations to support financial sector development.

3. Overall Performance

The January 2003 country assistance program evaluation reviewed ADB’s programs in the Philippines through 2001. It found that on the whole, the development impact of ADB’s assistance since 1966 had been mixed. Performance audit reports rated 43% of public sector projects successful, 36% partly successful, and the remaining 21% as unsuccessful. This performance record placed the Philippines below the average of ADB’s developing member countries. If only those projects/programs that were both approved and completed during 1986–2001 are considered, the evaluation sample of 14 projects reveals that four (29%) were rated generally successful, nine (64%) partly successful, and one (7%) unsuccessful.

While the overall portfolio assessment is instructive, it does not provide specific insight into the effectiveness of the strictly PSD-promoting programs of ADB. Evaluations of these programs are only available on an individual basis (through their project completion reports), and are not numerous enough to permit broad conclusions. The overall portfolio assessment does provide lessons that appear quite relevant for the design of PSD-related programs going forward, however, as detailed in section D below.

C. Private Sector Operations

During 1986–2004, the private sector operations arm of ADB implemented a total of $282 million in loans to 13 private sector projects with $109 million to transport and communications; $77 million to energy; $52 million to agriculture, manufacturing, and other industries; and $45 million to social infrastructure. In addition, 17 equity investments were made for a total of $34.8 million to provide funds for industrial and mining companies, to catalyze infrastructure development by the private sector, and to support financial institutions and investment funds. The financial sector received close to 50% of the equity

145 This does not include the $200 million peso swap facility approved in January 2004.
investments; the energy sector received the next largest percentage.

In 2004, two new investment programs were approved: a $200 million peso swap facility financed through a loan from ADB’s ordinary capital resources to release long-term peso funding to support infrastructure project finance and other long-term financing needs, and a $2 million equity investment in the LGU Guarantee Corporation, a quasi-government institution established to provide debt guarantees to LGUs for enhancing their ability to raise finance for infrastructure and other public service purposes.

On the whole, ADB’s private sector interventions in 1986–2001 had a mixed record. The January 2003 Philippine evaluation report summarizes the performance of the portfolio in the following way. Three BOT power plants resulted in profitable investments and a loan to PLDT was fully repaid. However, three ongoing projects for water services, an air terminal, and a toll road encountered serious difficulties that clouded their prospects. The BOT projects played an important role in addressing the power crisis of the early 1990s. Together with public sector loans, they acted as catalysts to attract other financing and brought about a rapid resolution to the crisis. While the immediate problems were alleviated by the BOT projects, the subsequent Asian financial crisis resulted in a slowdown in power demand growth that led to overcapacity in generation.

The private sector operations portfolio also includes financial support for seven financial institutions. Of these, one was a line of equity that was never drawn due to a weakness in the design of the financial instrument and another has been fully and successfully divested. The remaining five are all currently receiving positive ratings. Two country-focused venture capital funds in the Philippines have been more successful than others that ADB has funded. In addition, ADB’s public sector support through the capital market development program led to the restructuring of PSE and improved its efficiency, transparency, and accountability thus contributing to enhancing governance in the financial sector and to fostering private sector development.

In the industrial and mining sectors, ADB’s private sector operations were unsuccessful. None of the six companies assisted by ADB thrived. One was foreclosed; another prepaid its loan pending investigation of breaches of environmental protection provisions; and still another is in receivership with a view to salvaging the interests of lenders, including ADB. The other three have all been rated high risks. The failures are generally attributed to inadequate investigation of raw material sources and prices, poor assessments of market opportunities, and technical difficulties. These failures have led ADB to discontinue its private sector operations in these sectors.

D. Lessons Learned

The mixed performance of the ADB’s public and private sector operations in the Philippines has yielded some important lessons (ADB 2003).

i. Political and macroeconomic stability is a critical factor behind the success of a development assistance program. ADB projects have been more successful when they have been implemented in a stable environment.

ii. Success requires careful project preparation. An important cause of project failures in the Philippines has been the lack of thorough preparation involving detailed analytical work and active participation of beneficiaries in design and implementation.

iii. Project design should be relatively simple. Designs that are too complex and impose excessive demands on the organizational capabilities of the implementing agencies are likely to fail. Early loans to the Philippines were small and simple and made modest demands on the organizational capacity of executing agencies and as a result were more successful.

iv. Sustaining development impact requires close monitoring during implementation and after project completion. The Philippine experience strongly suggests that the quality of project monitoring has an important bearing on success.

v. The success of the assistance program depends on its ability to nurture institutional
development. Weak institutions have often been cited as a principal cause of project failures in the Philippines.

As ADB has evolved into a broad-based development institution, the role of nonlending activities in the form of knowledge products and services has increased in significance. The Philippines has been an important beneficiary of various technical assistance activities related to policy reform, institutional development, and capacity building in many sectors of the economy. Compared with 1968–1985, the number of technical assistance projects doubled and their combined value rose almost seven times during 1986–2001. Given the increased emphasis on advisory technical assistance, the growth in this category was even more dramatic—from $5 million in 1968–1985 to $65 million in 1986–2001. Although it takes some time for the effects of such substantial activities to materialize, one would expect a positive impact on project performance of the more conducive policy environment and from more comprehensive project preparation. Although the proportion of unsuccessful projects was reduced significantly in the 1990s, the Philippines remains a poor performer. As the country moves to a higher stage of development, the demand for knowledge products and services is likely to increase. Lessons learned indicate that selectivity will be essential.
V. PROPOSED ADB PRIVATE SECTOR DEVELOPMENT STRATEGY

A. Key Findings

The private sector dominates the Philippine economy, generating on average 95% of GDP and employing 92% of the registered workforce.\(^{146}\) Although the Philippine government still retains control of over 150 state-owned enterprises, the majority of productive assets are in private hands. By far the largest employers in the economy are microenterprises and SMEs, accounting for 36% and 33% of total employment, respectively.\(^{147}\) These firms are generally engaged in low value-added activities contributing an average of 32% of total value added per annum.

The Philippine corporate sector is dominated by large, family-owned businesses operating in diversified sectors. At the end of 2003, 62% of the market capitalization of PSE was composed of 23 family-controlled groups (Philippine Center for Investigative Journalism 2004). These groups are typically highly diversified, combining financial sector institutions with various manufacturing and service arms. Moreover, a high degree of market concentration exists with the four largest firms in 18 major sectors of the economy contributing 74% of the total value added of the sector (Aldaba 2000). It is widely accepted that these groups obtain and maintain protected market access through collusion with regulatory authorities, legislators, and other licensing authorities (Philippine Center for Investigative Journalism 2004). These practices not only limit growth opportunities for smaller firms but also remove incentives for efficiency of freely competitive markets.\(^{148}\)

In the absence of a rule-based business environment and the institutional capacity to enforce it, vested interests (in particular the close relationships between members of government and business owners) continue to exert undue influence and to preserve quasi-monopolistic structures. Disputes concerning private contracts in the power, water, and airport sectors have highlighted the weakness of the legal and regulatory framework, the limited recourse available to resolve disputes, and the high level of political intervention in the commercial sector. These factors significantly increase the risks of doing business in the Philippines and have largely contributed to the decline in FDI in recent years.\(^{149}\)

Despite a GDP growth rate averaging 4.2% during 2000–2003, high population growth has eroded these gains on a per capita income basis. Unemployment is on the rise,\(^{150}\) and the incidence of poverty in the country remains high at 34% with the greatest concentration of poor people in the rural areas. Significant geographic disparities in income persist with the regions of the southern Philippines experiencing the highest levels of poverty, the poorest


\(^{147}\) 1999 Annual Survey of Establishments, National Statistics Office.

\(^{148}\) Collusionary practices have been noted in the cement, shipping, sugar and flour-milling industries (Aldaba 2002).

\(^{149}\) $100 million in 2003, or 0.1% of GDP down from 1.75% in 1999.

\(^{150}\) 12.7% in 2003, according to National Statistics Office with an additional 20.8% underemployed.
levels of public service and infrastructure quality, and the highest unemployment.

The Philippines also has one of the poorest infrastructure sectors in the region.\textsuperscript{151} Despite an estimated $4 billion of private investment in infrastructure in 1993–1997, investment contracted to $1 billion in 1997–2001 and has yet to recover. It is estimated that 20\% of the population continues to lack access to power, 17\% to safe drinking water, and 14\% to adequate sanitation services. It is further anticipated that without added capacity, the current power infrastructure will be insufficient to meet the needs of connected users by 2007.

The poor investment climate is also aggravated by the weak financial system with limited funds available from the banking sector due to high levels of NPLs, thin capital markets, and very few financial instruments to diversify risk. Pension funds and insurance companies hold long-term liabilities that cannot effectively be channeled through the financial system. While progress has been made to strengthen and deepen the capital markets over the past several years, the development of a long-term debt market, asset-backed securities, and introduction of more equities together with strengthened market oversight will be critical to supporting economic growth.

The Philippine government no longer has the financial resources to support the development needs of the country. Consistently low revenue collection, mounting GOCC losses, and high external debt servicing costs have left it in a very weak financial position. Poor tax and customs administration together with poor taxpayer compliance are largely responsible for a decline in tax revenue that fell from 16\% of GDP in 1997 to less than 12\% in 2002. The national debt reached $55 billion in 2003, or 73\% of GDP with interest payments absorbing close to 38\% of total government revenues, up from only 17\% in 1997. GOCCs contributed another P97 billion ($1.76 billion) of losses in 2003 with few signs of a turnaround.

Adding to this fiscal burden are substantial contingent liabilities estimated at a further P3.1 trillion ($56 billion) representing maximum exposures under pension, risk, debt, and deposit guarantees. With this high level of contingent liabilities, the government has already exceeded its capacity and cannot feasibly contract additional exposure without first reducing liabilities that exist.

B. Overall Approach and Recommendations

The focus of ADB’s strategy in support of private sector development is to (i) create enabling conditions for business, (ii) generate business opportunities in ADB-financed public sector projects, and (iii) catalyze private investment (ADB 2000c). While all three “strategic thrusts” have important roles to play in fostering private sector development, creating the enabling conditions for business is the fundamental component for sustainability. Indeed, it can be argued that where enabling conditions exist, there is no need for donor interventions as market forces suffice to create business opportunities and to attract private investment.

The Philippines still needs considerable improvement in many fundamental enabling conditions for private sector-led growth. While private enterprises already dominate the economy, effective competition does not exist in many sectors. Lack of independence, objectivity, and efficiency of regulatory bodies significantly increases the risks of doing business in the infrastructure sectors. Corruption and bureaucratic inefficiencies plague the civil service and judiciary, further increasing the costs of private enterprise. In this environment, it follows that without squarely addressing these governance and regulatory weaknesses, further ADB assistance, whether in the form of equity investment, cofinancing, guarantees, or lending, is unlikely to have the maximum potential impact.

Governance reforms should therefore form the central tenet of ADB’s sustainable PSD strategy for the Philippines. In the current context, governance reform essentially means establishing and enforcing a rule-based business environment that encourages investment and rewards fair competition. In the Philippines, vested interests and systemic corruption will continue to make this process very challenging. Particular care will need to be taken in the design, implementation, and monitoring of programs to ensure that sufficient political will exists to support them.

\textsuperscript{151} A survey of investors by the World Economic Forum ranked the Philippines 68\% out of 75 economies.
If a favorable business environment is the most fundamental requirement for sustained private sector development, adequate physical infrastructure facilities and the availability of finance are key supporting factors as they allow businesses to operate, access markets, and finance growth. In the Philippines, however, it is recommended that ADB support for the development and modernization of the physical infrastructure and financial sectors should also emphasize fundamental governance reforms. While it is recognized that the country is in need of immediate private investment to address looming power shortages, deteriorating roads, poor water supply, and rising unemployment, the long-term benefits of these investments, and indeed their impact on poverty reduction, will depend on the implementation of a much stronger legal, regulatory, and institutional framework in each sector and in support of the economy as a whole.

1. Creating a Rule-Based Business Environment

ADB’s support to the Philippines for creating a rule-based business environment should include the following components:152

- **strengthening the legal framework for competition** by further liberalizing protected markets, clarifying anticompetitive provisions of existing legislation and making them part of the commercial code, considering further antitrust legislation, and strengthening the capacity of the courts to adjudicate;

- **pursuing corruption eradication efforts** including procurement reforms, increased computerization, phasing in of the new government accounting system, the introduction of lifestyle or asset consistency checks for government employees, and implementation of the new civil service code;

- **strengthening the competency, efficiency and integrity of the judiciary** by supporting the action program for judicial reform including the establishment of alternative dispute resolution mechanisms such as arbitration and mediation (see also section 2);

- **strengthening the legal framework and enforcement mechanisms for protecting credit and property rights** by supporting the adoption of a corporate recovery and insolvency law that would clarify the rights of parties involved in bankruptcy, restructuring, and/or liquidation; supporting the implementation of the corporate governance code and international accounting standards; strengthening the capacity of SEC to enforce compliance with both; completing the cadastral titling of all lands in the Philippines; and establishing a central registry for land titles and secured transactions that is fully accessible by the public online.

- **reducing political interference in the markets** by strengthening the independence of sector regulators and giving them sole authority over utility tariffs, privatizing the remaining nonstrategic GOCCs and unbundling the commercial and regulatory roles of government agencies wherever they coexist (e.g., ATO, PPA).

2. Attracting Private Sector Investment into Physical Infrastructure

Adequate physical infrastructure plays a vital role in facilitating private sector development and poverty reduction. In the Philippines, significant investments are required to meet looming power shortages, to rehabilitate water supply, and to improve transport infrastructure, yet few public funds are available. While the private sector has invested more than $28 billion in the sector to date, significant problems have arisen that have underscored the current deficiencies of the enabling environment for PPI. Investment has therefore slowed considerably, and if it is to return to the sector in a sustained manner, the following key elements must be in place.

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152 A more detailed discussion of the rationale and requirements for each component is presented in section 11.
- **Coherent investment planning and implementation.** In the absence of coherent development plans with supporting implementation mechanisms, private sector participation will necessarily remain chaotic with ad hoc proposals made and no systematic means to evaluate them in terms of economic benefit or alignment with the government’s economic development priorities. This is particularly true in the transport sector where the medium-term Philippine development plan (National Economic Development Authority 2001) does lay out a broad sector strategy, but the existing institutional framework makes it almost impossible to translate this into a coordinated, intermodal investment plan (ADB 1996 and 1999).

- **Credible and independent regulatory oversight.** Due to the natural monopolies associated with many infrastructure investments, economic regulation is necessary to balance the public interest. To be effective, regulating bodies must be independent of policy-making agencies and free of any conflict of interest when implementing sector rules. In the Philippines, regulators exist for each major infrastructure sector, but none is financially independent or effectively free from political influence. In the case of the transport sector, ATO and PPA combine policy, regulatory and operational responsibilities, thereby undermining their impartiality vis-à-vis private investors. This weak regulatory framework has resulted in formal legal challenges to almost every major regulatory decision and investment transaction.

In addition to their independence and credibility, regulators need to have the expertise and resources required to execute their complex mandates. Lack of capacity can raise the perceived risk for investors as well as the costs for the government as decisions are delayed or are based on flawed legal bases. In the case of the ERC, the scope of its responsibilities for enacting the EPIRA has not been supported with adequate resources contributing to delays in implementing the restructuring of the sector. Similarly, the National Water Resources Board has a significant backlog of licenses and other approvals due to the current mismatch between its scope of responsibilities and internal capacity. Measures to address this problem could include the use of outside advisors until adequate capacity can be built internally.153

- **Clear rules and regulations for the solicitation and evaluation of PPI proposals.** While the 1993 BOT Law provided the framework for PPI, there have been challenges to the law due to ambiguities in its implementing regulations. The law allows for unsolicited projects to be considered by the Investment Coordination Committee and sector agencies concerned, but is not clear on the role of the president in the final approval process. The recent and very high-profile invalidation of the NAIA 3 concession was facilitated by the ambiguous nature of these regulations. Clarifying the regulations would be an important step in reducing the risk factors for potential BOT investors. The proposal, evaluation, and award process should also be of the utmost transparency and should involve independent technical specialists who can add expertise and help depoliticize the process. Finally, improvements can be made to the “Swiss challenge” clause that allows any challenger to make a counter bid on an unsolicited proposal. While sound in principle, this clause raises the risks of preparing BOT proposals in the Philippines as the substantial costs involved in preparing such proposals are lost in the event of a successful challenge. One mechanism to address this risk would be to allow reasonable project preparation costs to be reimbursed to the preparer of a project that is ultimately awarded to another bidder.

Beyond strengthening the process of awarding contracts, mechanisms should be developed to protect the integrity of contracts under implementation, specifically, to restrict the review of private sector participation contracts from one generation of elected officials to the next. Reviews of such contracts should be allowed only on a strictly technical basis and should relate to provisions prescribed therein.

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153 Other measures include training such as that received by the Metropolitan Waterworks and Sewerage System and now National Water Relations Board under ADB’s sponsorship.
• **Tariff regimes based on cost recovery.** Investors in any infrastructure project must be assured that they can earn a reasonable rate of return on their investments. In most infrastructure sectors, this means charging a price for the service that allows full cost recovery plus a profit margin. In the water, power, and toll road sectors, this has proved difficult to implement due to political interference. It is therefore recommended that sole authority for setting tariffs rest with the independent sector regulator. If the authority of the Congress to approve tariff increases cannot be removed, then some form of compensation is required when normal tariff adjustments (supported by pre-agreed modes of calculation) are refused by the legislature. In scenarios where tariffs are judged too onerous for the target population, compensation schemes can be built into the operating contracts of service providers, be they public or private. The key element of this process is transparency in setting tariffs and reliability in implementation.

• **Efficient mechanisms for dispute resolution.** The frequency of legal challenges to infrastructure investments in the Philippines has highlighted the need for strengthened dispute resolution mechanisms. The weakness of the lower courts has meant that a large number of contractual disputes have been sent to the Supreme Court for resolution. Further, decisions by the Supreme Court have had significant consequences on the sustainability of private investments and have called into question the genuine independence of the Court. Examples of this are the use of an obiter dictum in its decision to uphold the Energy Regulatory Board’s decision to use accounting rules contrary to international standards to calculate rates of return for Meralco forcing Meralco to refund P28.15 billion to customers for overcharges, and the cancellation of the air terminal company’s contract for NAIA once construction was almost completed. Outside the traditional channels of the court system, which on the whole lacks the capacity to effectively deal with complex contractual issues, alternative dispute resolution mechanisms such as mediation or arbitration could be considered. While these are not a substitute for the need to strengthen the judiciary, they can serve as a complement and help to relieve the significant case backlog in the court system.

These reforms, which involve legislative input and significant capacity building, will require time to be fully implemented. Yet the needs for large-scale infrastructure investment, particularly in the power sector, are immediate. While it has been proposed that ADB help mitigate the risks for PPI in the short term with the use of its political risk guarantees, it may be unreasonable to expect that the government will issue a counter guarantee. The exceedingly high levels of contingent liabilities of the government (estimated at up to P 3.1 trillion) may make such counter guarantees unfeasible.

If ADB is to provide immediate financial assistance to the infrastructure sector (in particular to power), it is recommended that this only be undertaken as part of an overall sector reform program with credible commitments (indeed some of these commitments could be in the form of predisbursement conditions). From the government to address the fundamental issues listed above.

### 3. Mobilizing Finance for Private Sector Development

Financial sector strengthening is needed to facilitate the mobilization of funds to support MSME development, infrastructure investment, and the more efficient provision of public services. High levels of NPLs in the banking sector and underdevelopment of the capital markets have limited the supply and distribution mechanisms of funds to most enterprises. While improving, poor corporate governance practices among banks and businesses combined with the limited supervisory capacity of BSP and SEC have inhibited the development of the financial sector as an efficient source of business funding.

Increasing the efficiency of the financial sector as a source of business finance will require...
fundamental reforms in the legal, regulatory, and corporate governance regimes in practice including the following:

- **Legal means.** strengthening the legal framework for NPL resolution by adopting the corporate recovery and insolvency law and removing remaining tax disincentives; providing immunity from prosecution and harassment for BSP and SEC in the enforcement of regulations;

- **Regulatory reform:** strengthening the independence and capacity of SEC, BSP, and IC in regulating the markets in accordance with international standards including monitoring of related-party lending, risk-based capital adequacy, and corporate governance; harmonizing the regulations and tax treatments of similar financial instruments; eliminating directed lending programs and commercializing the terms of mortgage finance;

- **Corporate governance:** supporting the implementation of the corporate governance code and international accounting standards and strengthening the capacity of SEC to enforce compliance with both. The tightly held nature of many Philippine companies makes good corporate governance all the more important as accurate disclosure and the enforcement of minority shareholder rights is key to reducing investment risk, instilling investor confidence, and broadening the use of capital markets.

### 4. Facilitating the Growth and Development of Micro, Small, and Medium-Sized Enterprises

In the Philippines, as in most middle-income countries, the engines of job creation in the economy are MSMEs. Facilitating the creation and growth of these enterprises, particularly in rural areas most affected by poverty, must remain a development priority.  

While the limited access to funding of many MSMEs is a reality, many have reported that prohibitive interest rates are the real reason for their reliance on self-financing. More important constraints to growth are the poor state of infrastructure, the existence of protected markets and/or dominant market players crowding out new entrants, and the pervasive corruption within the tax, customs, and licensing administrations. In supporting the establishment of a rule-based business environment and attracting new private investment into the infrastructure sector, ADB would be directly serving the interests of MSMEs and creating the necessary conditions for their growth.

### 5. Local Implementation Approaches

The scope of the needed reforms outlined above is daunting, and their fundamental nature will require resources as well as substantial political will for implementation. Given the weak financial position of the government, there are limitations on its ability to contract new liabilities, both actual and contingent. There are also limitations on the absorptive capacity of government institutions, even the most willing, to implement reforms.

While engagement with the national government on policy, legal, and regulatory issues is and will remain essential in addressing private sector development issues, working with LGUs may present greater opportunities for focused governance reform. LGUs have responsibility for managing a large number of public services that directly affect the operating conditions of private enterprises, most notably the provision of infrastructure (water, power, roads, ports, airports).

Given the scope of their responsibilities and their direct impact on many enabling conditions for private sector development, LGUs could prove good candidates for piloting institutional reforms. ADB has been working with LGUs on various regional infrastructure, health, and agricultural programs and has a good understanding of their administrative capabilities and limitations. It is therefore

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156 SME development is a key poverty reduction strategy of the government under the Medium-Term Philippine Development Plan.

157 This is particularly true of SMEs, while microenterprises generally have fewer internal resources.
recommended that ADB explore the possibility of “partnering” with LGUs willing to embark on a holistic set of reforms addressing (i) public procurement, (ii) tax collection, (iii) business licensing, (iv) infrastructure planning, (v) PPI, and (vi) alternative dispute resolution mechanisms.

It may also be possible to involve regional courts in an LGU-ADB partnership, and support their efforts to improve efficiency and transparency. The feasibility of this option was not explored while preparing this private sector assessment but warrants further review if a regional approach is adopted.
## Appendix 1

### Country Economic Indicators

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<tbody>
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<td><strong>A. Income and Growth</strong></td>
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<tr>
<td>1. GDP per Capita ($, current)</td>
<td>1,054.9</td>
<td>1,153.0</td>
<td>1,166.8</td>
<td>911.7</td>
<td>1,044.9</td>
<td>1,009.0</td>
<td>977.7</td>
<td>1,033.7</td>
<td></td>
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<tr>
<td>2. GDP Growth (% in constant prices)</td>
<td>4.7</td>
<td>5.8</td>
<td>5.2</td>
<td>-0.6</td>
<td>3.4</td>
<td>4.4</td>
<td>3.0</td>
<td>4.4</td>
<td>3.8</td>
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<tr>
<td>Agriculture</td>
<td>0.9</td>
<td>3.8</td>
<td>3.1</td>
<td>-6.4</td>
<td>6.5</td>
<td>3.4</td>
<td>3.7</td>
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<td>Industry</td>
<td>6.7</td>
<td>6.4</td>
<td>6.1</td>
<td>-2.1</td>
<td>0.9</td>
<td>4.9</td>
<td>0.9</td>
<td>3.7</td>
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<td>Services</td>
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<td>5.4</td>
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<td>4.3</td>
<td>5.4</td>
<td>4.8</td>
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<tr>
<td><strong>B. Saving and Investment (current and market prices) (percent of GNP)</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>1. Growth Domestic Investment</td>
<td>21.8</td>
<td>23.1</td>
<td>23.8</td>
<td>19.3</td>
<td>17.8</td>
<td>19.9</td>
<td>19.4</td>
<td>18.1</td>
<td>20.4</td>
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<td>2. Gross National Saving</td>
<td>17.5</td>
<td>18.5</td>
<td>18.7</td>
<td>21.6</td>
<td>26.1</td>
<td>27.2</td>
<td>21.1</td>
<td>23.1</td>
<td>21.7</td>
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<tr>
<td><strong>C. Money and Inflation (annual percent change)</strong></td>
<td></td>
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<tr>
<td>1. Consumer Price Index</td>
<td>8.0</td>
<td>9.1</td>
<td>5.9</td>
<td>9.7</td>
<td>6.7</td>
<td>4.4</td>
<td>6.1</td>
<td>3.1</td>
<td>6.6</td>
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<td>2. Domestic Liquidity (M3)</td>
<td>25.3</td>
<td>15.8</td>
<td>20.9</td>
<td>7.4</td>
<td>19.3</td>
<td>4.6</td>
<td>6.8</td>
<td>9.5</td>
<td>13.7</td>
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<tr>
<td><strong>D. Government Finance (percent of GDP, current prices)</strong></td>
<td></td>
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<td></td>
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<tr>
<td>1. Revenue and Grants</td>
<td>19.0</td>
<td>18.9</td>
<td>18.7</td>
<td>16.5</td>
<td>15.3</td>
<td>14.7</td>
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<td>2. Expenditure and Onlending</td>
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<td>18.3</td>
<td>18.8</td>
<td>18.6</td>
<td>18.1</td>
<td>18.1</td>
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<td><strong>E. Balance of Payments</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1. Merchandise Trade Balance (% of GDP)</td>
<td>-12.1</td>
<td>-13.7</td>
<td>-13</td>
<td>-0.05</td>
<td>6.2</td>
<td>4.8</td>
<td>-1.0</td>
<td>0.5</td>
<td>-3.5</td>
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<tr>
<td>2. Current Account Balance (% of GDP)</td>
<td>-4.4</td>
<td>-4.8</td>
<td>-6.3</td>
<td>1.6</td>
<td>9.0</td>
<td>7.8</td>
<td>1.7</td>
<td>5.1</td>
<td>1.2</td>
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<tr>
<td>3. Merchandise Import ($) Growth (annual % change)</td>
<td>29.4</td>
<td>17.7</td>
<td>22.8</td>
<td>16.9</td>
<td>16.0</td>
<td>9.0</td>
<td>-16.2</td>
<td>10.1</td>
<td>13.2</td>
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<tr>
<td>4. Merchandise Import ($) Growth (annual % change)</td>
<td>23.7</td>
<td>20.8</td>
<td>14.0</td>
<td>-18.8</td>
<td>-0.9</td>
<td>14.5</td>
<td>-14.5</td>
<td>6.2</td>
<td>7.0</td>
</tr>
<tr>
<td><strong>F. External Payments Indicators</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Gross Official Reserves (including gold, $ million)</td>
<td>7,762</td>
<td>11,745</td>
<td>8,767</td>
<td>10,806</td>
<td>15,107</td>
<td>15,024</td>
<td>15,658</td>
<td>16,180</td>
<td></td>
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<tr>
<td>Months of current year's imports of good and services</td>
<td>2.6</td>
<td>3.2</td>
<td>2.0</td>
<td>3.1</td>
<td>4.4</td>
<td>4.1</td>
<td>4.5</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>2. External Debt Service (% of exports of good and services)</td>
<td>15.8</td>
<td>12.7</td>
<td>11.6</td>
<td>11.7</td>
<td>14.1</td>
<td>12.4</td>
<td>15.8</td>
<td>16.4</td>
<td></td>
</tr>
<tr>
<td>3. Total External Debt (% of GNP)</td>
<td>53.1</td>
<td>50.5</td>
<td>53.0</td>
<td>69.8</td>
<td>65.1</td>
<td>65.8</td>
<td>68.1</td>
<td>64.8</td>
<td></td>
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<tr>
<td><strong>G. Memorandum Items</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. GNP (current prices, P billion)</td>
<td>1,906.0</td>
<td>2,171.9</td>
<td>2,426.7</td>
<td>2,665.1</td>
<td>2,976.9</td>
<td>3,308.3</td>
<td>3,673.7</td>
<td>4,022.7</td>
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<tr>
<td>2. Exchange Rate (P/$, average)</td>
<td>25.7</td>
<td>26.2</td>
<td>29.5</td>
<td>40.9</td>
<td>39.1</td>
<td>44.2</td>
<td>50.9</td>
<td>51.6</td>
<td></td>
</tr>
<tr>
<td>3. Population (million)</td>
<td>70.3</td>
<td>71.9</td>
<td>73.5</td>
<td>75.2</td>
<td>76.8</td>
<td>78.4</td>
<td>78.6</td>
<td>80.4</td>
<td></td>
</tr>
</tbody>
</table>

GDP = gross domestic product, GNP = gross national product
Annual percentage change (period average)
Sources: National Economic and Development Authority, National Statistics Office, Bangko Sentral ng Pilipinas, Bureau of the Treasury.
APPENDIX 2

Restrictions on Foreign Ownership of Enterprises

List A. Foreign Ownership Is Limited by Mandate of the Constitution and Specific Laws

1. No Foreign Equity
   Mass Media except recording (Article XVI, Section II of the Constitution; Presidential Memorandum dated 4 May 1994)

2. Services involving the practice of licensed professionals save in cases prescribed by law
   - Engineering
     Aeronautical Engineering
     Agricultural Engineering
     Chemical Engineering
     Civil Engineering
     Electrical Engineering
     Electronics and Communication Engineering
     Geodetic Engineering
     Mechanical Engineering
     Metallurgical Engineering
     Mining Engineering
     Naval Architecture and Marine Engineering
     Sanitary Engineering
   - Medicine and Allied Professions
     Medicine
     Medical Technology
     Dentistry
     Midwifery
     Nursing
     Nutrition and Dietetics
     Optometry
     Pharmacy
     Physical and Occupational Therapy
     Radiology and X-ray Technology
     Veterinary Medicine
     Accountancy
     Architecture
     Criminology
     Chemistry
     Custom Brokerage
     Environmental Planning
     Forestry
     Geology
     Interior Design
     Landscape Architecture
     Law
     Librarianship
     Marine Deck Officers
     Marine Engine Officers
     Master Plumbing
     Sugar Technology
     Social Work
     Teaching
   (Article XIV, Section 14, of the Constitution; Section I of Republic Act No. 5181)

3. Retail Trade (Section I of RA No. 1180). This law was amended by RA No. 8762 otherwise known as the Retail Trade Liberalization Act of 2000, which opens large retail businesses to foreign ownership.

4. Cooperatives (Chapter III, Article 26, of RA No. 6938)

5. Private Security Agencies (Section 4 of RA No. 5487)
6. Small-scale Mining (Section 3 of RA No. 7076)
7. Utilization of Marine Resources in archipelagic waters, territorial sea, and exclusive economic zone (Article XII, Section 2, of the Constitution)
8. Ownership, operation, and management of cockpits (Section 5 of Presidential Decree No. 449)
9. Manufacture, repair, stockpiling, and/or distribution of nuclear weapons (Article II, Section 8 of the Constitution)
10. Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons (various treaties to which the Philippines is a signatory and conventions supported by the Philippines)
11. Manufacture of firecrackers and other pyrotechnic devices (Section 5 of RA No. 7183)

**Up to Twenty-Five Percent (25%) Foreign Equity**

1. Private recruitment, whether for local or overseas employment (Article 27 of Presidential Decree No. 442)
2. Contracts for the construction and repair of locally funded public works except:
   - infrastructure/development projects covered in RA No. 7718; and
   - projects which are foreign funded or assisted and required to undergo international competitive bidding (Commonwealth Act No. 541; Presidential Decree No. 1594; Letter of Instruction No. 630; Section 2a of RA No. 7718)

**Up to Thirty Percent (30%) Foreign Equity**

1. Advertising (Article XVI, Section 11 of the Constitution)

**Up to Forty Percent (40%) Foreign Equity**

1. Exploration, development, and utilization of natural resources (Article XII, Section 2, of the Constitution)
2. Ownership of private lands (Article XII, Section 7, of the Constitution; Section 7 of the Constitution; Chapter 5, Section 22, of Commonwealth Act No. 141)
3. Operation and management of public utilities (Article XII, Section 11, of the Constitution; Section 16 of Commonwealth Act No. 146)
4. Ownership/establishment and administration of educational institutions (Article XIV, Section 2, of the Constitution)
5. Engaging in the rice and corn industry (Presidential Decree No. 194)
6. Contracts for the supply of materials, goods, and commodities to government-owned or controlled corporation, company, agency, or municipal corporation (Section 1 of RA No. 5183)
7. Project proponent and facility operator of a build-operate-transfer (BOT) project requiring a public utilities franchise (Article XII, Section 11, of the Constitution; Section 2a of RA No. 7718)
8. Operation of deep-sea commercial fishing vessels (Section 27 or RA No. 8550)
9. Adjustment Companies (Section 323 of Presidential Decree No. 612 as amended by Presidential Decree No. 1814)
10. Ownership of condominiums (Section 5 of RA No. 4726)

Up to Sixty Percent (60%) Foreign Equity

1. Financing companies regulated by the Securities and Exchange Commission (SEC) (Section 6 of RA No. 5980 as amended by RA No. 8556)
2. Investment houses regulated by SEC (Presidential Decree No. 129 as amended by RA No. 8366)

Up to Forty Percent (40%) Foreign Equity

1. Manufacture, repair, storage, and/or distribution used in the manufacture thereof requiring Philippine National Police (PNP) clearance
   Firearms (handguns or shotguns), parts of firearms and ammunition thereof, instruments used or intended to be used in the manufacture of firearms
   Gunpowder
   Dynamite
   Blasting supplies
   Ingredients used in making explosives:
   Chlorates of potassium and sodium
   Nitrates of ammonium, potassium, sodium barium, copper (11), lead (11), Calcium and cuprite
   Nitric acid
   Nitrocellulose
   Perchlorate of ammonium, potassium, and sodium
   Dinitrocellulose
   Glycerol
   Amorphous phosphorus
   Hydrogen peroxide
   Strontium nitrate powder
   Toluene
   Telescopic sights, sniperscope and other similar devices (RA No. 7042 as amended by RA No. 8179)
2. Manufacture, repair, storage and/or distribution of products requiring Department of National Defense (DND) clearance:
   Guns and ammunitions for warfare
   Military ordinance and parts thereof (e.g., torpedoes, mines, depth charges, bombs, grenades, missiles)
   Gunnery, bombing, and fire-control systems and components
   Guide missiles/missile systems and components
   Tactical aircraft (fixed and rotary-winged), parts and components thereof
   Space vehicles and component systems
   Combat vehicles (air, land, and naval) and auxiliaries
   Weapons repair and maintenance equipment
   Military communication equipment
   Night vision equipment
   Simulated coherent radiation devices, components and accessories
   Armament training devices
   Others as may be determined by the DND Secretary (RA No. 7042 as amended by RA No. 8179)
3. Manufacture and distribution of dangerous drugs (RA No. 7042 as amended by RA No. 8179)
4. Sauna and steam bathhouses, massage clinics, and other like activities regulated by law because of risks they impose to public health and morals (RA No. 7042 as amended by RA No. 8179)
5. Other forms of gambling, e.g., race track operation (RA No. 7042 as amended by RA No. 8179) goods and services)
6. Domestic market enterprises with paid-in equity capital of less than the equivalent of $200,000 (RA No. 7042 as amended by RA No. 8179)
7. Domestic market enterprises that involve advanced technology or employ at least fifty (50) direct employees with paid-in equity capital of less than the equivalent of $100,000 (RA No. 7042 as amended by RA No. 8179)
APPENDIX 3

Legislative and Executive Measures to Promote Competition

1. The Revised Penal Code of 1930 (Republic Act [RA] No. 3815) describes the punishable acts, such as monopolies and combinations in restraints of trade, and the penalties for such acts.

2. RA 3247 (1961) prohibits monopolies and combinations in restraint of trade and provides for recovery of treble damages for civil liability arising from anticompetitive behavior.


4. RA 386 Civil Code of the Philippines (1949) stipulates the collection of damages arising from unfair competition. Article 28 allows the collection of damages arising from unfair competition in agricultural, commercial, or industrial enterprises. It enumerates the methods by which unfair competition can be committed: force, intimidation, deceit, machination, or any other unjust, oppressive, or high-handed method.

5. The Philippine Corporation Code, Batas Pambansa Blg. 68 (1980), provides for rules and procedures to approve all combinations, mergers and consolidations and the acquisition of all or substantially all the assets or shares of stock of corporations.


Since 1986, executive and legislative initiatives that bear on competition—particularly in the fields of trade and investment liberalization, service industry deregulation, demonopolization of public utilities, privatization of state enterprises, taxation, monetary and fiscal reforms, and peace and order and administration of justice—have been enacted or promulgated.

1. Trade and Investment Liberalization

To liberalize trade and in compliance with international commitments, tariffs on numerous industrial and agricultural products have been reduced and/or modified through various laws.

- RA No. 8178 (1996) replaced quantitative import restrictions on agricultural products (except rice) with tariffs and created the Agricultural Competitiveness Enhancement Fund.
- RA 7650 (1993) repealed Section 1404 and amended Sections 1401 and 1403 of the Tariff and Customs Code relative to the physical examination of imported articles.

1 This is adopted from Advento (2002) with some changes due to recent passage/issuance of new laws/regulations.
• RA 8181 (1996) shifted the basis for the computation of duties from home consumption value to transaction value to address leakages in collections.

• RA 7843 (1994), also known as the Anti-Dumping Act of 1994, rationalized and strengthened the provisions on antidumping in the Tariff and Customs Code.

A series of executive orders were issued, which modified the nomenclature and the rates of import duty on imported articles under Section 104 of the Tariff and Customs Code.


• Executive Order No. 313 (1996), Executive Order No. 328 (1996)

• Executive Order No. 388 (1996), Executive Order No. 390 (1996)

• Executive Order No. 287 (1995), to implement the 1996 Philippine Schedule of Tariff Reduction under the new time frame of the accelerated Common Effective Preferential Tariff (CEPT) scheme for the ASEAN Free Trade Area (AFTA)

• Executive Order No. 365 (1996) modified the nomenclature and the rates of import duties on certain imported articles under RA Nos. 8180 and 8184.

2. Demonopolization/Deregulation of Public Utilities

a. Maritime Industry

Executive Order No. 185 (1994) was adopted to foster competition through more liberalized rules on the entry of new operators for existing routes, the deregulation of the entry of newly-acquired vessels into routes already served by franchised operators, and vessel rerouting or amendment of authorized route and change in sailing schedules and frequency.

Executive Order No. 213 (1994) provided for the deregulation of domestic shipping rates in the following areas: a) first and second class passage rate for passenger-carrying domestic vessels, b) passage rates for vessels catering to tourism as certified by the Department of Tourism (DOT) or those serving DOT-certified tourist priority links/areas, c) freight rates for all commodities classified as Class “A” and “B” and “C”, except for non-containerized basic commodities, and where the route/link is still being serviced by only one operator.

b. Civil Aviation

Executive Order No. 219 (1995), under which international civil aviation was liberalized through the designation of at least two official carriers for the Philippines, and the possibility of designating other carriers as official carriers when the total frequency requirements of the Philippines under its various Air Services Agreement cannot be fully serviced by the first two designated official carriers. For domestic air transportation, a minimum of two operators in each route/link is encouraged, and for routes/links presently serviced by only one operator, additional operators are likewise encouraged to enter. Passage rates for routes/links serviced by more than one operator is no longer regulated but merely monitored by the Civil Aeronautics Board (CAB). Passage rates for routes/links serviced by only one operator remains regulated by CAB.

c. Port Services

Executive Order No. 212 (1994) was issued to accelerate the demonopolization and privatization program for government ports. The said executive order encouraged competition through the provision of cargo handling and other port services. Under the demonopolization program, shipowners, operators, charterers or other users have the option to contract or engage the services of the Philippine Ports Authority (PPA) authorized handler or port service

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1 Association of Southeast Asian Nations.
contractor of their choice. Under the privatization program, private sector participation in the operation, maintenance, and development of government ports is encouraged through capital leases, cargo licenses, and service contracts to private companies to carry out cargo handling, dredging, port security, and other services. The PPA is directed to ensure that free access to the ports is allowed to all sectors of the industry and that there shall be no discrimination in the provision and availment of service contracts.

d. Telecommunications

Executive Order No. 59 (1993) required mandatory interconnection for other telecommunications firms with the Philippine Long Distance Telephone Company (PLDT) backbone.

Executive Order No. 109 (1993) laid down the Government's policy to improve the Local Exchange Carrier Service. Authorized international gateway operators were required to provide local exchange service in served and unserved areas, including Metro Manila, within 3 years from the grant of authority from the National Telecommunication Commission. RA No. 7925 (1995), Telecommunications Law was enacted to provide a comprehensive guideline regulating the public telecommunications industry in the Philippines.

e. Energy

Executive Order No. 215 (1987) was issued to promote private sector participation in the business of generating electricity.

RA No. 8180 (1996), which provides for the deregulation of the oil industry, was also enacted, but was however declared unconstitutional by the Supreme Court. RA No. 8479 (1998) was enacted to take the place of R.A. No. 8180 minus the provisions that caused the latter's unconstitutionality.

Executive Order No. 377 (1996) provided the institutional framework for the administration of the deregulated local downstream oil industry.

To address the power crisis that was then debilitating the economy, RA 7648 was enacted granting then President Ramos emergency powers for one year to enter into negotiated contracts for the construction, repair, rehabilitation, improvement, or maintenance of power plants, projects, and facilities, to fix the rate of return on rate base of the National Power Corporation (NPC) to not more than 12%, and to reorganize the NPC. The law encouraged the entry of foreign power firms and the execution of various power contracts.

f. Water

A crisis in the water sector prompted the enactment of RA No. 8041 or the Water Crisis Act. The president was conferred emergency powers to enter into negotiated contracts for water supply and distribution projects under the BOT or related schemes. Although the law expired on 15 July 1996 without any such contract having been finalized, the same law provided for the privatization of the Metropolitan Waterworks & Sewerage System (MWSS).

Executive Order No. 311 (1996) was issued to encourage private sector participation in the operation and facilities of MWSS. The government engaged in its largest privatization effort to date with the sale of MWSS to the Manila Water Company and the Maynilad Water Services Inc., both private companies.

3. Service Industry Deregulation

a. Banking

RA No. 7653 (1993) reorganized the Central Bank of the Philippines into the Bangko Sentral ng Pilipinas (BSP). The BSP regulates the entry and decides on the closure of banks.

RA No. 7721 liberalized the entry of foreign banks into the Philippines by allowing foreign equity ownership of up to 60% of the voting stock of existing domestic banks or the incorporation of a new subsidiary in the Philippines, and the entry of foreign bank branches with full banking authority.
RA No. 8791 (2000) allows a foreign bank to acquire up to 100% of the voting stock of only one bank organized under the laws of the Republic of the Philippines within 7 years of the effectivity of the act.

b. Insurance

With the Department Of Finance Order No. 100-94 issued on 24 October 1994, several multinational insurance companies have already signified interest in penetrating the Philippine market.

c. Infrastructure and Development Projects

RA No. 6857 of the Build Operate and Transfer (BOT) Law allows the private sector to participate in infrastructure and development projects ordinarily undertaken exclusively by the Government.

Private sector participation was further enhanced with the enactment of RA No. 7718 by expanding the contractual arrangements that may be entered into by the government implementing agency and a private proponent.

d. Mining

RA No. 7942 (1995) or the Philippine Mining Act provides for the requirements and incentives for the exploration, development, utilization, and conservation of mineral resources.

4. Privatization of State Enterprises

Executive Order No. 298 (1996) was issued by the President to provide for alternative and/or intermediate modes of privatization through joint ventures, BOT schemes, management contracts, lease purchase arrangements, and securitization.
## APPENDIX 4

### Market Share of Group of Companies in Selected Industries, 1991-1997 (percent)

<table>
<thead>
<tr>
<th>SUBSECTOR AND INDUSTRY</th>
<th>SHARE OF GROUPS</th>
<th>POINT DIFFERENCE</th>
<th>SHARE OF LEADING COMPANY</th>
<th>POINT DIFFERENCE</th>
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</thead>
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<tr>
<td><strong>FOOD &amp; OTHER FOOD PRODUCTS SUBSECTOR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Alcoholic, Beverages, Malt Liquor</td>
<td>94.1</td>
<td>89.5</td>
<td>-4.6</td>
<td>58.7</td>
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<tr>
<td>Chocolate, Other Food Products</td>
<td>55.6</td>
<td>69.1</td>
<td>13.5</td>
<td>45.3</td>
</tr>
<tr>
<td>Meat &amp; Vegetable Oil</td>
<td>57.1</td>
<td>56.4</td>
<td>-0.7</td>
<td>50.7</td>
</tr>
<tr>
<td>Flour Milling &amp; Animal Feeds</td>
<td>52.4</td>
<td>35.1</td>
<td>-17.3</td>
<td>52.4</td>
</tr>
<tr>
<td>Milk &amp; Dairy Products</td>
<td>38.0</td>
<td>51.8</td>
<td>13.8</td>
<td>32.1</td>
</tr>
<tr>
<td>Coconut Oil</td>
<td>33.4</td>
<td>31.3</td>
<td>-2.1</td>
<td>25.5</td>
</tr>
<tr>
<td><strong>Sub-Total (above industries)</strong></td>
<td>72.2</td>
<td>64.5</td>
<td>-7.7</td>
<td>51.9</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>67.3</td>
<td>63.0</td>
<td>-4.3</td>
<td>48.1</td>
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<tr>
<td><strong>ELECTRICITY, GAS AND WATER SUBSECTOR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Gen. &amp; distribution of electricity</td>
<td>44.8</td>
<td>38.7</td>
<td>-6.1</td>
<td>43.2</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>44.8</td>
<td>38.7</td>
<td>-6.1</td>
<td>43.2</td>
</tr>
<tr>
<td><strong>TRANS, STORAGE AND COMM. SUBSECTOR</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Telecommunication</td>
<td>85.0</td>
<td>80.3</td>
<td>-4.7</td>
<td>76.0</td>
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<tr>
<td>Inter-island water transport</td>
<td>14.5</td>
<td>29.7</td>
<td>15.2</td>
<td>11.2</td>
</tr>
<tr>
<td>Pipelines</td>
<td>59.0</td>
<td>96.5</td>
<td>37.5</td>
<td>59.0</td>
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<tr>
<td><strong>Sub-Total (above industries)</strong></td>
<td>62.1</td>
<td>76.9</td>
<td>14.8</td>
<td>88.9</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>61.7</td>
<td>71.6</td>
<td>9.9</td>
<td>84.3</td>
</tr>
<tr>
<td><strong>WHOLESALE AND RETAIL SUBSECTOR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Retail Selling in Supermarkets</td>
<td>66.8</td>
<td>45.7</td>
<td>-21.1</td>
<td>31.1</td>
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<tr>
<td>Passenger Motor Vehicle Retailing</td>
<td>47.0</td>
<td>45.6</td>
<td>-1.4</td>
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<tr>
<td>Construction Materials</td>
<td>31.2</td>
<td>51.9</td>
<td>20.7</td>
<td>27.9</td>
</tr>
<tr>
<td>Medical, Pharmaceutical Prod.</td>
<td>55.3</td>
<td>13.5</td>
<td>-41.8</td>
<td>26.0</td>
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<tr>
<td><strong>Sub-Total (above industries)</strong></td>
<td>57.6</td>
<td>41.5</td>
<td>-16.1</td>
<td>28.8</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
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<td>26.8</td>
<td>-10.8</td>
<td>14.8</td>
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<tr>
<td><strong>FINANCIAL INTERMEDIATION SUBSECTOR</strong></td>
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<td></td>
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<td></td>
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<tr>
<td>Fin. Holding &amp; Investment Co.</td>
<td>52.7</td>
<td>65.4</td>
<td>12.7</td>
<td>27.3</td>
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<tr>
<td>Financing Companies</td>
<td>6.6</td>
<td>15.2</td>
<td>8.6</td>
<td>2.7</td>
</tr>
<tr>
<td><strong>Sub-Total (above industries)</strong></td>
<td>18.2</td>
<td>61.7</td>
<td>43.5</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>37.8</td>
<td>40.2</td>
<td>2.4</td>
<td>1.2</td>
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<tr>
<td><strong>REAL ESTATE AND BUSINESS SECTOR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>60.4</td>
<td>41.3</td>
<td>-19.1</td>
<td>20.4</td>
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<tr>
<td>Real Estate Renting</td>
<td>52.0</td>
<td>81.0</td>
<td>29.0</td>
<td>45.7</td>
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<tr>
<td>Architectural Eng’r Services</td>
<td>36.6</td>
<td>12.1</td>
<td>-24.5</td>
<td>36.6</td>
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<tr>
<td><strong>Sub-Total (above industries)</strong></td>
<td>58.2</td>
<td>40.2</td>
<td>-18.0</td>
<td>25.2</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>56.9</td>
<td>45.4</td>
<td>-11.5</td>
<td>20.3</td>
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<tr>
<td><strong>MOTOR VEHICLES SUBSECTOR</strong></td>
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<tr>
<td>Motor Vehicles</td>
<td>29.4</td>
<td>47.9</td>
<td>18.5</td>
<td>29.4</td>
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<tr>
<td>Motorcycles</td>
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<tr>
<td>Parts and Accessories</td>
<td>8.5</td>
<td>20.9</td>
<td>12.4</td>
<td>8.5</td>
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<tr>
<td>Shipbuilding</td>
<td>78.1</td>
<td>38.5</td>
<td>-39.6</td>
<td>78.1</td>
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<td><strong>Sub-Total (above industries)</strong></td>
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<td>40.1</td>
<td>12.7</td>
<td>27.4</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>28.0</td>
<td>39.0</td>
<td>11.0</td>
<td>25.6</td>
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<tr>
<td><strong>CONSTRUCTION SUBSECTOR</strong></td>
<td></td>
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<tr>
<td>General Engineering</td>
<td>48.6</td>
<td>37.7</td>
<td>-10.9</td>
<td>20.8</td>
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<tr>
<td><strong>Sub-Total for the Subsector</strong></td>
<td>48.6</td>
<td>35.1</td>
<td>-13.5</td>
<td>20.8</td>
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</table>
### Market Share of Group of Companies in Selected Industries, 1991-97

(Percent)

<table>
<thead>
<tr>
<th>SUBSECTOR AND INDUSTRY</th>
<th>% SHARE OF GROUPS</th>
<th>% POINT DIFFERENCE</th>
<th>% SHARE OF LEADING COMPANY</th>
<th>% POINT DIFFERENCE</th>
</tr>
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<tbody>
<tr>
<td>CONSTRUCTION MATERIALS SUBSECTOR</td>
<td></td>
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<td></td>
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<tr>
<td>Cement</td>
<td>53.7</td>
<td>56.9</td>
<td>3.2</td>
<td>14.7</td>
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<tr>
<td>Glass Products</td>
<td>87.2</td>
<td>8.1</td>
<td>-79.1</td>
<td>87.2</td>
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<tr>
<td>Ceramic &amp; Other Concrete Prod.</td>
<td>15.7</td>
<td>13.8</td>
<td>-1.9</td>
<td>15.7</td>
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<tr>
<td>Sub-Total (above industries)</td>
<td>52.9</td>
<td>58.5</td>
<td>5.6</td>
<td>28.3</td>
</tr>
<tr>
<td>Sub-Total for the Subsector</td>
<td>24.5</td>
<td>31.6</td>
<td>7.1</td>
<td>12.3</td>
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<td>HOTELS AND RESTAURANTS SUBSECTOR</td>
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<tr>
<td>Rest., Cafes, &amp; Fast Food Centers</td>
<td>41.6</td>
<td>51.4</td>
<td>9.8</td>
<td>41.6</td>
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<tr>
<td>Sub-Total for the Subsector</td>
<td>28.8</td>
<td>11.3</td>
<td>-17.5</td>
<td>25.0</td>
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<tr>
<td>MINING AND QUARRYING SUBSECTORS</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Gold Mining</td>
<td>83.2</td>
<td>97.7</td>
<td>14.5</td>
<td>53.5</td>
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<td>Sub-Total for the Subsector</td>
<td>70.8</td>
<td>76.6</td>
<td>5.8</td>
<td>21.8</td>
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<tr>
<td>TEXTILE, WOOD &amp; PAPER PRODUCTS SUBSECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paper Products</td>
<td>9.7</td>
<td>15.8</td>
<td>6.1</td>
<td>7.3</td>
</tr>
<tr>
<td>Sub-Total for the Subsector</td>
<td>11.5</td>
<td>15.0</td>
<td>3.5</td>
<td>4.8</td>
</tr>
<tr>
<td>OTHER COM., SOCIAL AND PERSONAL SERV. SUBSECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Radio and TV Broadcasting</td>
<td>49.6</td>
<td>57.8</td>
<td>8.2</td>
<td>49.6</td>
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<tr>
<td>Sub-Total for the Subsector</td>
<td>49.6</td>
<td>23.9</td>
<td>-25.7</td>
<td>49.6</td>
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<tr>
<td>ELECTRICAL MATERIALS SUBSECTOR</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insulated Wires &amp; Cables</td>
<td>54.0</td>
<td>40.4</td>
<td>-13.6</td>
<td>54.0</td>
</tr>
<tr>
<td>Electrical Transformers</td>
<td>98.8</td>
<td>78.9</td>
<td>-19.9</td>
<td>98.8</td>
</tr>
<tr>
<td>Sub-Total (above industries)</td>
<td>30.0</td>
<td>11.9</td>
<td>-18.1</td>
<td>30.0</td>
</tr>
<tr>
<td>Sub-Total for the Subsector</td>
<td>5.3</td>
<td>3.4</td>
<td>-1.9</td>
<td>4.2</td>
</tr>
<tr>
<td>AGRICULTURE, HUNTING AND FORESTRY SUBSECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hog Farming</td>
<td>64.5</td>
<td>52.1</td>
<td>-12.4</td>
<td>64.5</td>
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<tr>
<td>Sub-Total for the Subsector</td>
<td>38.0</td>
<td>52.1</td>
<td>14.1</td>
<td>52.1</td>
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<tr>
<td>PETROCHEMICALS SUBSECTOR</td>
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<td></td>
<td></td>
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<tr>
<td>Organic Chemicals</td>
<td>6.2</td>
<td>32.4</td>
<td>26.2</td>
<td>6.2</td>
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<tr>
<td>Sub-Total for the Subsector</td>
<td>16.2</td>
<td>9.1</td>
<td>-7.1</td>
<td>0.8</td>
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<tr>
<td>METAL PRODUCTS SUBSECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forge, Packaging Oth. Fab. Metal</td>
<td>4.3</td>
<td>16.9</td>
<td>12.6</td>
<td>4.3</td>
</tr>
<tr>
<td>Sub-Total for the Subsector</td>
<td>2.6</td>
<td>6.0</td>
<td>3.4</td>
<td>2.6</td>
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<tr>
<td>Aggregate Group for Subsectors A to Q</td>
<td>54.5</td>
<td>39.5</td>
<td>-15.0</td>
<td>39.6</td>
</tr>
<tr>
<td>AGGREGATE GROUP OF COS. FOR ALL SUBSECTORS AND INDUSTRIES</td>
<td>41.1</td>
<td>31.9</td>
<td>-9.2</td>
<td>21.9</td>
</tr>
</tbody>
</table>

a/ 37 groups in 1991
b/ 29 groups/ 1998 figures in place of 1991

Sources of basic data: SEC-Business World Annual Survey of Top 1000 Corporations (1991); PSE databank and Annual Reports of Companies; Saldana
APPENDIX 5

List of Government-Owned and/or Controlled Corporations (GOCCs) and Other Government Corporate Entities (OGCEs) Per Departmental Attachment (as of February 2005)

COMMISSION ON INFORMATION AND COMMUNICATIONS TECHNOLOGY (CICT)
Philippine Postal Corporation
a. Philippine Postal Savings Bank, Inc.
b. PHILPOST Leasing and Financing Corporation

BANGKO SENTRAL NG PILIPINAS
Philippine International Convention Center, Inc.

DEPARTMENT OF AGRICULTURE
Human Settlements Development Corporation
a. National Agri-Business Corporation
b. Philippine Fruits and Vegetables Industries, Inc.
c. San Carlos Fruits Corporation
Livelihood Corporation
a. Northern Foods Corporation
National Dairy Authority
National Food Authority
a. Food Terminal, Inc.
National Irrigation Administration
a. NIA Consult, Inc.
National Tobacco Administration
Philippine Coconut Authority
Philippine Crop Insurance Corporation
Philippine Fisheries Development Authority
Philippine Rice Research Institute
Quedan & Rural Credit Guarantee Corporation

DEPARTMENT OF ENERGY
National Electrification Administration
National Power Corporation
Philippine National Oil Company
a. PNOC Development and Management Corporation
b. PNOC Energy Development Corporation
c. PNOC Exploration Corporation
d. PNOC Petrochemical Development Corporation
e. PNOC Shipping and Transport Corporation
Power Sector Assets and Liabilities Management Corporation
a. National Transmission Corporation

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES
Laguna Lake Development Authority
Natural Resources Development Corporation
a. Bukidnon Forest, Inc.
Natural Resources Mining and Development Corporation

DEPARTMENT OF FINANCE
Development Bank of the Philippines
a. DBP Data Center, Inc.
b. DBP Management Corporation
Government Service Insurance System
a. GSIS Family Bank (Formerly Comsavings Bank)
b. GSIS Mutual Fund, Inc.
c. GSIS Properties, Inc.  
d. Meat Packing Corporation of the Philippines

Land Bank of the Philippines
a. Land Bank Countryside Development Foundation, Inc.
b. LBP Financial Services SpA (Rome, Italy)
c. LBP Insurance Brokerage, Inc.
d. LBP Leasing Corporation
e. LBP Realty Development Corporation
f. LBP Remittance Company (USA)
g. Masaganang Sakahan, Inc.
h. People’s Credit and Finance Corporation

Municipal Finance Corporation  
Philippine Amusement and Gaming Corporation  
(Transferred from Office of the President to Department of Finance pursuant to E.O. 330 dated 16 July 2004)

Philippine Deposit Insurance Corporation
Philippine Reclamation Authority (Formerly PEA)  
(Transferred from Office of the President to Department of Finance pursuant to E.O. 199 dated 21 April 2003)

Social Security System
Trade and Investment Development Corporation of the Philippines (PhilExim)

DEPARTMENT OF HEALTH
Lung Center of the Philippines
National Kidney and Transplant Institute
Philippine Children’s Medical Center
Philippine Health Insurance Corporation
Philippine Heart Center
Philippine Institute of Traditional and Alternative Health Care

DEPARTMENT OF LABOR & EMPLOYMENT
Employees Compensation Commission

DEPARTMENT OF NATIONAL DEFENSE
Philippine Veterans Assistance Commission
Philippine Veterans Investment Development Corporation

[Temporary suspension of operations per Executive Order (E.O.) 257 dated 28 June 2000]
a. Panay Railways, Inc.
b. PHIVIDEC Industrial Authority

Phividec Panay Agro-Industrial Corporation

DEPARTMENT OF PUBLIC WORKS AND HIGHWAYS
Metropolitan Waterworks & Sewerage System

DEPARTMENT OF TOURISM
Nayong Pilipino Foundation, Inc.
(Not operational per E. O. 135 dated 21 October 2002)
Philippine Convention and Visitors Corporation
Philippine Tourism Authority
a. Leyte Park Hotel
b. Paskuhan Development, Inc.

DEPARTMENT OF TRADE AND INDUSTRY
Center for International Trade Expositions and Missions, Inc.
Cottage Industry Technology Canter
National Development Company
b. First Cavite Industrial Estate, Inc.
c. First Centennial Clark Corporation
d. G.Y. Real Estate, Inc.
e. Kamayan Realty Corporation
f. PEA Tollway Corporation  
(Transferred from PEA to NOC pursuant to E.O. 380 dated 26 November 2004)
g. Philippine International Trading Corporation
h. Pinagkaisa Realty Corporation

Philippine Economic Zorn Authority
Philippine Leisure and Retirement Authority
Philippine National Construction Corporation  
Small Business Guarantee and Finance Corporation

DEPARTMENT OF TRANSPORTATION AND COMMUNICATIONS
Cebu Port Authority
Light Rail Transit Authority
a. Metro Transit Organization, Inc.
Mactan-Cebu International Airport Authority
Manila International Airport Authority
  a. Aviation Services and Training Institute
Philippine Aerospace Development Corporation
Philippine National Railways
Philippine Ports Authority

NATIONAL ECONOMIC DEVELOPMENT AUTHORITY (NEDA)
Philippine Institute for Development Studies

OFFICE OF THE PRESIDENT
Al-Amanah Islamic Investment Bank of the Philippines
Bases Conversion Development Authority
  a. Bataan Technological Park, Inc.
  b. BCDA Management and Holdings, Inc.
  c. Clark Development Corporation
  d. Clark International Airport Corporation
  e. John Hay Management Corporation
  f. North Luzon Railway Corporation
  g. Philippine Centennial Expo '98 Corporation
     (Formerly Expo Filipino)
  h. Poro Point Management Corporation
Boy Scouts of the Philippines
Cagayan Economic Zone Authority
Central Bank - Board of Liquidators
Cultural Center of the Philippines
Development Academy of the Philippines
Home Development Mutual Fund
Home Guaranty Corporation
  a. HGC Subic Corporation
Local Water Utilities Administration
  a. Water Districts: 588 (446 - Operational; 142 - Not Operational)
National Home Mortgage Finance Corporation
  a. Social Housing Financing Corporation
National Housing Authority
Partido Development Administration
Philippine Center for Economic Development
Philippine Charity Sweepstakes Office
Philippine National Red Cross
Philippine Sugar Corporation
Southern Philippines Development Authority
(Deactivated per E. O. 149 dated 18 November 2002)
  a. Integrated Feedmills Manufacturing Corporation
  b. Marawi Resort Hotel, Inc.
Subic Bay Metropolitan Authority
  a. Freeport Services, Inc.
Technology and Livelihood Resources Center
Zamboanga City Special Economic Zone Authority

OFFICE OF THE PRESS SECRETARY
People's Television Network, Inc.

PRESIDENTIAL COMMISSION ON GOOD GOVERNANCE (PCGG)
Anchor Estate, Inc.
Banahaw Broadcasting Corporation
Chemfields, Inc.
Independent Realty Corporation
International Broadcasting Corporation (IBC-13)
Mid-Pasig Land Development Corporation
Performance Investment Corporation
Radio Philippines Network (RPN-9)

PRIVATIZATION COUNCIL (PrC)/ PRIVATIZATION MANAGEMENT OFFICE (PMO)
Satong Buhay Gold Mines, Inc.
Menzi Development Corporation
National Sugar Development Company
North Davao Mining Corporation

* Attached to CICT pursuant to Executive Order No. 259 dated 12 January 2004
* Not yet operational
* Yet to be organized but have SEC Registration, Articles of Incorporation and By-Laws.
* Received letter from PAGCOR dated 03 February 2005 stating they are not under DOF.
* Transforms PEA to Phil. Reclamation Authority pursuant to E.O. 380 dated 26 November 2004.
* Attached to DTI pursuant to Executive Order No. 331 dated 18 July 2004.

Source: Presidential Committee on Effective Governance, an inter-agency committee composed of Department of Finance (DOF), Department of Budget and Management (DBM), Commission on Audit (COA), and Privatization Council (PrC)/Privatization Management Office (PMO).
APPENDIX 6

Landmarks in Economic Liberalization

June 1989: Privatization of 30% equity in the Philippine National Bank

June 1991: Foreign Investment Act allowing 100% foreign equity ownership except in sectors where it is specifically restricted (to 25-40%) or banned

August 1992: Lifting of exchange controls on most current-account transactions

February 1993: Ending of telecommunications monopoly

February–June 1994: Privatization of 60% equity in state-owned oil refinery

May 1994: Lifting of ban on entry of operating branches of foreign banks

January 1995: Opening up of aviation services; extension of land-lease period for foreigners from 50 to 75 years

February 1995: A total of 100% foreign equity allowed in mining under terms of financial and technical agreements

March 1996: Deletion of the negative list in the Foreign Investment Act relating to sectors where there is already adequate capacity to meet domestic demand

January 1997: Manila water system privatized through two 25-year franchises

February 1997: Downstream Oil Industry Deregulation Law ends administered pricing of petroleum products

December 1999: Congress lifts the ban on foreign investment in retail trade

May 2000: Amendment to the General Banking Law permits 100% ownership by a foreign bank of a local bank classified as distressed

June 2001: The power sector is liberalized with the passage of the Electricity Power Industry Reform Act, providing for the privatization of the state utility

December 2002: Special-purpose asset vehicle law passed, making it easier for banks to spin off bad loans to asset management companies—key policy change on the monetary side.

Source: Economist Intelligence Unit; Philippines Country Profile, 2003.


**APPENDIX 7**

**ADB's and Other Donors’ Assistance to Private Sector Development in the Philippines**

ADB and other development partners’ institutions utilize the capabilities of both their public and private sector operations to reinforce the private sector's role in helping reduce poverty in the Philippines. Most initiatives, especially on policy and finance and capacity building, use public sector instruments to provide a favorable business environment for private sector operations. On the other hand, development partners directly provide funding instruments to eligible private entities for infrastructure development and other projects using windows for private sector development.

<table>
<thead>
<tr>
<th>Sector/Thematic Area</th>
<th>ADB’s Strategies/Activities 1</th>
<th>Other Development Partners’ Strategies/Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Rural Development</td>
<td>Helps the Government modernize agriculture and accelerate rural development by supporting: • agrarian reform communities development • irrigation systems improvement • upland agriculture productivity • rural infrastructure development, and • rural microfinance.</td>
<td>AusAID: Helps improve key livelihood areas of rural income Belgium: Supports agrarian reform communities CIAD: Supports sustainable agricultural enterprises development, through private sector participation DANIDA: Supports agri-industry EC: Supports area-based, sustainable rural development and agrarian reform GTZ: Supports land reform and rural development IFAD: Supports community-based agricultural resource management, rural microenterprise, livestock development, and irrigation JICA: Supports agrarian reform, irrigation, and rural roads JICA: Funds agricultural research, development and extension network, rural infrastructure development and system management, and supports agrarian reform communities Netherlands: Supports agrarian reform and sustainable agriculture Spain: Helps ensure food security, supports microfinance, aquaculture and agroforestry, rural livelihood and irrigation USAID: Supports grains sector development and microfinance facilitation UNDP: Promotes asset reform, indigenous communities and microfinance WB: Promotes priority policy and market reforms in agriculture, rural credit, agrarian reform, and land administration</td>
</tr>
<tr>
<td>Sector/Thematic Area</td>
<td>ADB’s Strategies/Activities</td>
<td>Other Development Partners’ Strategies/Activities</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Environment</td>
<td>Supports environmental management by improving the environmental quality of urban centers, also continues to support improvements in managing solid and medical waste.</td>
<td>CIDA: Supports watershed, lowland, and coastal resources management. Danida: Supports wastewater treatment. GTZ: Supports environmental policy, protection and sustainable use of natural resources like coastal resources, fisheries, forestry, eco-industrial processing zone and watershed. JBIC: Funds air quality improvement programs (in partnership with ADB); and supports community-based forestry management, fisheries, and coastal resources management. JICA: Provides environmental management capacity building; supports mining, pollution prevention, solid waste management, and forest conservation. KfW: Finances SME investments in pollution reduction, including improvement in occupational health and safety, waste minimization, and clean technology in industrial processes; will support community-based forestry management. Netherlands: Supports biodiversity conservation, watershed and natural resources management, and climate change. NZAID: Supports natural resource management at the community level including ecotourism and coastal resources. Spain: Supports uphill agriculture, eco-tourism, water, and soil waste management. Sida: Helps in ensuring sustainable use of natural resources, biological diversity conservation, waste management, and air and water pollution management. USAID: Supports environmental waste management, strengthening air quality standards, forests, and coastal resource management. UNDP: Helps in strengthening, rationalizing and implementing environment and natural resource policies, frameworks, and plans; supports streamlining environment and natural resources services, and strengthening sustainable development planning and implementation capacity. WB: Supports community-based resource management, coastal marine biodiversity conservation, river basin management, Laguna de Bay institutional strengthening and community participation; and conducts country environmental analyses.</td>
</tr>
<tr>
<td>Natural Resources Management</td>
<td>Helps in the protection and management of natural resources by:  • supporting the use of a community-based, demand-driven participatory approach to prevent deforestation and degradation of forest land; and  • Promoting sustainable and integrated management of coastal resources and related ecosystems.</td>
<td></td>
</tr>
<tr>
<td>Sector/Thematic Area</td>
<td>ADB’s Strategies/Activities</td>
<td>Other Development Partners’ Strategies/Activities</td>
</tr>
<tr>
<td>----------------------</td>
<td>-----------------------------</td>
<td>--------------------------------------------------</td>
</tr>
</tbody>
</table>
| Energy               | Supports in implementing the full restructuring and privatization of the power sector as prescribed in the Electric Power Industry Reform Act to create competitive power and support economic development with affordable electricity tariffs. Also supports the following activities  
  - promoting good governance in the restructured power sector;  
  - priority power transmission reinforcement;  
  - institutional strengthening on natural gas industry; and  
  - pilot rehabilitation of renewable energy for rural electrification and livelihood development. | Danida: Promotes renewable energy  
JBIC: Funds electric power development, natural gas infrastructure, renewable energy (wind, geothermal), and transmission  
JICA: Supports sustainable energy resource development and rural electrification  
KfW: Supports special program for renewable energy  
Sida: Helps in energy conservation and promotes infrastructure projects in the energy sector  
Spain: Promotes renewable energy  
USDOE: Supports power sector restructuring and privatization and promotes renewable energy for rural electrification  
WB: Supports reforms and priority investments to improve rural electrification in partnership with private sector, and promotes renewable energy where cost effective |
| Transport            | Assists in formulating policy frameworks and provide financing for the development of secondary national roads, provincial roads, and intermodal transport (ports and airports), with the overall objective of improving access to/in the Southern Philippines. | Danida: Supports the construction of seaports and airports  
JBIC: Transportation and road traffic infrastructure development such as mass rail transit, highways, seaports, and airports  
JICA: Helps in improvement of the national road network and rural roads; establishment of the national aviation network, port facilities and sea transportation network development; maritime traffic safety; and traffic alleviation in Metro Manila  
ECDF: Supports airports and railways  
Kuwait Fund: Supports the transportation sector  
Saudi Fund: Supports infrastructure development in the Southern Philippines  
WB: Supports institutional reforms and development/maintenance of the road sector; urban transport in Metro Manila  
Spain: Supports the establishment of mass transport, air and maritime safety, and airport and seaport maintenance and improvement  
Sida: Assists in the establishment of infrastructure projects in the transportation sector |
<table>
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<tr>
<th>Sector/Thematic Area</th>
<th>ADB's Strategies/Activities¹</th>
<th>Other Development Partners’ Strategies/Activities</th>
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<tr>
<td>Water Supply and Sanitation, Housing, and Urban Development</td>
<td>Supports the preparation of water supply, sanitation, housing, and urban development projects through public and private sector infrastructure investments including: • urban and rural water supply and sanitation, • solid waste management, • housing for the poor, • public facilities for livelihood development, and • urban environment (air and water quality) improvement. Provides assistance for development and capacity building of relevant institutions and agencies including but not limited to water utilities and regulatory bodies.</td>
<td>[CIDA: Helps improve access of the poor to housing, water and sanitation. Danida: Assists in water supply and wastewater treatment. GTZ: Supports provision of drinking water, water management, sanitation and waste management, and institutionalization of water districts. JBIC: Supports flood control, water supply, and solid waste management. JICA: Supports improvement of rural water supply system, water resource development and management, urban development policy, and low-income housing development. KfW: Supports rural water supply, water districts, drinking water, and solid waste management. Spain: Helps in urban development planning, and urban and rural water supply. WB: Assists water utilities; mobilizes private resources for water and sanitation; improves urban environment by investing in drainage, wastewater treatment, solid waste and air pollution reduction; helps build financial and institutional capacity of local government units (LGUs); supports community infrastructure upgrading, and development of national urban strategy.]</td>
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<td>Education</td>
<td>Strengthens policy reforms, builds capacity and provides quality improvement in basic education, higher education, and skills training.</td>
<td>[AusAID: Supports basic education, technical education and skills development, and human resources development through overseas study scholarships. GTZ: Supports dual training and education. JBIC: Helps in improving quality and access to primary and secondary education; provides cofinancing for ADB and WB secondary and elementary education projects. JICA: Helps in improving primary and secondary education; supports physical infrastructure development such as school buildings, classrooms, and teaching equipment; supports science and mathematics education; and provides teaching materials/equipment. KfW: Supports dual training and education and maritime education. Republic of Korea: Supports manpower training.]</td>
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<td>Health</td>
<td>Helps improve the provision of primary health care, including maternal and child health care; and supports the reforms and activities espoused in the Philippines' health sector reform agenda, particularly local health systems development</td>
<td>AusAID: Provides capacity building for effective health service delivery at the local level CIDA: Helps ensure access of the poor to health and nutrition services like nationwide tuberculosis eradication program, maternal and child health in the ARMM, health insurance through cooperatives, provision of relief and rehabilitation for evacuees in Mindanao, and improved reproductive health care programs and services EC: Supports reproductive health and population management programs GTZ: Supports family and reproductive health, social health insurance, pharmaceutical, and local health systems development JICA: Supports health and medical care administration, rural health promotion, and infectious disease control KfW: Supports immunization programs, social marketing, family planning and HIV/AIDS prevention; provides cold chain equipment, hospital equipment, and essential drugs Netherlands: Supports nutrition planning Spain: Supports the health sector reform, upgrading of health facilities, National Tuberculosis Program and Manila Eye Hospital UNAIDS: Supports HIV/AIDS prevention UNFPA: Supports family planning and reproductive health UNICEF: Helps in providing health nutrition for women and children</td>
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<td>Private Sector and SME Development</td>
<td>Supports private sector development by:</td>
<td>USAID: Supports family planning and tuberculosis control and expands the role of the private sector to support these services UNDP: Supports community-based approaches to HIV prevention WB: Supports the health sector reform agenda, early childhood development, women’s health; and, conducts study of private provision of health services</td>
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<td>• increasing the private sector’s participation and competitiveness;</td>
<td>CIDA: Helps in building private sector capacity to create jobs, primarily by SMEs and cooperatives EC: Promotes trade and investment of Filipino/European businessmen/companies GTZ: Supports private sector development, SME development and industry training JICA: Supports SME development KfW: Provides financing for MSMEs USAID: Helps in improving competition policies in infrastructure; supports SME development WB: Helps in strengthening the business environment, improving domestic mobilization of long-term resources, and improving and improving the infrastructure needs</td>
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<td>• improving the policy environment in which the private sector operates; and</td>
<td>AusAID: Supports corporate governance reform, specifically reform of the Philippine Stock Exchange; public financial management; trade, policy and decentralization through capacity building for LGUs CIDA: Promotes effective, transparent, and accountable governance through national and local capacity building, support for the Judiciary, and fighting corruption EC: Promotes good governance and transparency in the management of public affairs; and focuses on efforts to create a business-friendly environment of law, tax, and public policy GTZ: Supports institutional strengthening of national agencies and LGUs JICA: Enhances economic management capabilities, focusing on customs administration; provides capacity building for central and local government administration; and supports improvement in police function The Netherlands: Assists in local government planning and child justice system NZAID: Supports activities that enhance quality and sustainability</td>
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<td>• enhancing infrastructure support</td>
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<td></td>
<td>Also continues to promote development of small and medium enterprises (SMEs) as part of its private sector strategy</td>
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<tr>
<td>Governance and Finance</td>
<td>Provides advisory and capacity building assistance to national and local governments to ensure that operations are implemented with high degree of transparency and accountability. Will support the following activities</td>
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<td>• strengthening of official development assistance monitoring and facilitation;</td>
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<td>• development of LGU financing mechanisms for development expenditures;</td>
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<td>• promoting good local governance in ARMM; and</td>
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<td>• setting up of local productivity and performance measurement system.</td>
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<td>Supports the development of the financial/capital market, particularly the nonbank financial sector by</td>
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enhancing market efficiency; strengthening governance (e.g. anti-money laundering support); and addressing weak and fragmented regulatory and supervisory framework for the nonbank sector.

Gender and Development
Promotes gender concerns in most loan and technical assistance operations and will build projects with special design features and strategies to facilitate and ensure women’s involvement and access to program/project benefits.

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<tbody>
<tr>
<td>Gender and Development</td>
<td>- enhancing market efficiency; - strengthening governance (e.g. anti-money laundering support); and - addressing weak and fragmented regulatory and supervisory framework for the nonbank sector.</td>
<td>of governance; currently providing support for the Government’s Program on Rationalizing and Improving Public Service Delivery; supports public sector reform and LGU capacity building Sida: Promotes good governance Spain: Supports trade unions USAID: Assists in combating money laundering and corruption in Government; supports reforms in the financial and fiscal sectors, trade, savings and securities, and openness and competition UNDP: Supports public sector reform; strengthens citizenship and citizens’ oversight in governance; supports the mainstreaming of human rights, and gender and globalization concerns in governance; assists in poverty monitoring and coordination of antipoverty programs WB: Supports the strengthening of public finance/expenditure, procurement and financial management; provides LGU capacity building; supports judicial reform and civil service reform AusAID: Aids in participatory monitoring of gender projects CIDA: Supports the National Commission on the Role of Women and Global Environment Facility and microfinance services for rural women EU: Helps in fostering gender equality JICA: Supports social and economic empowerment of women NZAID: Supports the Department of Social Welfare and Development’s National Family Violence Prevention Programme; ensures that gender considerations are built in for all projects Sida: Advocates human rights and democracy UNICEF: Helps in the prevention of violence against women; supports girl child education, health and nutrition, and protection UNIFEM: Supports the expansion of gender and development budget WB: Assists women’s health programs, ensures gender dimension in projects, and conducts study on gender issues in Mindanao</td>
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</tbody>
</table>

### Key to abbreviations and acronyms:
- AusAID = Australian Agency for International Development
- CIDA = Canadian International Development Agency
- Danida = Danish International Development Assistance
- EC = European Commission
- ECDF = Economic Development Cooperation Fund
- EU = European Union
- GTZ = Deutsche Gesellschaft für Technische Zusammenarbeit
- JICA = Japan International Cooperation Agency
- JBIC = Japan Bank for International Cooperation
- KfW = Kreditanstalt für Wiederaufbau
- NZAID = New Zealand’s International Aid and Development Agency
- NZAID = The Saudi Fund for Development
- Sida = Swedish International Development Cooperation Agency
- UNAIDS = The Joint United Nations Programme on HIV/AIDS
- UNFPA = United Nations Population Fund
- UNICEF = United Nations Children’s Fund
- UNIFEM = United Nations Development Fund for Women
- USAID = United States Agency for International Development
- USDOE = United States Department of Energy
- WB = The World Bank

1 ADB activities use various instruments to promote private sector development: public and private sector loans, technical assistance, economic and sector work, cofinancing, partial credit risk guarantees, equity investments, etc.

Sources: 2002 and 2003 Consultative Group (C-G) Meeting donors’ statements, donors’ websites, and country assistance strategies/programs.

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