Republic of the Philippines
DEPARTMENT OF FINANCE
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Letter of Development Policy

02 September 2014

Dr. JIM YONG KIM
President
World Bank Group
Washington, DC

Dear **Dr. Kim,**

The national development objectives of my Government are guided by the President's "Social Contract with the Filipino People", which envisions a country that has achieved inclusive growth characterized by rapid, sustained, and broad-based economic growth. It is focused on creating more jobs and new opportunities to attain full employment and significantly reduce poverty. The Philippine Development Plan (PDP) 2011-2016 provides a comprehensive analysis of our development challenges and the actions we are taking to address them, as also reaffirmed in the recent PDP Midterm Update and Revalidated Results Matrices.

The President reiterated the Government's commitment in his fourth State of the Nation Address (SONA) in July 2014. Good governance and institutional strengthening are at the core of the present reform priorities and at the heart of the future legacy of our administration. With two years left in our term, we are redoubling efforts to deliver on the Government's inclusive growth agenda. The tragedies brought about by Typhoon Yolanda and the Bohol earthquake in 2013 did not hinder us from our development track, but rather served as an opportunity for us to institutionalize our building back better initiatives to address the threat of natural disasters. Stronger than before, we are back on our feet, armored with lessons learned from the past, and keen in implementing new policy reforms towards a more resilient Philippines.

Building-up on the progress made from previous development policy loans initiated in 2010 by the Government, we would like to request financial assistance from the World Bank through a Third Development Policy Loan to Foster More Inclusive Growth (DPL-3) to sustain the momentum gained from said DPLs.

Recent Macroeconomic Performance and Outlook

The Philippine economy proved to be resilient despite Typhoon Yolanda and a string of natural disasters throughout 2013. We managed to sustain our economic growth as GDP growth increased from 6.8% in 2012 to 7.2% in 2013. In that same year, our deficit narrowed to 1.4% of GDP, below the 2.0% programmed and lower by almost 50% of the recorded deficit in 2010. Our national government debt-to-GDP ratio significantly decreased from 52.4% in 2010 to 49.2% in 2013. These can be attributed to our strong fiscal position brought about by prudent debt management and increasing revenue collections.

The country's financial system remained buoyant as it continued to have sufficient resources to weather market volatilities. The gross international reserves increased by 65.8% from USD48.70 billion in June 2010 to USD80.73 billion in June 2014. The sound and stable banking system supported sustainable loan expansion as manifested by the increase in the total loan portfolio of universal and commercial banks from PhP2.68 trillion in June 2010 to PhP4.43 trillion in May 2014. The non-performing loans ratio of these banks also declined from 2.8% in May 2013 to 2.2% in May 2014. Moreover, inflation was kept at 3%, the lower end of the inflation target range of 3% to 5%.

Last year, we achieved investment grade ratings from the three major credit rating agencies, with a fresh rating upgrade by Standard & Poor's (S&P) in May of this year. This shows that the structural reforms that we have put in place continue to gain traction, as also demonstrated by the significant improvements in the country's position in international governance and competitiveness surveys.

While growth has been robust, the Government remains vigilant in addressing the constraints and risks to the country's inclusive growth agenda and poverty reduction efforts. Typhoon Yolanda vividly demonstrated our vulnerability to natural disasters, including as likely to be aggravated by climate change. We therefore are strengthening our efforts to build a more resilient economy, notably by advancing institutional reforms.

Moving forward, a key priority is mitigating the risks posed by climate change while also addressing the identified constraints to growth: inadequate public infrastructure, barriers to doing business, low human capital of the poor, public sector governance and opacity challenge, tax efforts and fiscal risks.

The Medium-Term Program of the Government

Recognizing the country's constraints to growth, we embarked on implementing policy reforms focused in i) meeting public infrastructure gaps to enhance connectivity while confronting climate change and natural disaster vulnerability; ii) addressing barriers to jobs to promote private investment; iii) enhancing the human capital of the poor while reducing their vulnerability to shocks; iv) enhancing the transparency of notably public spending; and v) doubling revenue efforts to finance significant scale-up of public infrastructure investment and social spending, while managing fiscal risks from natural disasters, public enterprises and public-private partnerships.

Public Infrastructure Investments

The Global Economic Competitiveness Report underscores the progress we have made on a number of fronts, but flags the dire state of our connectivity. This infrastructure gap is coupled by low public investment, which was only 2.3% of GDP in 2011. To increase public investments, we have focused on improving the quality and timeliness of public infrastructure. The Department of Public Works and Highways (DPWH) surpassed its target of contracting over 80% of the combined 2012 and 2013 capital expenditure and of completing over 60% of infrastructure projects. For 2014, over 50% of the capital expenditure has already been contracted by the first half of the year.

Among public infrastructure areas, there is a focus on tourism interventions as it is associated with jobs growth. Our Tourism Convergence Program, of which the Tourism Roads Infrastructure Program (TRIP) is a part of, demonstrates how we can enhance the delivery of priority public infrastructure. Allocation amounts to PhP36.98 billion for 2011 to 2014. Supplementing this is the One Step program with DSWD linking communities to potential demand benefits from the tourism sector.

To promote agricultural productivity, rural livelihoods, and poverty reduction, we have also strengthened the process by which the regular Department of Agriculture (DA) Farm to Market Roads (FMR) program is prioritized and implemented. The DPWH already received the first approved list of FMRs for implementation under the 2014 General Appropriations Act (GAA). The Secretaries of DA and DPWH also signed a memorandum setting out detailed implementation guidelines and standards on FMRs. With these measures in place, we can now further strengthen this process for 2015 and 2016 GAAs, including efforts to institutionalize local community feedback in the selection and maintenance of these roads.

Ease of Doing Business

The formal establishment of sole proprietorships is an important source of growth for an economy. The DTI is committed to ease the process of setting up sole proprietorship through the Philippines Business Registry (PBR), by reducing the time it takes to register a firm across both national and sub-national registries, including the payment of associated fees. With this web-based one-stop shop, business application now only takes 30 minutes. From January to May 2014, 35,564 businesses registered through the PBR, 97% higher than those registered in the same period in 2013.

Equitable Access to Social Services

Enhancing investments on human capital development is at the heart of the Social Contract. We are committed to being bold about increasing the quality and quantity of public investments in our citizens to move them out of poverty. Hence, the "Listahanan" or the National Household Targeting System for Poverty Reduction (NHTS-PR) of the Department of Social Welfare and Development (DSWD) was further advanced to be of use in progressing key social development programs.

Among the Government's key social development programs is the Conditional Cash Transfer (CCT) program or the Pantawid Pamilyang Pilipino Program (4Ps). In view of the K to 12 program, the Modified CCT – Extended Age Coverage (up to 18 years of age) is now being implemented to include poor families with kids in Secondary School. As of 25 June 2014, 2,325 households are enrolled under Modified CCT.

Similarly, our continued commitment to provide Universal Health Care (UHC) remains. We expanded the number of beneficiaries under the PhilHealth Sponsored Program. From 5.2 million families covered in 2013, coverage has been expanded to 14.7 million families in 2014 to include those belonging to the next poorest segment of the population as identified through the NHTS-PR.

Apart from the 4Ps and UHC, government assistance through the Social Pension for Indigent Senior Citizens also makes use of the NHTS-PR system. Currently, around 850 entities use the system for targeting beneficiaries.

Fiscal Transparency and Good Governance

The Government recognizes that transparency of public finances requires strengthening institutional capabilities and automation to help decision makers perform their functions effectively and efficiently. Most importantly, it helps inform citizens how public funds are being spent. Thus, establishment of the Government Integrated Financial Management Information System (GIFMIS) is already being started.

A core building block of the realization of the GIFMIS is a consolidated financial management reporting requirements, using harmonized classification of budgetary, treasury and accounting accounts with standardized definitions for fiscal terminologies. To this end, we are instituting the Unified Account Code Structure (UACS) with the following categories: (i) Budgetary accounts – appropriations, allotments, obligations and expenditures, (ii) Treasury accounts – cash flow statement of the National Treasury, and (iii) General ledger accounts – assets, liabilities, equity, income and expenses.

In parallel, the Government successfully launched a government-wide open data portal, making over 600 datasets available to the public. We are now deepening this platform to focus on such areas as customs, and flagship programs such as Grass Roots Participatory Budgeting (GPBP) and Open Reconstruction.

Fiscal Sustainability: Revenue and Risk Management

In view of the execution of Republic Act No. 1035 (Sin Tax Law), several revenue issuances were passed to implement the provisions stated therein. Implementation proved to contribute largely to the Government's revenue as excise tax collections were recorded at PhP34.95 billion for the first half of 2014, exceeding last year's level by 29.7%.

A Tax Expenditure Report/ Statement (TER/ TES) covering FY 2011 was approved last March 2014 and was subsequently submitted to the President. The TES/ TER estimated estimated the value of tax and duty exemptions by sectoral classification at PhP144.3 billion or 1.49% of GDP. Recognizing its importance towards improving management of tax incentives, institutionalization of succeeding TER/ TES (FY 2012 and beyond) is being contemplated by publishing it annually as an annex to the GAA, or as part of the Budget of Expenditures and Sources of Financing (BESF).

Fiscal Risk Statements (FRS) were published to systematically outline some of the key fiscal risks, along with the mitigation strategies being pursued by the Government. The 2014 GAA also included explicit provisions for fiscal risk contingencies and reduction, of which the Calamity Fund in the 2013 budget was replaced by the National Disaster Risk Reduction Fund (NDRRMF). We increased its allocation with provision for resilience and risk reduction investments. Aside from the NDRRMF, contingent liabilities allocation for existing and new PPPs was introduced in the 2014 GAA. To complement these, the DOF is doing proactive valuation and monitoring of contingent liabilities.

Conclusion

The measures presented above comprise a key subset of the wider measures we are implementing in the context of the Social Contract and the 2010-2016 Philippine Development Plan. Major policy reforms mentioned are being done to address the country's constraints to growth. Priority outcomes anticipated from the implementation of the measures are (i) significant and sustained increase in the tax-to-GDP ratio, (ii) reduction in the public debt-to-GDP ratio, (iii) higher fixed investment-to-GDP ratio and reduced cost of entry for small and medium scale sole proprietorship firms, (iv) enhanced transparency in financial management, (v) higher school enrollment rates and better quality of education for poor households, and (vi) improved health service coverage for all Filipinos.

In conclusion, I would like to reiterate our strong commitment to the reform agenda presented in PDP 2011-2016, and outlined in this letter. We look forward to the Bank's continued support to our development efforts.

Very truly yours,

CESAR V. PURISIMA
Secretary of Finance

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