Senate Economic Planning Office

FIVE PILLARS OF GROWTH

An Economic and Social Development Framework

With support from the United Nations Development Programme
2004

An Economic and Social Development Framework:

FIVE PILLARS OF GROWTH

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FOREWORD

The Senate Economic Planning Office (SEPO), created through Senate Resolution No. 526, is mandated to provide technical support to the Senate President and Members of the Senate in their task to enact relevant and timely legislation and review existing and proposed policies on national economic and social development. While SEPO focuses on the conduct of policy research and technical analyses of key legislative proposals, the Office also desires to help strengthen the research capability of the Senate and improve the legislative process. The Final Report on the SEPO Economic and Social Development Framework: Five Pillars of Growth presents the major results of a short term research project identifying the five major areas of reforms deemed pivotal in pursuing sustained economic growth and alleviation of poverty for Filipinos. These major areas of reforms are macroeconomic stability, investment climate, governance, social reforms and environment management.

The preparation of this report has provided the SEPO staff a unique opportunity to gather a diverse group of local and international experts from research institutions, the academe and business to discuss emerging economic and social issues, to review policies that have not worked over the last 30 years, to identify the gaps and to recommend approaches in solving the pressing problems of the country. The preparation process included consultative meetings, briefings and a technical workshop made possible through the financial support of the United Nations Development Programme (UNDP).

This SEPO ESDF was prepared in order to present a menu of research and legislative proposals for the consideration of the Members of the Senate. Guided by the human development goals enshrined in the 2015 Millennium Development Goals, this document includes proposals from a number of cross-sectoral and sector specific assessment reports and sector specific policy papers.

We, in SEPO, recognize that the struggle for national development and nation building is not fought only through technical means, or through laws and position papers but also through discussions, consensus-building and collaboration among individuals and groups, within and outside of the Senate, who can mobilize people and institutions to action.

Much has been done in this recent endeavor, yet much more remains to be accomplished. This Final Report is only the beginning of the long crusade to produce and promote research and policy proposals that are truly reflective of and responsive to the needs of the majority of our people. We hope this report will stimulate interest and debate and help create a momentum for a reform oriented legislative agenda.

Ma. Susana T. Bulan

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Director-General
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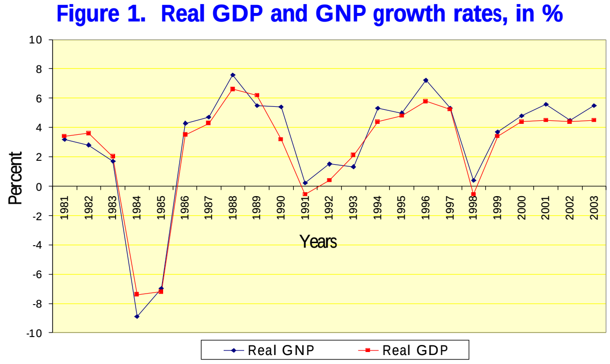
INTRODUCTION:
Philippine Economic Performance

After two decades, Philippine economic performance leaves much to be desired. The Philippine economy posted low average growth rates in its Gross Domestic Product and Gross National Product of 2.7 percent and 3.0 percent, respectively. Further, the growth was uneven and not sustained for long periods of time, and we have not regained our economic growth since the sharp reversal in the 1980s. (Refer to Figure 1.)

Figure 1. Real GDP and GNP growth rates, in %



Source: Philippine Institute of Development Studies

Our economic growth was only half of what most of our neighbors in Southeast Asia and the Pacific achieved. We were even overtaken by Vietnam, Laos and Cambodia in the last decade as shown in Table 1.

Table 1. GNP, GDP Across East Asia and the Pacific Region

Country	GNP growth rate 1965-1996 (in percent)	GDP growth rate 1990-2001 (in percent)
China	8.5	10
Hong Kong	7.5	3.9
South Korea	8.9	5.7
Singapore	8.3	7.8
Indonesia	6.7	3.8
Malaysia	6.8	6.5
Philippines	**3.5**	**3.3**
Thailand	7.3	3.8
Cambodia	na	4.8
Laos	na	6.4
Myanmar	na	na
Vietnam	na	7.6
East Asia and the Pacific	7.4	7.5

Source: Yue (2002)

Repercussions of low growth

After decades of moderate growth, the economy has not made a significant dent in poverty reduction. Posting the lowest growth rates since the 1970s, the country also registered the lowest decline in poverty incidence when compared to its Asian neighbors (Refer to Table 2). This is supportive of what economists proved that economic growth is the main driver of poverty reduction.

Table 2. GDP Growth (%) and Poverty Incidence, 1970-1996

Country	GDP Growth	Poverty Incidence (national poverty line)		Percentage Reduction
	1971 -1996	1970	1996	
Korea	8.03	23.0	9.6	58.3
Taipei China	8.04	30.0	*3.0	90.0
Malaysia	7.51	49.0	8.2	83.3
Thailand	7.61	39.0	11.4	70.8
Indonesia	7.37	58.0	11.3	80.5
Philippines	3.51	**52.0	36.8	29.2

Note: *1985 figure
**1975 figure
Source: Quibria (2002); Percentage reduction is SEPO's computation.

Moreover, the economy has not been able to provide sufficient employment for the growing number of labor participants. Figure 2 below presents the close link between employment levels and GDP growth rates. In times of economic deceleration, unemployment rises.

Figure 2. Philippine GDP Growth (%) and Unemployment Rates (%), 1983-2003

Source: National Statistical Coordination Board

Reasons for Underperformance

Government's inward looking policies of the past have played a critical role in shaping the economic growth process in the country. During the 1970s and 1980s, policies were mainly characterized by import substitution, strong interventionist stance through fiscal incentives, directed credit and the promotion of capital-intensive industries in a labor abundant country. Our export and industrial sectors suffered from these policies. Growth of industry stagnated at an average of 1.8 percent in the past 20 years. Thus, industry's share to GDP declined from 41 percent in 1981 to 33.5 percent in 2003. Likewise, agriculture did not develop as natural resources were depleted because of neglect. The agriculture, fisheries and forestry sectors which contributed 23.5 percent of GDP in 1981 declined to 19.8 percent in 2003.

Economic growth in the 1970s and 1980s was primarily financed through external debt which eventually became very difficult to sustain. Consequently, growth became uneven and the economy suffered episodes of macro-economic imbalances that resulted to a balance of payments crisis, increasing debt, staggering fiscal deficits, and periods of high inflation. The consequence of our inward looking policies was the insufficiency of foreign exchange for an economy dependent on foreign capital to finance growth.

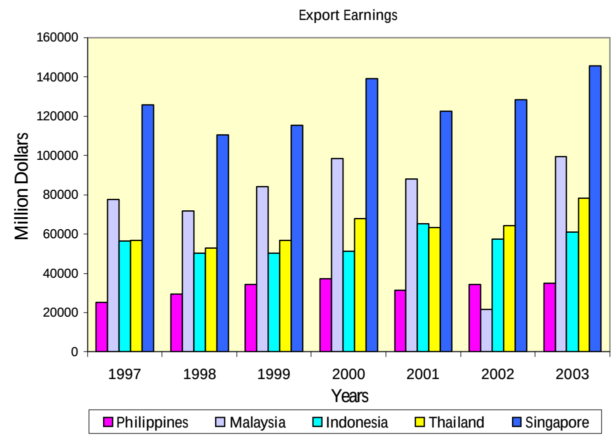
Given the weak macroeconomic fundamentals, the country became very vulnerable to external shocks such as the oil crises in 1971 and 1982. Our economic performance was also strongly linked to major economies of the world such that any slowdown in these economies affects our growth. Financial crises such as the

Mexican and Asian crises also adversely affected our economy. Domestically, episodes of political instability slowed down investment in the country and had derailed our growth.

After the 1986 EDSA revolution, significant policy shifts opened up and deregulated the economy and eased the government's protectionist stance. The Aquino administration started to liberalize trade and reduce government intervention in the economy. These reforms continued into the next administrations as we deregulated and liberalized many sectors of the economy such as telecommunication, investments, banking, foreign exchange market and retail trade. Trade liberalization doubled the ratio of exports and imports to GDP. Our economy, however, was hounded by military uprisings and major financial crises. These tempered growth and inevitably led to deceleration of growth in certain periods.

The vulnerability of the country to external shocks is a sign that the macroeconomic fundamentals of the country were weak. First, the fiscal sector exhibited drawbacks as the government continued to face deficits. The country had budget surpluses only during the years 1994 through 1997. This led to increasing debt and crowding out of private investments. Second, our exports have not grown significantly to finance our foreign exchange requirements. The country remained highly dependent on foreign capital to finance growth. In the ASEAN 5, we have been the worst export earner since 1997, as shown by Figure 3. The income from Overseas Filipino Workers, however, greatly boosted our foreign exchange earnings.

Figure 3. Merchandise Exports in Southeast Asia, in Million US $, 1997-2003



Source: Bangko Sentral ng Pilipinas

Third, entry of foreign investments decelerated and ran short of increasing the productive capacity of the economy. The investment climate has not met up to expectations of foreign investors, as competition from other countries further slowed down their entry.

Table 3. Net Foreign Direct Investment, Average Growth Rate (%), 1992-2003

ASEAN	'92-'97	'98-'00	'01-'03
Philippines	64.9	11.3	-20.1
Malaysia	5.3	-14.8	84.6
Thailand	16.2	20.0	-6.8
Indonesia	27.0	-307.8	-206.2
Singapore	27.6	145.9	92.1

Source: ARIC-ADB, World Investment Report

In addition, the low savings rate has not helped finance growth as national savings continue to be below international standards. (See Table 4.)

Table 4. Gross Domestic Savings (% of GDP)

Country	1980	1990	2002
Southeast Asia (ave.)	28.3	31.2	30.2
Indonesia	29.2	32.3	21.1
Malaysia	32.9	34.4	41.8
Myanmar	17.7	11.7	11.3
Philippines	26.6	18.7	19.5
Singapore	38.8	43.3	44.7
Thailand	23.0	34.3	32.0
East Asia (ave.)	21.5	22.8	21.4
China	34.1	38.7	39.4
Hong Kong	34.5	36.0	33.9
Korea, Rep. of	23.8	37.2	29.3
Mongolia	15.7	8.0	4.1
Taipei,China	32.6	28.1	24.3
Nepal	11.1	7.9	11.6
Pakistan	7.8	13.5	13.6
Sri Lanka	12.0	13.2	14.6

Source: Asian Development Bank

Moreover, growth in the recent years depended too much on consumption. The proportion of consumption to GDP increased to 73 percent in 2003 from 65 percent in 1981, while investments' share to GDP declined to 18 percent in 2003 from 26 percent in 1981. While a consumption-driven growth is not at all bad, the productive capacity of the economy must be increased in order to sustain growth.

The 'right' policies

Thomas et al. (2000) explained that during the 1980s to the 1990s, economies with high growth registered larger dents to poverty incidence than those with moderate growth. More striking is the observation that within the same period, low growth economies registered a substantial increase in poverty incidence. These underline the role economic growth plays in reducing poverty. Table 5 below illustrates the relationship between growth level and poverty incidence.

Table 5. GDP Growth and Poverty Incidence

	Period	High Growth	Moderate Growth	Low Growth
Poverty (%)	1990s	24.1	31.4	36.9
	1980s	31.0	32.1	30.2
Percentage				
Improvement		22.3	2.2	-22.2
GDP Growth (%)	1990s	5.3	4.2	0.3
	1980s	6.5	2.3	2.1
No. of Countries		13	53	39

Source: Thomas, *et al.* 2000

Quibria (2002) outlined the set of policies that provides an environment conducive to growth. Using the experience of Asian economies, she argued that the economic growth is supported by economic openness which brought in investments and access to new technology, and finding a niche in the unlimited opportunities in the world economy. She rightly argues, however, that for an economy to prosper in a liberalized environment, the domestic economy should have a stable macroeconomy, flexible labor markets, and legal and political institutions that provide good economic governance, encourage investments and efficient use of resources.

Indeed, economic growth is necessary but not sufficient in reducing the incidence of poverty. Ceteris paribus, growth that concentrates on labor-intensive sectors, is sustainable or environment-friendly, and anchored on the creation of stable and rule-based institutions makes more substantial dents on poverty.

As Thomas et al. (2000) reiterates in their document for the World Bank, the quality of growth matters considerably in reducing poverty.

A sustained and balanced growth is the best approach to reduce the incidence of poverty. The World Bank reinforces Quibria's conclusion that sustaining growth involves "right" policies.

Using the same tripartite classification system of countries, Thomas et al. (2000) identified policies and factors that positively contribute to high economic growth:

(1) as a major component of stabilizing the macroeconomy, they observed that the budget deficit of governments as percent of GDP in high and moderate growth economies is at 1.4 to 1.8 percent, substantially lower than the 3.4 percent budget deficit posted by low growth countries;

(2) for both high and moderate growth countries, there is a marked observation of lower financial repression, greater financial depth as measured by M2-to-GDP ratio, and larger international reserves as a percent of imports compared to low growth economies;

(3) economic openness, as measured by trade-to-GDP ratio and capital openness index, provides a positive relationship to growth;

(4) good governance plays a role in achieving higher growth rates. Indicators for rule of law and control of corruption show the watershed that separates the high growth and moderate growth economies from those achieving low growth; and

(5) environmental action showed a good correlation with the level of growth an economy achieves as it accounts for how well an economy manages its natural capital.

Moreover, the World Bank (particularly Thomas, 2000) underscored the appropriateness of interventions in education and health as modes of reducing poverty and promoting equity in the long run. It seems appropriate to focus on health and education policies as they are more politically acceptable to create new wealth through human capital investments than to redistribute existing capital like land or taxing those earning higher incomes. Larger spending and better program implementation on health and education provides the poor better opportunities in the labor market, levels out intergenerational equity by ensuring better access to education, reduces political conflict and boosts social cohesion which feeds back into the electoral process, among others.

Quibria, using Asian countries' experience since the 1960s, and the World Bank providing the larger global picture, provides a consensus on the role of economic growth and the "right" policies for higher and sustained growth which consequently reduces the incidence of poverty.

Moving the Philippines forward

We have identified the policies that boosted growth and consequently reduced poverty in other economies. It is in this light that the country's next development agenda must be anchored on the pillars of growth—pillars which in the past have been weak in supporting a sustained and balanced growth.

First, it is imperative that the country provides a policy environment that stabilizes the macroeconomy, primarily through better fiscal, financial and monetary management. This is not sufficient, however, as there are microeconomic interventions needed to create a better business environment to support the micro, small and medium enterprises (MSMEs) and export-oriented industries. Good governance—by creating institutional arrangements that makes policies predictable across administrations, preserves the sanctity of transactions and contracts, and provides an efficient bureaucracy that oversees policy-making and enforcement—is the third pillar. Finally, the fourth and fifth pillars focus on investing in human capital and environmental management. These two are vital to the poor as they affect those employed in rural areas specifically in the agriculture, fisheries and forestry sector, and as labor is argued to be the poor's primary asset.

The components of these five pillars will be discussed in great detail in the chapters that follow.

FIRST PILLAR:
Achieving Macroeconomic Stability

A large public sector deficit and a weak financial and banking sector spoil the country's macroeconomy and serve as major constraints to higher growth. Along these lines, ensuring macroeconomic stability requires focusing on fiscal consolidation measures through enhanced revenue generation and expenditure management to arrest the escalating public debt levels. It is crucial that this is supported by a prudent monetary and an effective external debt management policy to ensure external sector viability.

Improving private sector financing by strengthening the banking system and developing the capital market also remains crucial to achieve macroeconomic stability. Banks and the capital market play integral roles in generating the needed savings to finance and sustain investments in the country, hence their stability must be ensured.

A. Addressing fiscal deficits

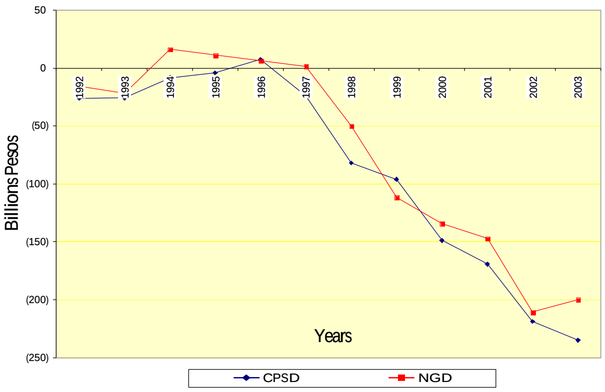
At present, the biggest threat to macroeconomic stability is the fiscal deficit. The Philippines has been experiencing a deteriorating fiscal position, from a budget deficit of P19.6 billion in 1989 to P199.9 billion in 2003.

Table 6. Fiscal Balance and Outstanding Debt of the Central Government In ASEAN Countries, 1996-2003 (% of GDP)

Country	1996	1997	1998	1999	2000	2001	2002	2003
Overall Fiscal Balance to GDP Ratio								
Indonesia	n.a.	0.0	-3.7	-2.8	-1.6	-2.3	-1.8	-1.9
Malaysia	1.1	2.5	-1.5	-4.1	-4.2	-6.7	-5.6	-5.3
Thailand	2.4	-2.1	-7.6	-10.5	-3.2	-3.8	-1.4	0.4
Philippines	0.3	0.1	-1.9	-3.8	-4.1	-4.1	-5.2	-4.6
Debt to GDP Ratio								
Indonesia	23.9	24.2	68.8	53.3	48.6	n.a.	n.a.	n.a.
Malaysia	35.9	31.9	36.4	37.3	36.9	n.a.	n.a.	n.a.
Thailand	3.9	5.1	10.7	20.9	22.6	25.0	n.a.	n.a.
Philippines (without contingent liabilities)	53.2	55.7	56.1	59.6	65.5	65.5	67.7	77.0
Philippines (with contingent liabilities)	61.3	66.9	67.6	72.0	80.1	79.1	84.7	93.2

Source: Manasan, 2002 and Asian Development Bank

Figure 4. Levels of Consolidated Public Sector and National Government Deficits, 1992-2003



Source: Department of Finance

On a broader front, the country's consolidated public sector deficit (CPSD) reached P235 B in 2003 which is equivalent to 5.4 percent of GDP. CPSD includes the financial positions of the National Government (NG), Government Owned and Controlled Corporations (GOCCs), Bangko Sentral ng Pilipinas (BSP), Government Financial Institutions (GFIs) and the Local Government Units (LGUs).

The continuing deficit position and the need to pay maturing obligations have caused the NG's debt (net of contingent liabilities) to balloon to P3.4 trillion in 2003. This amount is about 77 percent of GDP. If contingent liabilities were added, NG's debt will reach P4.1 trillion at the end 2003 or 93 percent of GDP. More alarmingly, the total public sector debt has reached P5.4 trillion as of September 2003, or 137 percent of GDP. This means every Filipino has to pay P65,853 to cover our outstanding public debt. Economists warn that if the country does not limit public borrowing, the Philippines will be bankrupt in two to three years.

The deficit problem is a result of spending more and collecting less. We should adopt the necessary measures to reduce this gap by examining our revenue collection and expenditure management program. Today, we collect only 12.5 percent of our GDP, compared to 17 percent in 1997.[1] The Philippines has the lowest revenue effort compared to Indonesia, Malaysia and Thailand (1999-2003) as shown in Table 7 below.

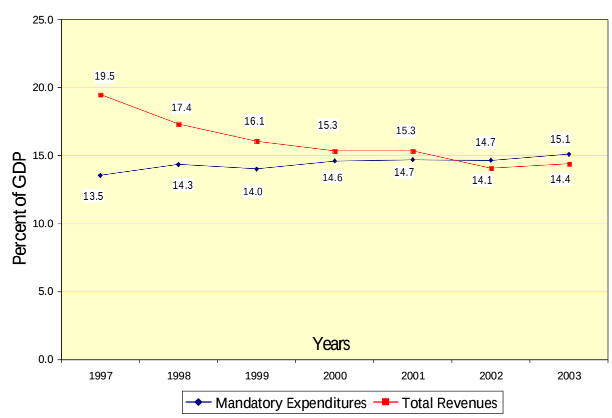
Table 7. Total Revenue in ASEAN Countries (% of GNP)

Country	1996	1997	1998	1999	2000	2001	2002	2003
Indonesia	17.4	18.5	13.8	18.6	15.8	20.7	18.7	16.9
Malaysia	23.0	23.3	20.0	19.5	18.1	23.8	23.2	20.2
Thailand	19.3	18.0	15.5	15.4	15.2	15.1	16.1	15.5
Philippines	18.2	18.7	16.4	15.3	14.7	14.4	13.2	13.4

Source: Philippine Institute of Development Studies

On the other hand, the country's public expenditure has increasingly become biased in favor of the ballooning debt service (28 percent of total expenditures in 2003) and the salaries and wages (34 percent).

Figure 5. Fiscal Inflexibility, % of GDP

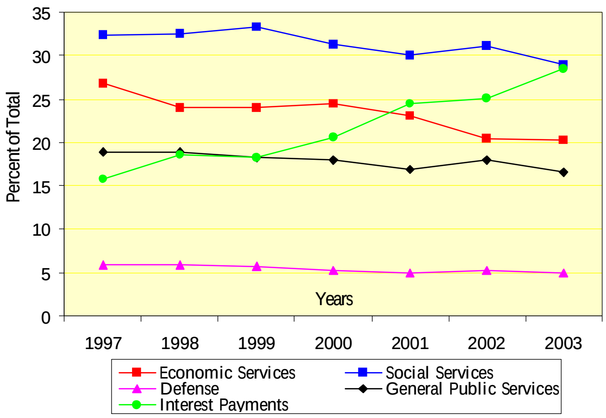


Source: Manasan, 2002

1 Half of the decline in tax effort in 1998 was mainly due to tax evasion.

Such bias effectively crowds out the social and economic expenditure needs. Although spending on social services continue to receive the biggest slice of the national budget, its share is continuously declining.

Figure 6. Government Expenditures, % of Total



Source: **Budget of Expenditures and Sources of Financing, 1999-2004**

Direction for Reforms:

To arrest further escalation of the country's deficits, the government must consider the following measures:

1. Improve revenue collection. Tax policy should be designed relative to an overarching goal and should not be ad hoc and fragmented. The following interventions are highly recommended/suggested:

a. Administrative Reforms

Ü ***Improve tax administration.*** Efficient system, procedures and benchmarking of tax collection should be established.

Ü ***Institutionalize an attrition system.*** Its provisions include the transfer or severance from government service for failure to meet collection targets, provision of performance standards and review mechanisms and provision of incentives to performing collection agency.

b. Revenue Measures

Ü ***Rationalize fiscal incentives.*** The current fiscal incentives structure in the country is complicated, fragmented, inefficient, and costly in administrative and revenue terms. The vulnerability of the tax incentive system to syndicated crimes of graft and corruption has resulted to substantial revenue losses and distortions in resource allocation. Aside from the additional revenues that it will generate, rationalizing the current fiscal incentives structure is ultimately concerned with implementing an incentive system that is easy to manage, administer, and monitor, which will encourage a healthy business environment in the country.

Ü ***Reduce exemptions from VAT***. VAT collection should reach 4 percent of GDP or 80 percent efficiency.

Ü ***Index excise taxes on cigarettes and alcohol***. Its prices have fallen drastically in real terms. Retail prices of these sin products have not been adjusted, hence, for several years now, manufacturers have not been taxed properly.

Ü ***Increase excise tax on petroleum products.*** This should be done preferably with rebate vouchers for public transport and utilities to avert resistance from transport groups.

Ü ***Pursue tax decentralization***. Local government units should be given more authority in the collection of its local taxes for greater accountability. Furthermore, in order to raise more local revenues, property taxes should be made more progressive (Manasan, 2004).

Ü ***Introduce a second wave of privatization***. Sale of all government holdings in the semi-private corporate sector, where no role of of government is self-evident (such as holdings in commercial banks – Cocobank, minority shares in PNB and DBP; business sector – San Miguel Corporation, National Steel Corporation, National Computer Center and PNOC; and media – Channel 9 and Channel 13) should be pushed. These holdings distort business and regulatory decisions since some of these businesses are with conflicts of interest with the government's objective.

2. Improve expenditure management. It may be worthwhile to do a thorough review of the expenditures of both national agencies and LGUs to seek areas of improving cost-efficiency or viability of projects.

Ü ***Review allocations for Priority Dev-elopment Assistance Fund (PDAF)*** (UPSE, 2004). This has been perceived highly political and promote corruption. The use of this fund must be made more transparent and aligned with the develop-ment agenda.

Ü ***Strengthen performance assessment and evaluation system for each agency.*** This can be done by strictly implementing the Sector Effectiveness and Efficiency Review (SEER) and Agency Performance Review (APR).

Ü ***Adopt a medium-term expenditure frame-work.*** In order to have better estimates on the programmed budget that is in line with policy priorities, the three-year budgeting system should be adopted and implemented. This will further reinforce the link between policy choices, budget and delivery of services that the government is responsible for.

Ü ***Re-engineer the bureaucracy***. Streamline scope and functions of government agencies as well as government corporations.

Ü ***Enact a fiscal responsibility bill***. There should be no new expenditures if there will be no new revenue for them. Clean-up unfunded laws and make certain that there will always be funding for future legislation.

3. Contain fiscal risks from GOCCs and con-tingent liabilities due to guarantees. The govern-ment has to keep track and understand the risks of contingent liabilities it is exposed to as past fiscal crises in the Philippines were triggered by extra-budgetary activities. It is then important for the government to effectively recognize, manage, report and provide for contingent liabilities (CLs) and off-budget risks of GOCCs.

Ü ***Strengthen congressional oversight of GOCC operations during budget deliberations.***

Ü ***Limit automatic guarantees to BOT investors and GOCCs.*** Direct guarantees on GOCC loans should be reviewed and the degrees of guarantees given to them should be limited.

Ü ***Undertake an assessment of capacity-build-ing needs.*** Strengthen institutional capacity to monitor and manage fiscal risks and the establishment of a centralized risk manage-ment unit.

Ü ***Make Contingent Liabilities (CLs) more transparent.*** Information on CLs' size, nature and risks should be provided in budget documents.

Ü ***Set a budget for contingent liabilities separate from GAA that should be approved by Congress.*** This budget will set limits on the CLs for the year, allocate and provide for guarantee calls.

4. Manage Public Debt Effectively. Considering the increasing size of the debt stock, the government should have a deliberate policy to mitigate the further increase of its total debt.

Ü ***Ensure effective debt management at all times by borrowing preferably at least cost with longer maturities.***

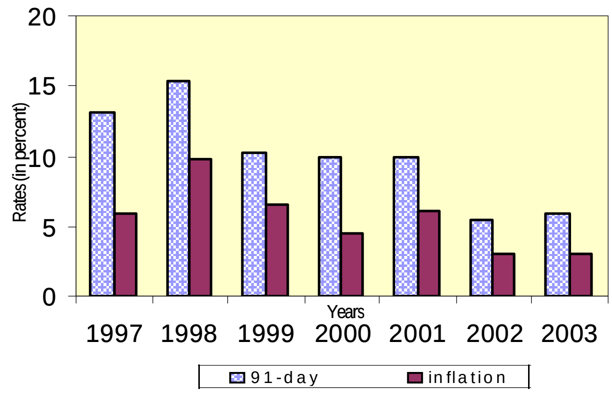
B. Maintaining stable monetary indicators

Inflation

Over the years, the country's price level was kept at low, single-digit levels despite hikes in petroleum prices, electricity charges and the depreciation of the peso. From an inflation rate of 6.6 percent in 1999, inflation fell to 3.0 percent in 2003, bringing the five-year inflation average to 4.6 percent. In 2002, the Bangko Sentral ng Pilipinas shifted to an inflation targeting framework of monetary policy with the primary objective of maintaining stable prices conducive to a balanced and sustainable growth.

Compared to 1997 levels, interest rates based on the benchmark 91-day Treasury Bill declined to single digit levels from 1997 to 2000. It hit its lowest annual average of 4.4 percent in 2002 although it climbed higher to 4.5 percent in 2003 (See Figure 7 below). For the near-term, interest rates are expected to remain benign. The Bangko Sentral, however, may need to review its monetary stance in the near-term in consideration of the hike in US interest rates.

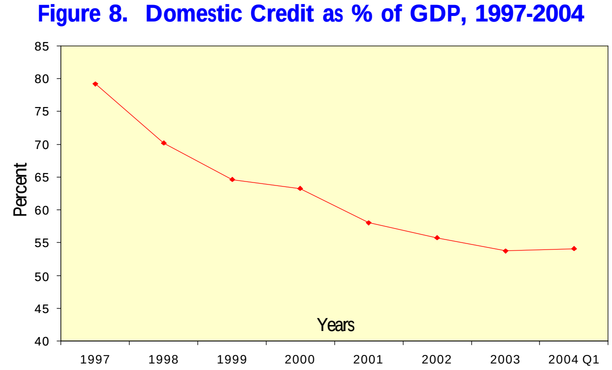
Figure 7. Inflation and Interest Rates, in %



Source: Statistical Yearbook 2003; Bangko Sentral ng Pilipinas

Relatedly, the availability of credit and its ratio to the real economy (domestic credit as percent of GDP) remained low in 2003 (See Figure 8) compared to pre-crisis period in 1997. The country has a lower ratio of domestic credit to GDP compared to Malaysia, Thailand

Figure 8. Domestic Credit as % of GDP, 1997-2004



Source: Bangko Sentral ng Pilipinas

and Singapore. This highlights the need to further improve financial intermediation in the country necessary to boost domestic business and investments.

Following market pressures in 2003, the peso-dollar exchange rate have relatively weakened compared to its levels for the period 1998-2000, posting a high peso-to-dollar rate of P 54.20 in 2003. As of June 2004, the peso-dollar exchange rate averaged P 55.90.

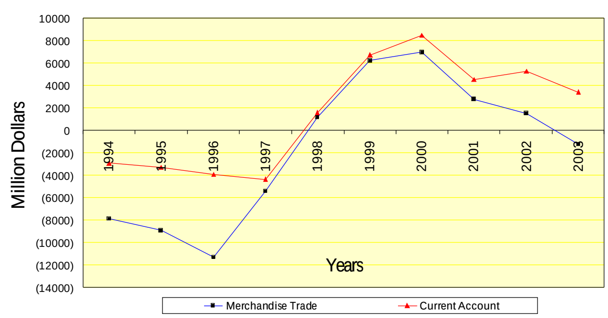
Direction for Reforms:

Ü ***Ensure a flexible and market-based interest and foreign exchange rates.*** If inflation increases due to demand side pressures (e.g. expectation of higher minimum wages, rising oil and food prices), an adjustment in interest rate policy may be called for. Steering the economy under a careful monetary course should allow interest rate adjustment to stimulate the economy while keeping inflation in check. Consistent with inflation targeting, monetary authorities should continue a market-based exchange rate policy, flexible enough to respond to any changes in the country's competitiveness. A sharp depreciation of the exchange rate could affect the government's inflation target and may prove harmful to both the private and public sectors' financial position. Complementing a prudent monetary stance requires keeping a tight rein on the fiscal deficit problem by focusing on fiscal consolidation.

External sector and external debt

The country's external sector faced major shocks in 2001. A rebound, however, was noted in 2002 as increasing intra-regional trade in Asia tempered the sluggish demand from the country's traditional markets such as the US and Japan. In the period of 2001 to 2003, exports shrank by 1.5 percent. However, this was countered by a larger contraction of imports by 2.9 percent. The level of gross international reserve for the period is enough to cover 4.6 months worth of imports of goods and payments for services, above the 4.2 months target of the government. Gross international reserves (GIR) as of end-December 2003 remained comfortable at US$ 16.9 billion, adequate to cover 4.7 months worth of imports of goods and payment for services and income.

Figure 9. Merchandise Trade and Current Account Balance, 1994 - 2003 (In Million US $)



Source: **National Economic and Development Authority; Philippine Institute of Development Studies**

Direction for Reforms:

Ü ***Promote trade cooperation and enhance trade competition policy.*** Regional trade cooperation among ASEAN economies also needs to be reinvigorated. The East Asian region led by China's economy is set to record strong growth fueled mainly by a healthier global environment, improving domestic conditions and combined strength of China's economy. Globalization and China's accession into the World Trade

Organization is seen to promote greater efficiency and productivity in East Asia through trade integration.

Ü *Expand the export base***.** The country is still unable to reap the full benefits of globalization due to the slow pace of industrialization particularly in the manufacturing sector. This has resulted in a narrow export base with electronic products (semiconductors) accounting for more than 70 percent of total exports. The homogeneity of our export line is risky as the country remains heavily exposed to the fluctuating trends of just one sector. Export diversification programs should be explored, aimed at expanding the country's export base and developing international markets for high-value-added and labor-intensive goods.

Ü *Assist micro, small and medium enterprises (MSMEs) through financial and technical support*. The government must also look into ways of providing financial and technical support for MSMEs, in terms of loan grants and the upgrading of equipment and machinery. All in all, research must be directed towards finding ways for the government to minimize bureaucratic obstacles and ownership restrictions, provide adequate utility supplies, and allow for quick and easy access to international markets geared towards enticing local and foreign investors to engage in manufacturing and production in the country.

C. Strengthening the Financial sector

While the basic monetary indices have been kept in check, the financial sector is, however, continuously threatened by fragilities in the banking sector and the slow development of the capital markets. As banks and capital markets play integral roles in generating the needed savings to finance and sustain investments in the country, their stability must thus be ensured.

1. Addressing the Banking Sector's Problems

Banks remain the dominant sector in the financial market. Its assets make up 81.6 percent of GDP and 82.3 percent of the whole financial system. It is thus increasingly important to address the lingering problems of its high non-performing loans which have increased from 4.7 percent in 1997 to 14.1 percent in 2003 (See Table 8) as a result of over-exposure in real estate lending and foreign exchange borrowing. In fact, among its ASEAN neighbors, only the Philippines has not significantly reduced their banks' NPLs since the Asian financial crisis. Similarly, proper corporate governance practices among banks must be enforced to ensure the soundness and stability of bank operations.

Table 8. NPLs in the banking system of ASEAN Countries, as % of total loans

	1997	1998	1999	2000	2001	2002	2003
Philippines	4.7	10.4	12.3	15.1	17.3	15.0	14.1
Indonesia	7.2	48.6	32.9	18.8	12.1	7.5	6.7
Korea	6.0	7.3	13.6	8.8	3.3	2.4	2.7
Malaysia		10.6	10.6	8.3	10.5	9.3	8.3
Thailand		45.0	39.9	19.5	11.5	18.1	14.0

Source: Asian Development Bank-East Asia Update

Direction for Reforms:

Ü *Synchronize regulatory functions.* Corporate governance among banks may be improved by synchronizing the functions of the regulatory bodies, i.e. Bangko Sentral ng Pilipinas and Securities Exchange Commission, to strengthen supervision and monitoring of banks and Non-Bank and Financial Institutions (NBFIs).

Ü ***Address issues of ownership structure and jurisdiction***. Bank's corporate soundness can be ensured by amending Republic Act No. 7653, the New Central Bank Act to address the issue of ownership structure of banks and NBFIs and expand BSP's jurisdiction over quasi-banks, trust entities and other financial institutions.

Ü ***Enact a Credit Reporting Law***. The limitations on banks' sharing of information on their borrowers must be relaxed to allow for better processing and more informed decisions. The creation of a Credit Information Bureau will likewise complement this effort.

2. Capital Mobilization from Non-Bank Sources

Public interest in savings instruments outside of the banking sector is low as the Philippine capital market is still in the early stages of development. Domestic credit depends largely on banks' lending and there is little participation in the equity market. This is evidenced by the small number of companies listed in the Philippine Stock Exchange and the low value of share trading. Table 9 below indicates that the Philippines has the least developed equities market compared to other Asian economies. Only about two companies/investors are added to the list of the Philippine bourse every year (World Federation Exchanges, 2001).

Table 9. Stock Market Performance-ASEAN and Other Selected Exchanges

Exchange	# of listed companies (as of 2003)	stock market importance (2001) (stock market value as % of GDP)
Philippines (PSE)	236	28.80
Jakarta (JSX)	333	*17.50
Kulala Lumpur (KLSE)	902	135.10
Singapore (SGX)	551	137.00
Thailand (SET)	418	31.30
Korea (KSE)	684	46.10
Shanghai (SSE)	780	-
Taiwan (TSEC)	674	-
Tokyo (TSE)	2,206	55.40

Note: *2000 data
Source: World Federation of Exchanges Statistics, *www.fibv.com/WFE/home*; IMF International Financial Statistics Yearbook 20001

Moreover, the insurance sector contributes a meager share of 6% to GDP (2001) as shown in Table 10. In contrast to countries with more developed capital markets, the country's pension funds are limited to mandatory schemes such as the GSIS and the SSS. The mutual fund industry, even as it has been growing significantly over the past five years, remains to contribute minimally to the over-all capital markets industry.

The stability of the key institutions that comprise the capital markets sector must also be ensured to improve investor confidence in other financial intermediaries. They must be governed in a manner that protects the interest of its stakeholders. Hence, proper corporate governance must be implemented for both non-bank financial institutions and corporations in general. Likewise, encouraging the development of more savings instruments will spur the development of the capital market.

Table 10. Comparative asset size of the financial sector in the ASEAN 5, in %

ASEAN 5	Assets of deposit money banks Total financial assets			Assets of deposit money banks % of GDP			Assets of otherfinancial institutions % of GDP			Assets of insurance companies % of GDP		
	1994	1997	2001	1994	1997	2001	1994	1997	2001	1994	1997	2001
Indonesia	89	n.a.	n.a.	51	58	49	n.a.	n.a.	n.a.	3.8	5.1	n.a.
Malaysia	65	64	69	79	115	117	39	52	44	10.9	12.4	17.9
Philippines	65	81	84	36	65	56	7	6	4	5.0	5.8	6.0
Singapore	n.a.	n.a.	n.a.	93	110	137	13	13	9	16.0	20.0	38.9
Thailand	89	79	73	89	118	99	10	15	24	5.3	5.3	n.a.

Source : Asian Development Bank

Direction for Reforms:

Ü ***Enact a law on personal equity retirement account (PERA).*** A law on personal equity retirement account must be enacted to provide an alternative financial instrument and augment non-bank savings.

Ü ***Amend the Insurance Code.*** Provisions of the Insurance Code which prevent the expansion of the industry must be amended. The tax structure of the industry must also be reviewed.

Ü ***Manage pension systems efficiently.*** In the absence of an institutionalized pension and retirement system, the two largest state-owned insurance companies, the Social Security System (SSS) and Government Service Insurance System (GSIS) must be made solvent and managed properly to contribute to investments growth.

Ü ***Update the Investment Corporation Act.*** The Investment Corporation Act that govern mutual funds must be updated to allow the expansion of growing investment companies, and rationalize the regulation of the industry.

Ü ***Ensure efficiency in regulating corporations.*** Current legislations must be reviewed to assess the weaknesses in regulating Philippine corporations. Reforms must be geared towards providing more protection to stockholders that include the appointment of outside or independent directors, and mandating board of directors to protect the interest of minority shareholders.

Ü ***Disentangle banks from corporations.*** This will prevent connected or syndicated lending and prohibit corporations from relying excessively on domestic credit. This can be done through efforts to strengthen bank regulations such as tightening disclosure requirements.

Second Pillar:
Creating a Better Business Environment

Improving the investment environment in the Philippines does not only require establishing a sustainable fiscal position. It embodies a climate that makes business less costly and employs measures that improve productivity. Infrastructure plays a crucial role in minimizing costs for business. Public infrastructure spending of the country is less than 3 percent of GNP, one of the lowest in the region. The country's paved roads density is one of the lowest as well, while electricity rates are among the highest in the region. Productivity, which has much to do with technological innovations and the application of research and development, has also been insufficient. Lastly, the unpredictable regulatory regimes have been weak and bureaucratic, further hampering business initiatives.

A. Infrastructure Development

An efficient infrastructure system is a key factor in a country's economic development because it facilitates the movement of goods, services and people. By opening up new markets, infrastructure systems induce economic activity and are crucial inputs to enhance economic productivity.

In an archipelagic country such as the Philippines, infrastructure development is critical to growth given the wide disparity in incomes and growth rates in various regions across the country. There is positive evidence to link trends in regional economic performance to patterns of investments in transportation infrastructure. It is therefore imperative to interconnect geographic spaces to allow a system of shared growth across the country.

Given the limited amount of public resources, government must focus on prioritizing critical infrastructure undertakings in the countryside and identify those that can be better provided by the private sector. In particular, government can focus on measures which will bring down exorbitant transportation costs, particularly sea transport, and improve the flow of inter-regional trade. Ironically for an archipelagic country, there is a distinct lack of ports and players in the shipping industry. Given the current costs of shipping in the country, it is actually cheaper to source goods from other countries such as Thailand and Singapore, compared to transporting them from domestic ports such as Cagayan de Oro and Davao.

Table 11 below provides the current international and domestic shipping rates in selected major ports.

Table 11. Selected International and Domestic Shipping Rates, Phils. (2004)

Route	Distance (Nautical Miles)	Cost (US$ per Nautical Miles)
Manila - Kaoshiong	547	0.55
Manila - Hong Kong	633	0.39
Manila - Singapore	1,308	0.27
Manila - Bangkok	1,485	0.40
Manila – Jakarta	1,308	0.41
Manila – Cebu	392	0.54
Manila - Cagayan de Oro	504	0.61
Manila - Zamboanga	512	0.61
Manila - Gen. Santos	723	0.43
Manila – Davao	892	0.97

Source: Philippine Shippers Bureau; Domestic Shipping Association

Increasing investments in rural infrastructure is similarly important to increase productivity and promote social equity. It is estimated that more than two-thirds of families living below the poverty line are found in the rural sector and engaged in agriculture and other agri-related industries (Refer to Table 12). Improving the productive capacities of rural areas through the provision of critical infrastructure facilities such as farm-to-market roads, irrigation, and post-harvest facilities will go a long way towards encouraging development in the regions and improving the lives of millions of poor Filipinos living in the provinces.

Table 12. Magnitude of Poor Families

		Urban		Rural	
	Total Poor Families	Poor Families	% of Total	Poor Families	% of Total
1988	4,230	1,199	28	3,032	72
1991	4,781	1,848	39	2,933	61
1994	4,531	1,522	34	3,009	66
1997	4,511	1,208	27	3,303	73
2000*	5,140	1,494	29	3,646	71
2000**	4,339	1,122	26	3,217	74

Note: * old method
** new method
Source: Templo, Philippine Development Context and Challenges, 2003

Direction for Reforms:

Ü ***Ensure efficient management of public funds for rural infrastructure.*** Rural infrastructure undertakings should be prioritized considering the significant contribution of agriculture to the economy and given that private investments have been minimal due to low returns and high risks. Bureaucratic coordination between the various agencies handling agriculture such as the DA, NIA, DENR, and DAR is necessary in order to maximize the limited resources available to the government. Likewise, the Department of Agriculture must be re-engineered to change the commodity-based organizational structure of DA and its attached agencies, and reorganized according to their basic functions. The decentralization must also be completed to allow for better coordination between the DA central office and the LGUs.

Ü ***Promote transparency in project bidding and implementation.*** The build-operate-transfer (BOT) mechanism must be made transparent so as to prevent unsolicited projects that are costly to the government because of attached guarantees.

B. Power Sector Development

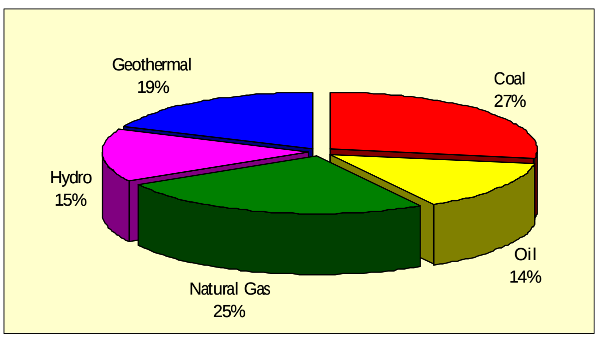
The high cost of electricity (Refer to Table 13 below) in the Philippines has been discouraging foreign investors. This is due mainly to the expensive generation mix of the country's energy supply which relies heavily on coal and oil (See Figure 10). Changing this mix, however, requires huge capital investments that necessitate greater participation of private investors in the energy sector.

Table 13. Cost of electricity across selected Asian countries, (US cents/kWh)

Country	Residential	Commercial	Industrial
Japan	13.05	13.05	13.05
Singapore	11.70	7.82	7.42
Cambodia	10.86	16.24	16.24
Hong Kong	10.48	12.48	14.07
Brunei	10.30	7.66	7.66
Philippines	9.12	9.33	8.09
South Korea	8.29	8.29	8.29
Myanmar	7.73	7.73	7.73
Malaysia	6.42	5.90	4.41
Vietnam	4.57	6.19	2.44
China	4.50	7.40	6.30
Thailand	3.55	2.40	2.38
Indonesia	3.92	4.07	2.36
Laos	0.71	1.17	0.79

Source: Department of Energy

Figure 10. Philippines' Energy Generation Mix, 2003



Source: Department of Energy

Another important concern in the power sector is the imminent power crisis in Visayas and Mindanao (Table 14). The Visayas grid, including Leyte-Bohol, Cebu-Negros and

Table 14. Philippine Power Supply and Demand Forecast (MW)

Island Grids		2004	2008	2013
Philippines	Supply	13,403	13,338	12,348
	Demand	9,134	12,203	17,240
Luzon	Supply	10,520	10,520	9,660
	Demand	6,937	9,322	13,280
Visayas	Supply	1,423	1,358	1,228
	Demand	1,085	1,468	2,097
Mindanao	Supply	1,459	1,459	1,459
	Demand	1,111	1,412	1,863

Source: Department of Energy

Negros-Panay interconnection projects, requires P30 billion, while Mindanao requires about P55 billion in investments to prevent an impending power shortage in 2005[2]. Luzon still maintains excess capacity but will have to infuse an additional capacity of 150 megawatts (MW) or P357 billion in investments to prevent a power crisis by 2008. The government's current financial condition makes it very difficult for it to invest in expanding the country's generation and transmission infrastructure, thus making it imperative to encourage greater private sector participation in the power industry.

Direction for Reforms:

Ü ***Strengthen the regulatory framework of the energy sector.*** This means giving the Energy Regulatory Commission (ERC) fiscal autonomy and independence to make its own decisions, and assurance of minimal intervention from other sectors of the government.

Ü ***Rationalize generation rates.*** The country's artificially low generation rates have also been seen as a deterrent to private investment in the power industry. The country's power rates should

2 Report of the Department of Energy to the Joint Congressional Power Commission, October 2003.

gradually be brought in line with the true cost of power and allow generation companies to realize a reasonable rate of return.

Ü ***Develop new, renewable energy sources.*** The country must begin exploring alternative sources of electricity such as biomass, solar, wind, hydro, geothermal and ocean energy or hybrids of such. The Senate can help DOE accelerate the process by passing the ***Renewable Energy Bill*** in the Senate.

Ü ***Accelerate open access.*** The Senate must re-evaluate and possibly revoke the requirement under the EPIRA regarding open access that is contingent on the 70 percent privatization of NPC generation capacity. If this is not possible, then the government must act swiftly to privatize the 32 remaining power plants in order to reach the 70 percent capacity requirement.

Ü ***Re-examine vertical mergers and cross-ownership***. Cross-ownership could lead to uncompetitive practices to the detriment of the end consumers when distribution companies are allowed to buy electricity from allied generators and discriminate against rival generators.

C. Regulatory Concerns

An efficient regulatory environment is critical in attracting investments necessary to generate employment and encourage productivity. The Philippines is considered to have a restrictive regulatory regime for setting up businesses, hiring and firing workers, enforcing contracts and closing a business. A productive regulatory environment should allow the easy entry and exit of players in the market. In the Philippines, it takes an average of 40 days (it takes only 2 days in Australia) and 11 procedures to start a business[3]. With regard to the orderly exit of investors particularly on occasions of bankruptcy, the proceedings are deemed outdated and tedious, and these encumber them to recover their investments.

Another critical aspect of creating an efficient regulatory environment is the proper definition and protection of property rights. Businesses must also be protected from unfair trade practices that lead to market inefficiencies such as monopolies and/or oligopolies. This particular reform area has to be strengthened particularly in the ports, airports, shipping and telecommunications industry. It does not help that in some industries, government participates both as regulator and owner.[4]

Direction for Reforms:

Ü ***Minimize corruption through streamlining of government regulations***. Streamline government regulations to increase bureaucratic efficiency and minimize costs and corruption involved in setting up businesses.

3 Peter Wallace, "Keep It Simple, Stupid!" BusinessWorld OnLine, July 29, 2004. This article was based on the World Bank study on business regulations entitled, "Doing Business in 2004: Understanding Regulations."

4 Enrico Basilio, "Competition at the Manila Ports," The TAPS Project –PHILEXPORT / USAID/PIDS, August 16, 2004. Manila, USAID.

Ü ***Enact the Corporate Recovery Law.*** The government must simplify corporate insolvency proceedings while providing different methods that suit the interest of investors. Thus, a ***Corporate Recovery Law*** must be passed.

Ü ***Enact a comprehensive competition policy.*** Establish a comprehensive competition policy that diffuses the control of a few players and encourages private investments particularly in capital-intensive industries. This policy should properly define monopolies and oligopolies and anti-competitive behavior, clarify penalties and sanctions and establish a regulatory body that can efficiently implement the competition policy. Considering the intricacies innate in developing a competition policy, government must start the process.

Ü ***Liberalize further the public utilities sector***. There is a need to further liberalize the shipping, ports, air transportation and cargo service, and telecommunication services.

1. For the shipping industry in particular, the government must review the existing cross-subsidization (between the cargo shipping services in favor of the third class passenger services) and the return on investment (ROI) and revenue deficiency method requirement for new shipping operators or investors.

2. The mandate of PPA to operate and regulate ports must be delineated. Also, local governments must be given autonomy over the operations of their respective ports which can be achieved with the creation of autonomous port authorities (APAs). This would increase competition in port operations by allowing APAs to compete against each other.

3. For air transportation, there is a need to assess the impact of granting "pocket open skies", particularly in Clark and Subic and how these have served to improve air traffic. Given the country's strategic location as a gateway to the Asian continent, regional development can be pursued by developing the country as a cargo hub. Air transport policies must also be assessed and designed towards improving the tourism industry.

4. Finally, the country should maximize the potential of Voice-Over-Internet-Protocol (VOIP) service. VOIP rights must not be made exclusive to telephone operators. Rather, they must also be extended to internet service providers (ISPs) in order to improve competition and effectively bring down communication costs. The National Telecommunications Commission must also be empowered to review interconnection charges to prevent overpricing by dominant players.

D. Technology Management

The Philippines' overall record in terms of science and technology has been poor. The Philippines performed quite poorly in terms of research and development expenditures, science and engineering manpower, patents and the Technology Achievement Index. The only technology indicator in which the country does excellently is in terms of high technology exports.

The Philippines does not invest enough in research and development activities. A country needs to spend a minimum of one percent of GDP per year on research and development in order to have a significant impact on the level of development (UNESCO). From 0.22 percent in 1992, the Philippines spent a measly 0.15 percent in 1996 as shown in Table 15.

Table 15. Research & Development Expenditures of Selected Countries

Country	R&D Expenditures as % of GDP
South Korea (1996)	2.82
Japan (1996)	2.80
USA (1997)	2.61
Australia (1996)	1.80
Singapore (1995)	1.13
New Zealand (1995)	1.04
Hong Kong (1996)	0.61
Malaysia (1996)	0.24
Philippines (1996)	0.15
Thailand (1996)	0.13
Indonesia (1994)	0.07

Source: UNESCO Statistical Yearbook 1999
Survey on National R&D Expenditures and Manpower

The Philippines also suffers from a huge deficiency in terms of science and technology manpower. In 2002, the country had only 160 scientists and engineers per million population engaged in research and development (See Table 16), a figure way below those of its neighbors.

Table 16. R&D Personnel of Selected Countries (1988-2002)

Country	Scientists and engineers in R&D (per million population)
Japan (2000)	5,095
USA (1997)	4,099
Singapore (1995)	4,140
Australia (1998)	3,353
South Korea (1999)	2,319
New Zealand (1997)	2,197
China (2000)	545
Viet Nam (1995)	274
Indonesia (1988)	182
Philippines (2002)	160
Malaysia (1998)	160
Thailand (1997)	74

Source: World Bank, World Development Indicators 2003

Mani's (2002) survey of US Patent and Trademark Office (USPTO) data indicates that the country has been lagging very far behind its neighbors in terms of patent applications. These data further reveal that most of these patents are secured by affiliates of transnational corporations in the country. In 2001, the Philippines only recorded seven patents granted by the USPTO compared to 24 by Thailand, 39 by Malaysia and 304 by Singapore.

As far as local patents are concerned, the Philippines has not been faring well either. The number of patents for inventions has been decreasing in recent years. In the 1990s, the Philippines averaged 28.6 inventions per year while from 2000 to 2002 the country only had 10 new inventions a year. Furthermore, the majority of new patents are either for utility models or industrial designs.

Table 17. Technology Achievement Index of Selected Countries, 2000

Country	TAI Value	TAI Rank
United States	0.733	2
Japan	0.698	4
South Korea	0.666	5
Singapore	0.585	10
Malaysia	0.396	30
Thailand	0.337	40
Philippines	0.300	44
China	0.299	45
Indonesia	0.211	60
India	0.201	63

Source: National Science and Technology Plan 2002-2020. DOST

The Philippines also performed quite poorly with regard to the Technology Achievement Index (TAI) scoring 0.300 and ranking 44th among 70 countries as shown in Table 17.

The TAI is a composite measure of various technological indicators which includes tech-nology creation (measured through patents and royalty fees), diffusion of recent and old technology (in terms of per capita internet hosts, telephones and electricity consumption and high tech exports) and human skills (mean years of schooling and tertiary enrollment in science, mathematics and engineering).

Nevertheless, the Philippines continues to be a world leader in the export of high technology products. These exports, mostly computing and office equipment and electronics and telecommunications comprise 71 percent of the country's total exports. Among ASEAN countries, Singapore's 59 percent and Malaysia's 54 percent, are the closest competitors.

Direction for Reforms:

Ü ***Prioritize the research agenda.*** The government needs to review the allocation of the meager research budget. Key areas such as agriculture, fisheries, manufacturing and process engineering should definitely receive attention. Nascent sectors in which the country could have a competitive edge, such as information and communication technology, should also get a share of the research budget. Even within the identified priority areas, research and development expenditure should also be rationalized.

Ü ***Provide a more attractive tax incentive scheme.*** A straight forward tax incentive should be adopted in order to encourage private sector to commit more resources to R&D. Mani (2002) for example proposes the deduction of the firm's actual R&D expense from their taxable income.

Ü ***Strengthen the governance and institutional framework of the science and technology system.*** Government research agencies and institutions have to be synchronized and rationalized to make research more efficient. In agriculture, for example, the Bureau of Agricultural Research (BAR), Philippine Council for Agriculture, Forestry, Natural Resources, Research and Development (PCAARD), Philippine Council for Aquatic and Marine Research and Development (PCAMRD), and State Universities and Colleges (SUCs) have overlapping functions and sometimes divergent research goals.

Ü ***Improve science and technology education.*** Increasing investment in science and technology education is the most crucial investment to spur and sustain long-term growth.

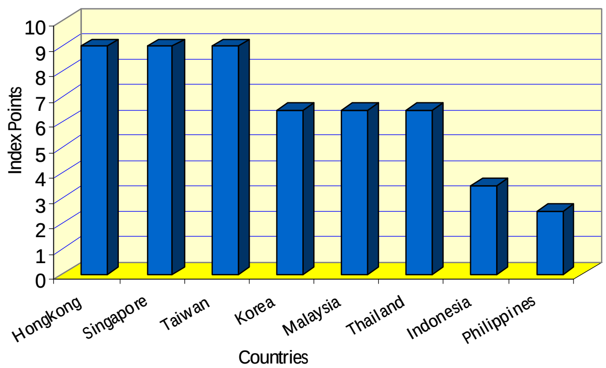
Ü ***Manage technology transfer, utilization and commercialization.*** There is a need to establish strong linkages between the research agencies and the end-users.

THIRD PILLAR:
Establishing Good Governance and Strong Institutions

The relationship between governance, institutions and economic growth has long been argued. With increased pressure to create efficient markets and attract investments, governments are now compelled to build better institutions and to incorporate good governance in policy and program implementation. However, developing institutions remains a challenge for the Philippines as its growth path is continually hampered by unpredictable policies, vested interests, red tape, corruption and an inefficient bureaucracy. Thus, the Philippines has been perennially labeled as a ***weak state*** (McCoy, 1994; Hutchcroft, 1998).

An Asian Development Bank (ADB) study showed that compared to some of its Asian neighbors, the Philippines is tailing behind in terms of economic governance. Based on Figure 11 , both Indonesia and the Philippines scored less than 5 points with the former garnering 4 points and the latter having a mere 3 points. Because this index serves as a guide to potential investors, one can say that a very low score for the country translates into foregone investments.

Figure 11. Index of Good Economic Governance



Source: **International Country Risk Guide cited in an Asian Development Bank Study, 2002** [5]

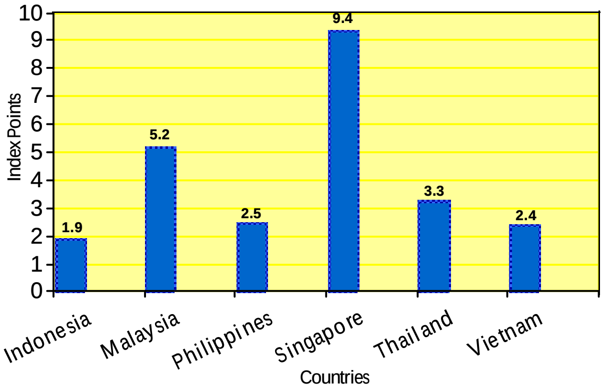
Perhaps the most striking evidence of the nexus between institutions and the economy is the result of recent research demonstrating that corruption leads to lower capital inflows and lower productivity. Specifically, according to a recent report by Transparency International[6], corruption may deter foreign investors because it is often associated with a lack of secure property rights as well as bureaucratic red tape and mismanagement. In recent years, the country's corruption record is alarming. In 2000, the Office of the Ombudsman published a report estimating that $48 billion was lost to corruption in the last 20 years. Likewise, the

5 The ADB study, "Growth and Poverty: Lessons from the East Asian Miracle Revisited" by M.G. Quibria cites the 1995 study of S. Knack and P. Keefer which compiled the above index from a set of surveys done by the International Country Risk Guide, a publication of the PRS Group, an international business publisher which provides financial, political and economic risk ratings for 140 countries since 1980.

6 Transparency International is a Berlin-based non-governmental organization that seeks to curb corruption all over the world.

Philippines, along with Indonesia and Vietnam, ranks low in the 2003 Corruption Perception Index (CPI) compared to some of its ASEAN neighbors. (See Figure 12)

Figure 12. Corruption Perception Index, ASEAN Selected Countries, 2003



Note: The Corruption Perception Index (CPI) is the result of surveys done by Transparency International, a non-governmental organization dedicated to curbing corruption. The surveys relate to perceptions of businessmen, academics and risks analysts with regard to the degree of corruption in a specific country. The index ranges between 10 (highly clean) and 0 (highly corrupt).

Other factors that reveal the weakness of the country's institutions affect the economy. The persistence of extraordinary leadership change (or at least similar plans) in the face of EDSA 2 and the failed EDSA 3 has earned the country the label ***mob democracy*** as some members of the international media have claimed. Along with this, military adventurism remains a threat in the post-Marcos Philippines. Other political uncertainties brought about by legislative-executive gridlock, perceived high levels of corruption and electoral fraud, and peace and order problems threaten the peso-dollar rate and the stability of the market, thereby making the economy more vulnerable. Some have blamed this malaise in the 1987 Constitution's design which accordingly is not only prone to gridlock but also allows little room for institutionalized leadership change except every six years.

Thus, the overarching thesis of the reform effort is to transform the ***weak state*** into a responsive state not only to the market but also to the underprivileged. To be able to achieve this, the four interrelated principles of good governance, namely: ***transparency, accountability, predictability*** and ***participation*** must be the themes that run through the reform effort. The assumption is that institutions and their concomitant processes and policies that are transparent, accountable, predictable and participatory produce dual effects. They create an enabling environment for markets to work efficiently and contribute to sustained growth. Also, they empower the vulnerable and transform them into stakeholders of growth. Four key areas of reform are proposed below with the corresponding interventions. Though the list is by no means exhaustive, this is a good take-off point for making Philippine institutions work better for the economy.

Direction for Reforms:

1. Strengthen the Bureaucracy

Ü ***Re-engineer the bureaucracy by rationalizing the functions of agencies***. As of 2001, there are more than 1.5 million government employees. It is interesting to note that still, a huge bulk (1.2 million) of these are national government employees. This despite more than a decade since the Local Government Code of 1991 has devolved the functions of a number of government agencies and years after the country has embarked on liberalization and deregulation efforts. At present the weaknesses in the institutional structure of governance (e.g. overlapping, overstaffing and fragmentation of responsibilities across agencies) have caused rent-seeking and incoherence in government policies and programs. Thus, there is a need for Congress to give the President the mandate to re-engineer the bureaucracy. However, an adequate separation and benefits package must be ensured for the employees that will be displaced by a re-engineering program.

Ü ***Amend the Civil Service Code***. Merit and fitness should be the foundation of a strong bureaucracy. As the bureaucracy's human resource agency, the Civil Service Commission (CSC) is hard put to implement this as it is continually hampered by antiquated issuances and political influence. As such, there is a need to consolidate and update the legal framework pertaining to the CSC to strengthen its mandate. Moreover, this measure seeks to depoliticize the bureaucracy by empowering the CSC to oversee the appointment and discipline of public employees that have ranks below assistant secretary. This also limits the political appointments of civil servants.

Ü ***Review the Salary Standardization Law (SSL)***. According to the World Bank, the salaries of senior civil servants are as little as 20 percent of private sector equivalents. Meanwhile senior officials of public enterprises who managed to be exempted from the SSL receive remunerations that are many times higher than their counterparts in line agencies, causing distortion in the public sector compensation system. As such, a review of the SSL must be geared toward making public sector salary more competitive and performance-based. Performance contracts, for instance, may be explored to rationalize the existence of some agencies and as a basis for a more flexible salary scale. Though a more competitive pay does not automatically reduce corruption, it encourages people to play by the rules and attracts the so-called best and the brightest in the public sector.

2. Improve the Delivery of Basic Services

Ü ***Strengthen the oversight function of Congress***. As a means to ensure that laws are effectively implemented by the Executive Branch, enhancing legislative oversight by strengthening the committee system of Congress and its support services, better equips legislators in seeing to it that corruption and inefficiency do not hamper the provision of basic services.

Ü ***Pass an integrated identification system for efficient service delivery***. This system seeks to integrate public transactions with various agencies (NBI, LTO, GSIS, SSS, BIR, DFA, etc.) into one identification card. Not only will it facilitate and make efficient the delivery of vital services, it will also reduce the probability of so-called "fixers" since faster transactions discourage people from hiring their services.

3. Ensure Enforcement of the Rule of Law

Ü ***Support reforms in the judicial system.*** An independent judiciary is a strong pillar of a democratic state. Furthermore, a penal system that sends the signal that criminality must pay and that contracts are consistently enforced ensures the maintenance of the rule of law. This in turn entices foreign investors to bring their businesses and create jobs in the country. Thus, reforms under the Action Plan for Judicial Reform (APJR) that have been initiated should be ensured continued budgetary support by Congress.

Ü ***Consider the recommendations of the Feliciano Commission***. The Feliciano Commission outlines a number of reforms that Congress may consider in both its legislative and appointive functions so as to prevent episodes of military adventurism. In particular, it recommends that a civilian be appointed to the Department of National Defense to institutionalize the supremacy of civilian authority over the military. It also proposes the creation of the AFP Service and Insurance System in place of the AFP Retirement System and Benefits Service (RSBS).

Ü ***Amend the Ombudsman Law (RA 6770).*** To strengthen the Ombudsman's mandate in curbing corruption, amendments to RA 6770 should be pursued. It should create an investigation unit that will investigate not only graft cases but also lifestyle checks patterned after the Independent Commission Against Corruption (ICAC) in Hong Kong. To further enhance the capability of the agency, it is necessary to increase the number of investigators and prosecutors, and authorize the agency to hire private lawyers to help them prosecute cases.

Ü ***Enact a whistleblower's protection act.*** This measure expands the coverage of the Witness Protection Program by including whistleblowers or those who expose government irregularities. It not only provides that evidence presented be handled with utmost confidentiality but also frees whistleblowers from criminal and civil prosecution in the event of reprisal by the accused.

4. Institute Political and Electoral Reforms

Ü ***Develop genuine political parties***. Political parties must be made viable institutions of democracy as a vital link of the public to the political system. Issue-based platforms rather than personalities must be their hallmark. In the Philippines, the lack of genuine and issue-based political parties has been a perennial concern. To correct this, strengthening political parties must consist of a ban on political turncoats and regulation of party activities. Government support for parties should also be examined as part of efforts to democratize access to the political process.

Ü ***Institute campaign finance reforms.*** Money politics is at the root of corruption and patronage. The lack of transparency in campaign donations and expenditures cripples the public trust in electoral contests and institutions. This measure will seek to correct this malaise. Government support to parties will reduce ill effects of money politics.

Ü ***Pursue COMELEC reorganization and review the Omnibus Election Code***. In anticipation of the much delayed automated elections, there is a need to re-organize the COMELEC to strengthen its capability to deal with a modernized electoral process. Likewise, electoral laws that are still designed for manual elections (write-in system, e.g.) must be reviewed to make them consistent with the modernization of the electoral process.

Ü ***Review the 1987 Constitution***. There is a need to objectively study the merits of this proposal to change the present presidential-unitary set-up to a parliamentary-federal system so that legislators and the public would have an informed opinion about it. This must be accompanied by a nationwide civic education campaign on the Constitution and the proposed revisions in the light of surveys done by Pulse Asia which indicate that eight out of 10 Filipinos have not read the Charter.

FOURTH PILLAR:
Instituting Social Reforms to Improve Equity

Economic growth alone cannot sufficiently address the issue of inequitable distribution of wealth. According to development literature, a growth that is broad-based and beneficial to the poor leads to a greater decline in poverty. Economic policies should be complemented with the appropriate social reform policy interventions which empower the individual to be productive agents in the economy, and ultimately, in society. Empowering individuals is in itself an opportunity to improve the distribution of wealth in the country. One reason why the poor people remain in their state and are continuously being left behind is their inability to take advantage of the opportunities offered by economic progress.

With limited education and limited access to health services, the poor are not adequately prepared to engage productively in society. Empowering the poor is a necessary ingredient of development, and gives them equal chances in participating in the economic development process. Human capital assets are considered an important factor in the pursuit of sustained economic growth. Empirical studies have shown that improved human capital contributes to increased economic development. Countries with well-trained and healthy workforce do experience increased labor productivity that attracts foreign investors. Foreign investors tend to locate their businesses in areas where a competent labor force is present. In effect, investments in human capital translate to probable increases in financial capital. For a country which has lagged behind other Southeast Asian countries in attracting foreign investments, improving and enhancing its labor force's competencies potentially increases the Philippines' competitiveness. It is in this context that social reforms must be adopted. Economic policies should be complemented with the appropriate social development policies to ensure that a balanced development outcome is achieved. In pursuing social reforms, it is suggested that a comprehensive approach to human development be implemented.

A comprehensive approach to human development means more investments in education, health, housing and other human capital services. Apart from the provision and increased access to social services, a comprehensive human development approach involves reforms directed to address the security aspect of the individual's livelihood and employment. Reforms in the area of expanding access to land and labor opportunities protect the poor from possible unanticipated income shocks.

Government expenditures in the social services sector have been above the 20 percent level (as a percentage of total government expenditure) throughout the different administrations sincce 1975 (See Table 18). This level of government spending on the social sector is consistent with the 20/20 initiative[7] of developed and developing countries in ensuring equity through a fixed budgetary allocation for social services.

Likewise, it should be noted that among social services, the education sector has traditionally received the most resources. (See Table 19) This signifies the importance given by all administrations to education.

Despite this level of government expenditure on social services, recent trends seem to indicate that such government commitment to the sector is slowly decreasing. In the last four years, budgetary allocations for social services have been declining. According to the study of Manasan (2003), national government expenditures for social services decreased to 22.20 percent as a

Table 18. Percent Distribution of National Government Expenditures, By Sectoral Classification, 1975-2004

	1975-1985 (Marcos)	1986-1992 (Aquino)	1993-1998 (Ramos)	1999-2000 (Estrada)	2001-2004 (Arroyo)
Total Social Services	19.97	20.71	24.12	25.32	22.42
Total Economic Services	42.27	24.16	20.85	18.82	14.06
National Defense	12.46	7.13	6.16	5.54	5.08
Total Public Services	10.72	12.17	14.48	13.25	12.53
Others	5.21	6.34	14.46	17.50	18.29
Debt Service	9.38	29.49	19.97	19.57	27.61

Source: **Manasan (2003)**

Table 19. Percent Distribution of National Government Expenditures for the Social Services Sector By Average Years and Administrations

	1975-1985 (Marcos)	1986-1992 (Aquino)	1993-1998 (Ramos)	1999-2000 (Estrada)	2001-2004 (Arroyo)
Total Social Services	19.97	20.71	24.12	25.32	22.42
Education	12.51	14.72	17.41	17.96	16.33
Health	4.02	3.73	2.56	2.33	1.74
Social Security, Welfare and Employment	1.06	1.55	3.49	4.06	4.11
Housing	2.39	0.71	0.67	0.98	0.25

Source: **Manasan (2003)**

7 The 20/20 Initiative calls for the allocation of at least twenty percent of a country's national budget to social services. The Initiative was endorsed by the World Summit for Social Development in 1995.

percentage of the total budget in 2003 from 24.31 percent, 22.63 percent, and 22.89 percent in 2000, 2001, 2002 respectively. Investments in human capital are suffering because of the fiscal problems of government. Government's decreasing budget for the social sector is a cause for concern.

A. Prioritizing Social Reforms

Given that social reforms are important ingredients in achieving the goal of sustained economic growth and that the present financial capacity of the government is constrained by fiscal position problems, there is then a need to prioritize social reform interventions. This prioritization means concentrating government efforts to social reform measures which will give the highest contribution to the objective of sustained high economic growth.

B. Education Sector

The education sector's important contribution to development is based on the assumption that a better educated or trained worker would be more flexible and productive. Similarly, an educated populace, particularly the poor, can better take advantage of any economic opportunity that may arise due to progress. Given this premise, it is therefore important that reforms be made to make quality education and training accessible.

At present, the provision of quality education and training is beset with several challenges that need to be addressed.

The dismal performance of students in the National Elementary Assessment Teast (NEAT) and, National Secondary Assessment Test (NSAT) and the National Achievement Test (NAT) in English, Math and Science competencies reflect the deteriorating quality of Philippine education. According to the National Educational Testing and Research Center of the Department of Education, for the school year 2000-2001 students from public schools got mean percentage scores[8] of 51.39 and 51.91 in the NEAT and NSAT respectively. Similarly, students from private schools did not fare much better and got mean percentage scores of 55.40 in the NEAT and 57.52 in the NSAT.

In the National Diagnostic Tests held last June 2002 by the Department of Education, which tested Grade 4 students for grade 3 competencies and First Year students for Grade six competencies, Grade 4 students got 40 percent of total as correct answers while First Year students got 28 percent of total as correct answers. This deterioration in quality is brought about by the inadequacy of textbooks, classrooms and chairs; the low quality of teaching and learning; weak educational foundation during childhood; and uneven distribution of teachers across regions.

Another issue that needs to be addressed is the high drop out rate in elementary and high school. Less than 70 percent of Grade 1 entrants actually graduate from Grade 6 and less than half of Grade 1 entrants complete high school.

8 The Department of Education defines mean percentage score as the ratio between the number of correctly answered items and the total number of test questions or the percentage of correctly answered items in a test.

Table 20 below shows cohort survival, completion and drop out rates in elementary and high school in the Philippines.

Table 20. Basic Education Indicators, in %

Indicators	SY 99-00	SY 00-01	SY 01-02
Participation Rate			
Elementary	96.95	96.77	94.54
Secondary	65.43	66.06	1.06
Cohort Survival Rate			
Elementary	69.48	67.21	67.13
Secondary			
Based on Grade 1	48.68	49.76	49.86
Based on First Year	72.08	73.05	73.16
Completion Rate			
Elementary	68.38	66.13	66.33
Secondary			
Based on Grade 1	47.20	48.10	48.39
Based on First Year	69.89	70.62	71.01
Drop Out Rate			
Elementary	7.72	7.67	n.a.
Secondary	9.55	8.50	n.a.

Source: Department of Education, (Factsheet as of Sept. 27, 2004)

Investment in education is also low when compared to other countries. The Philippines' total public expenditure on education as a proportion of GDP is just 3.2 percent while Thailand spends 5 percent, Malaysia 7 percent and India 4.1 percent of GDP (Please refer to Table 21 below).

Table 21. Education Expenditure Comparison

Country or Territory	Public expenditure per student as a % of GDP per capita			Total public expenditure on education	
	2001/2002				
	Primary	Secondary	Tertiary	% of GDP	%of gov't exp.
Philippines	11.8	9.4	13.9	3.2	14.0
Rep. of Korea	17.2	16.9	7.4	3.6	17.4
Thailand	15.9	13.0	31.1	5.0	28.3
Malaysia	17.0	27.6	83.5	7.9	20.0
Bangladesh	8.3	13.4	42.5	2.3	15.8
India	13.7	23.0	85.8	4.1	12.7
Japan	22.1	21.8	17.5	3.6	10.5
United States	21.1	23.9	26.5	5.6	15.5

Source: World Education Digest, 2004

More than the problem of access, the government must prioritize completion and quality of the country's basic education.

Direction for Reforms:

Ü ***Review the Magna Carta for Public School Teachers*** to look for means to effectively deploy teachers in order to address the low pupil-teacher ratio in elementary and high school.

Ü ***Rationalize the public higher education sector*** by re-focusing the mandate of state universities and colleges based on area of academic and research expertise.

Ü ***Conduct a study on the special education fund of the LGUs*** focusing on the fund's efficient and optimum utilization.

Ü ***Address financial constraints to meet classroom and book shortages and teacher training.***

C. Health Sector

The performance of the Philippine health sector has produced encouraging results, most particularly since the implementation of the Health Sector Reform Agenda. Infant mortality rate was reduced from 57 in 1990 to 35 per 1,000 livebirths in 1998 while the children-under-five mortality rate also decreased from 80 per 1,000 live births in 1990 to 48 in 1998. Maternal mortality improved for the period 1991-97 at 172 per 100,000 live births compared to the maternal mortality rate for the period 1987-93 of 209.

Morbidity rates from infectious diseases such as malaria and tuberculosis (TB) have also improved (refer to Table 22). Life expectancy has also increased to 66.3 years for males and 71.6 for females in 2000. Although these figures suggest that the sector is unproblematic, studies have noted that the sector is financed inadequately. Similarly, health service delivery seemed to be unfocused due to the devolution provided for under the 1991 Local Government Code.

Table 22. Mortality and Morbidity Rates from Infectious Diseases, Philippines

Infectious disease		Mortality Rate (cases per 100,000 population)	Morbidity Rate cases per 100,000 population)
Malaria	1998	0.9	73
	1990	1.5	123
Tuberculosis	1995	39	***n.a.***
	1975	69	***n.a.***

Source: **Department of Health**

Direction for Reforms:

Ü ***Increase delivery of primary health care.*** There is a need to prioritize government immunization programs and social health insurance.

Ü ***Re-tool and re-train the health professionals.*** Health and program managers at the national, regional and local levels must update their leadership and management skills and knowledge given their new roles in the delivery of health care services devolved to local governments.

Ü ***Develop and strengthen the technical expertise of public health practitioners*** particularly on disease surveillance and epidemiology, health risk assessment, research, policy and standards development, project development, disease prevention and control, and health promotion.

Ü ***Improve the role of the local government in health care delivery and financing.*** Local governments should find ways to increase resources for health services and make delivery of health care services more efficient and effective.

Ü ***Adopt and implement priority programs and policies to improve maternal health that include information, education and communication (IEC) activities*** to encourage informed decisions and promote better health particularly among the urban poor.

D. Housing Sector

The provision of shelter is important as it positively affects an individual's predisposition to work and outlook in life. Shelter is an important asset of the poor which they are hesitant to part with even in times of economic hardships since it provides a sense of security, prestige and dignity. Access to decent shelter, however, has always been a problem for many Filipinos, especially in the urban areas. According to the estimates of the Housing and Urban Development Coordinating Council (HUDCC), a backlog of 3.6 million housing units is expected by 2004. As of October 2000, there has been an estimated 7.5 million informal settlers in key urban centers in the country, with 57 percent in Metro Manila. The lack of funding assistance and the private sector's reluctance to invest in low cost housing has been cited as reasons why the ***squatting problem*** has persisted.

Direction for Reforms:

Ü ***Prioritize government funding assistance.*** There is a need to focus government funding assistance to the low-income groups, particularly those availing the socialized housing packages worth P225,000 and below. It would be best to allocate such resources in the sector which do not attract much financial support. Similarly, with limited resources there is an urgent need to make subsidies well targeted.

Ü ***Encourage private sector investment in low cost housing***. Government should encourage the private sector to invest in the low cost and socialized housing. To maintain construction costs to a minimum and thus make investments in these sectors viable, the government can provide the private sector with technical assistance on low-cost housing technologies.

Ü ***Encourage community approach home-ownership***. Continue the community approach in home-ownership. Based on the experience of the Community Mortgage Program (CMP) of the National Home Mortgage Finance Corporation (NHMFC), this type of home-ownership is well-received by the poor as shown by their high amortization payment rate. According to NHMFC, the CMP which started in 1989 has averaged a 77.61 percent collection efficiency (as of June 2004).

E. Access to land

One of the primary objectives of the Comprehensive Agrarian Reform Program (CARP) is the promotion of social equity by transferring land property rights to farmers. Its successful implementation is hindered, however, by the slow land distribution process, land valuation, premature conversion of agricultural lands to residential and commercial uses, and limited access of farmers to credit.[9]

Another major stumbling block to the land reform process is the land valuation issue which springs from the country's inconsistent land laws and inadequacies in land management. Only recently has the formula for land valuation been revised effecting an increase in land values that are more tenable to landowners. The premature conversion and reclassification of lands have also deprived beneficiaries from owning land which is rightfully classified within the land reform program. Moreover, farmer's access to credit from formal sources has been limited primarily because the law prohibits land collateralization within 10 years from the awarding of titles.

Direction for Reforms:

Ü ***Allow farmers to use land as collateral.*** Enact a law that will allow land to be used as collateral in securing credit from formal lending institutions.

Ü ***Enact and implement a national land use policy***. Pass a comprehensive land use act that will delineate forest lands and agricultural land areas with proper consideration of the areas' supply and demand requirements and productivity trends.

9 Marideth Bravo and Blanquita Pantoja, "Beyond 2000: Assessment of the Economy and Policy Recommendations – Dealing with Agrarian Reform, Philippine Institute of Development Studies (PIDS), May 1998.

Ü ***Increase tax on idle lands.*** Provide disincentives for keeping land idle by increasing idle land taxes. This will help also minimize land ownership for speculative purposes and minimize conflicts among landowners and the government.

Ü ***Adopt a more acceptable land valuation system.*** Find a strategic formula for proper land valuation that will be acceptable to private individual landowners.

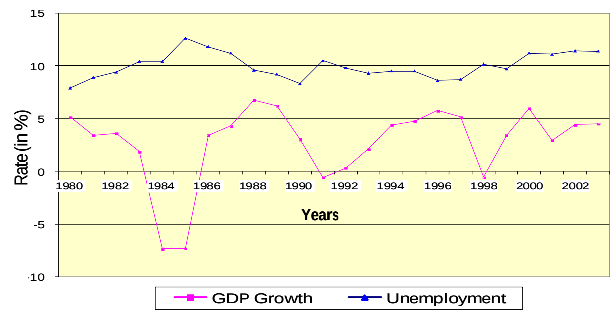
Ü ***Ensure efficient use of government funds.*** Review the mandates of the related government agencies to ensure efficient utilization of resources in delivering support services to farmers and agrarian reform beneficiaries.

F. Access to employment opportunities

Employment acts as a major route out of poverty because labor power is the principal, and most often than not, the only asset of the poor. Unfortunately, the Philippines' track record in employment creation over the years has been generally inadequate relative to its rapidly increasing labor force. As a result, unemployment rate has increased from 7.9 percent in 1980 to 11.4 percent in 2003 while underemployment remains at a high level of 17 percent.

Unemployment is particularly high among the young. In the April round of the Labor Force Survey this year, the 15- to-24-year-old bracket constituted more than half (50.7 percent) of the total unemployed. Moreover, unemployment is highest (43.2 percent) among those who only reached high school level. Understandably, the

Fig.13. Philippine GDP Growth Rates (%) and Unemployment Rate (%), 1980-2003



Source: National Statistical Coordination Board

young, less-experienced and less-trained people are more likely to be jobless than their older counterparts. Hence, government policies must be geared towards reducing the number of young people leaving school sooner. Keeping the youth in school will not only prepare them for a more productive future, it will also effectively lessen the number of people entering the labor market.

Table 23. Unemployment by Highest Grade Completed, April 2003-2004

Highest Grade	April 2003		April 2004	
	(in '000)	(in %)	('in '000)	(in %)
Total	4,217	100.0	4,989	100.0
No Grade Completed	68	1.6	100	2.0
Elementary	827	19.6	1,001	20.1
Undergraduate	402	9.5	469	9.4
Graduate	425	10.1	532	10.7
High School	1,827	43.3	2,156	43.2
Undergraduate	718	17.0	814	16.3
Graduate	1,109	26.3	1,342	26.9
College	1,494	35.4	1,732	34.7
Undergraduate	801	19.0	945	18.9
Graduate	693	16.4	787	15.8

Source: National Statistics Office

Tertiary education, however, does not guarantee a job with decent wage as 35 percent of the total unemployed today are college graduates. Several factors may explain this. One is simply the lack of jobs or when jobs are available, they are usually not in the fields of specialization where graduates were trained for. Students, or their parents, choose courses unaware of the current demands of the market and they find it difficult to land jobs in the future. The quality of tertiary education also matters as some college graduates are still deficient of the minimum competencies required at the time of job entry. Most fresh graduates fail to get hired over their lack of the minimum six-month job experience. Another kind of mismatch is "over-qualification" wherein college degrees are required even in the relatively less skill-intensive jobs.

These cases imply the need for improvements in the labor market information system and the forging of closer links between schools, training institutions and industry to provide job security. Government must be able to ensure favorable terms of employment and ensure that these job opportunities are made available to the skilled and productive individuals.

Direction for Reforms:

Ü ***Incorporate a six-month on-the-job training in the school curricula.*** This will expose the students to the rudiments of the real work environment and improve their employability as most of new graduates fail to get hired over their lack of experience. To improve the new graduates' chances of getting jobs, a six-month, on-the-job training can be included in the school curricula.

Ü ***Upgrade workers' skills and competencies***. Because of the high rate of obsolescence these days, it is important to put in place a program that will allow the retraining and upgrading of skills, particularly of the unemployed, to make them more responsive to the rapidly changing needs of the labor market.

Ü ***Promote a stronger public-private partnership in developing an effective labor market information system***. This would facilitate the determination of the supply of skills needed by the economy, shorten the period and reduce the cost of job search, and effectively lessen the job-skills mismatch. Direct government interventions in the labor market such as the Public Employment Services Office in every local government as well as private initiatives such as the Job Matching Radio Program, which regularly air job openings in different companies, must be encouraged.

Ü ***Review the system of providing retirement, disability and other social protection schemes to workers.*** Apart from the questions raised on the financial viability of GSIS and SSS, it is also important to widen the scope of social security coverage to better reach the informal sector.

Ü ***Amend the Labor Code of the Philippines.*** With the changing of the economic environment due to globalization, labor laws must also be more attuned to the current realities of the market. A thorough review of some Labor Code provisions, particularly those pertaining to Administration and Enforcement ***(Book III, Chapter VI Article 129)***, Powers and Duties of the National Labor Relations Commission ***(Book V, Chapter II, specifically Article 217),*** Greater Employment Flexibility with Appropriate Safeguards for Worker ***(Articles 106 to 109 of the Labor Code in relation to Articles 279, 280, 281***) and the State Insurance Fund ***(Book IV)*** must be conducted.

Fifth Pillar:
Managing the Environment

The pervasive and accelerating environmental degradation is one of the leading contributors to poverty. Poor environmental conditions caused by poor sanitation, air and water pollution undermine the ability of the country's poor to pursue economic opportunities. When a person becomes unable to anticipate, cope with and recover from the impact of calamities or natural disasters and health risks due to the degradation of the environment or depletion of the natural resources, he or she reduces his or her opportunities to improve the quality of his life and security.

Rapid environmental change can lead to special circumstances in the society, such as migration, urbanization, deterioration of the person's health condition, displacement of indigenous peoples or communities and lack of access to basic environmental services such as water. These changes put added stress on the lives of the people and those who already are deprived in many aspects of their lives. Indeed development specialists have recognized the strong link between economic activity and environmental change. This interaction became the basis of identifying economic (foregone opportunities/revenues), social (e.g. health, poverty), natural (loss of biodiversity) and institutional (conflicts in management) criteria for efficient management of resources. Needless to say, any poverty alleviation effort should work alongside a framework of growth that seeks to maximize social returns (quality of life) and minimize environmental costs. Hence, there is a need to integrate indicators of the economy and the environment more closely (World Bank, 2003).

State of Philippine Environment

According to the Environmental Outlook report of the Asian Development Bank (2001), environmental ***degradation in the Asia-Pacific region is pervasive, accelerating, and unabated***. This condition is now one of the leading contributors to poverty in the Asia and Pacific region. Further, inadequate health conditions caused by poor sanitation, drainage and air quality undermine the ability of the region's poor to pursue economic opportunities.

Recent indicators show that the Philippines' environment is no exception and its natural resources are now under considerable stress. The country has the second lowest supply of available water in Southeast Asia. Metro Manila generates the highest BOD[10] ***(biochemical oxygen demand)*** loading (water effluent) in the country, about 201,952 kg per day in 2000, of which 58.2 percent came from the food and beverage processing firms. A higher BOD level indicates that there is a greater number of organisms that are competing for available oxygen in the water. This shows that Metro Manila's waste water treatment system is unable to avert pollution of nearby bodies of water given its level of industrialization. Moreover, urban air pollution has led to health and productivity losses. Metro Manila alone generated 60 ***mcg***/ cu.M. of particulate matter (1999) and 33 ***mcg***/cu.M. sulfur dioxide (1998). The country's fish stocks are on the verge of depletion and our mangrove forests have decreased by 70 percent. Similarly, our biodiversity has diminished because of the increasing number of endangered species of flora and fauna, i.e. 212 in 1988 to 284 in 2000.

Today, only 5.4 million hectares of the 15.88 million hectares of the country's forestland remain covered with forests. Over-exploitation and inappropriate land use practices have disrupted the hydrological condition of watersheds, resulting in accelerated soil erosion, siltation of rivers and valuable reservoirs, increased incidence and severity of flooding, and decreasing supply of potable water (ADB, 2001). The contribution of forestry to GNP has declined considerably through the years. Overall, it lost 96 percent of its share of GNP over a 25-year period (See Table 24). Considering this trend and the degradation that happened to the forest resources, it is highly unlikely that forestry will ever regain its lost share of the GNP.

Table 24. Contribution of Forestry to GNP, 1975-1995

Year	% share of forestry to GNP
1975	2.48
1980	2.55
1985	1.97
1990	0.83
1995	0.14

Source: Rapera, 2003

The Philippine economy loses an average of P17 billion annually due to the depletion of the fish stocks brought about by unsustainable fishing methods (World Bank, 2003). The said depletion, coupled with increases in the fishing effort seriously threatens the long-term condition of our marine resources particularly the fisheries sector. Table 25 below shows the decline in fisheries production over the last eight years.

Table 25. Fisheries Production in MT, 1997-2004

Year	Production in Metric Tons	Change in Production (%)	Production Value (billion P)	Losses in billion P
1997	884,651	-	25.9	1.4
1998	940,533	6.3	29.7	1.6
1999	948,754	0.9	32.2	1.7
2000	946,485	-0.2	33.9	1.8
2001	976,539	3.2	36.1	1.9
2002	1,041,360	6.6	38.9	2.0
2003	1,045,316	0.4	41.4	2.2
2004	1,070,725	2.4	43.8	2.3
Ave.	956,387	2.8	32.8	2.0

Source: BFAR
****Losses due to siltation and sedimentation; Municipal (30%); Commercial (5%)***

10 BOD measurements are used to measure the organic strength of wastes in water. The greater the BOD, the greater the degree of organic pollution (WB, 2003).

The evident threat of environmental degradation and resources depletion should draw our attention to addressing management problems. To work for the efficient use and/or conservation and protection of the country's watersheds, forests and marine resources, the following reforms are recommended.

Direction for Reforms:

Ü ***Adopt and implement an integrated watershed management policy.*** Enact the Forest/Watershed Management Bill that gives way for a comprehensive and integrated approach of utilizing and managing our forests and mangrove areas. The integrated approach provides for a synchronized set of guidelines on how the competing uses of forestlands/watersheds such as agricultural and infrastructure development can be harmonized in order to achieve economic and environmental objectives. Likewise, critical watersheds and damaged habitats should be rehabilitated to arrest further degradation of resources.

Ü ***Enact a national land use policy.*** Adopt and implement a comprehensive land use policy to delineate what, when, where and how the private firms and the public should employ our natural assets. A national land use policy allows for an orderly and optimal use of the country's land resource and harmonization of different land use objectives.

Ü ***Formulate and adopt capacity-building and awareness initiatives.*** Empower the direct and indirect resource users (i.e. fisherfolk, farmers, indigenous peoples) thru capacity-building and environment awareness initiatives which may be spearheaded by the LGUs. The Fisheries Code of 1998 for example strengthened further the capacity of the LGUs to oversee the fishing and aquaculture activities within their jurisdiction. More than the LGUs, the resource users such as the fisherfolk must be well informed and well trained to make them equally involved and participate in the day-to-day management of coastal resources. The active participation of the stakeholders will also help establish transparency and accountability in ecogovernance and promote equity in the approaches of local resources management.

Ü ***Formulate and adopt an appropriate incentive system.*** Create and adopt economic incentives and disincentives, and appropriate pricing mechanisms to direct the behavior of resource users and other stakeholders. Provision for taxes, subsidies, grants, and technical assistance that entice resource users to organize themselves for the purpose of protecting and conserving the forest, marine and coastal resources is needed. Environmental costs such as extraction or rehabilitation costs and externalities such as pollution must also be made an integral part of the production process. This helps reduce risks and attract more investors to participate.

Ü ***Establish proper environment accounting system.*** Improve the information system in natural resources to establish baseline information in water resources, inventory of forest and watershed resources. Maximum sustainable yield and carrying capacity of our ecosystems must be established and be made readily available to stakeholders and other interested parties.

Ü ***Ensure strict implementation of environmental laws.*** Strengthen the oversight function of Congress to ensure the proper and strict implementation of vital environmental laws such as the Solid Waste Management Act**,** Clean Air Act and the Clean Water Act**.**

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