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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF EQUIVALENT TO US$300 MILLION TO

THE REPUBLIC OF THE PHILIPPINES

FOR THE

THIRD PHILIPPINES DEVELOPMENT POLICY LOAN TO FOSTER MORE INCLUSIVE GROWTH

September 03, 2014

Macroeconomics and Fiscal Management Global Practice
East Asia and Pacific Region

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of July 31, 2014)

Currency Unit

1.0 PhP = US$0.023 / US$ 1.00= PhP 43.63

ACRONYMS AND ABBREVIATIONS

Australian DFAT	Department of Foreign Affairs & Trade, ex-Australian Agency for International Development	LGUs	Local Government units
ASEAN	Association of Southeast Asian Nations	LTS	Large Taxpayer Services
ACLC	Automatic Conversion into Local Currency	MDGs	Millennium Development Goals
BESRA	Basic Education Reform Agenda	MTEF	Medium Term Expenditure Framework
BIR	Bureau of Internal Revenue	NAT	National Achievement Tests
BPLS	Business Permit and Licensing System	NDRRF	Natural Disaster Risk Reduction Fund
BPO	Business Process Outsourcing	NEA	National Electrification Agency
BOI	Bureau of Investments	NEDA	National Economic and Development Authority
BOC	Bureau of Customs	NERBAC	National Econ. Research & Business Action Centre
BOSS	Business One-Stop Shop	NFA	National Food Authority
BSP	Bangko Sentral ng Pilipinas (Central Bank)	NIA	National Irrigation Agency
CAS	Country Assistance Strategy	NG	National Government
CCT	Conditional Cash Transfer	NGICS	National Guidelines on Internal Control Standards
CFAA	Country Financial Accountability Assessment	NHIP	National Health Insurance Program
COA	Commission on Audit	NHTS-PR	National Household Targeting System for Poverty
CPS	Country Partnership Strategy	NSW	National Single Window
DA	Department of Agriculture	OPIF	Organizational Performance Indicator Framework
DBCC	Development Budget and Coordination Committee	4Ps	Pantawid Pamilyang Pilipino Program (CCT)
DBM	Department of Budget and Management	PBR	Philippine Business Registry
DepED	Department of Education	PDAF	Priority Development Assistance Fund
DILG	Department of the Interior and Local Government	PDF	Philippines Development Forum
DPL	Development Policy Loan	PDP	Philippine Development Plan
DRMO	Debt and Risk Management Office	PER	Public Expenditure Review
DOF	Department of Finance	PEZA	Philippine Export Zone Authority
DOH	Department of Health	PFM	Public Financial Management
DOJ	Department of Justice	PGIAM	Philippines Government Internal Audit Manual
DOTC	Department of Transportation and Communications	PhilHealth	Philippine Health Insurance Corporation
DSWD	Department of Social Welfare and Development	PPPs	Public-Private Partnerships
DTI	Department of Trade and Industry	PSALM	Public Sector Asset Liability Management Company
EAP	East Asia and the Pacific	PSIA	Poverty & Social Impact Analysis
EIA	Environmental Impact Assessment	PWC	Price Waterhouse Cooper
E2M	Electronic-to Mobile Customs	RATE	Run After Tax Evaders
ESC	Education Service Contracting	RATS	Run After the Smugglers
FIR	Fiscal Incentives Rationalization	RIPS	Revenue Integrity Protection Service
FMR	Farm to Market Road	ROSC	Report on the Observance of Standards and Codes
FRS	Fiscal Risk Statement	SDR	Special Drawing Rights
GAA	General Appropriations Act (annual budget)	SPFs	Special Purpose Funds
GASTPE	Govt. Assistance Students/Teachers in Priv. Education	SEC	Securities and Exchange Commission

GDP	Gross Domestic Product	ROSC	Report on the Observance of Standards and Codes
GCG	Governance Council for GGCCs	SEC	Securities and Exchange Commission
GIFMIS	Govt. Integrated Financial Mgmt. Information System	SPF	State and Peace-Building Fund
IAS	Internal Audit Service	SBM	School Based Management
IBRD	International Bank for Reconstruction & Development	TTRI	Trade Tariff Restrictiveness Index
IMF	International Monetary Fund	TRIP	Tourism Road Infrastructure Program
IRA	Internal Revenue Allotment	TCCs	Tax Credit Certificates
LDP	Letter of Development Policy	UACS	Unified Account Code Structure
		UNDP	United Nations Development Program
		USAID	US Agency for International Development

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Republic of the Philippines
Third Development Policy Loan to Foster More Inclusive Growth

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SUMMARY OF PROPOSED LOAN AND PROGRAM

Republic of the Philippines

Philippines Third Development Policy Loan

Borrower	Republic of the Philippines
Implementation Agency	The Department of Finance is the main liaison of the World Bank on budget support operations, but policy dialogue, monitoring and evaluation or the program supported by this DPL is shared with DBM, DPWH, DoT, DA, GCG, DTI, DSWD, DepEd, and DoH.
Financing Data	IBRD Loan Terms: A single-tranche operation to be fully disbursed upon effectiveness; Amount: USD 300 million
Operation Type	Programmatic (3rd in a series of 3)
Pillars of the Operation and Program Development Objective(s)	The PDO is defines as fostering inclusive growth by: Pillar 1: Strengthening Priority Public Investment Implementation Pillar 2: Reducing the Cost of Doing Business for Jobs Creation and Poverty Reduction Pillar 3: Developing the Human Capital of the Poor by Strengthening the Basic Education and Health Sector Pillar 4: Fiscal Transparency & Good Governance Pillar 5: Consolidating Fiscal Sustainability: Revenue Mobilization and Risk Management
Result Indicators	Public infrastructure investment (percent GDP, DWPH contracts in H1, execution, #convergence programs) Ease of Doing Business Indicators Fiscal Transparency/Open Government Indicators Net Education Enrollment Ratios/Teacher to Student/Student to Class room ratios Improved health insurance protection for the poor (PhilHealth coverage measures) Tax/GDP (percent net contribution by BIR, policy measures) Disclosure of Tax Expenditures & Fiscal Risks Net GOCC Contribution to Deficit, Major GOCCs with Performance Contracts
Overall risk rating	Substantial
Operation ID	P147803

IBRD PROGRAM DOCUMENT FOR A
PROPOSED PHILIPPINES DEVELOPMENT POLICY LOAN 3
TO FOSTER MORE INCLUSIVE GROWTH
IN THE REPUBLIC OF THE PHILIPPINES

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Despite buoyant growth rates, achieving inclusive growth continues to present significant challenges in the Philippines.** Growth peaked at 6.6 percent in 2012, and continued apace at 7.2 percent in 2013. The latest official poverty statistics show a 3 percentage points (ppt) decline in the poverty rate between the first semesters of 2012 and 2013, from 27.9% to 24.6%. Fiscal consolidation has progressed to overcome the macro-economic instability that was at the forefront of the country's policy agenda in the past decade. With sustainable deficit levels and a steadily declining debt to GDP ratio, market confidence has been restored in the Philippines. All three major credit agencies have upgraded the country's sovereign credit ratings to investment grade in 2013 with a recent further upgrade to one notch above investment grade by S&P in May 2014. Unfortunately, high growth was not accompanied by significant poverty reduction and employment creation. Income poverty levels remained almost unchanged since 2003, with the 2012 poverty level remaining at 27.9%. The apparent notable decrease in the poverty rate between 2012 and 2013 by 3 percentage points may suggesting initial gains from the administration's focus on anti-poverty programs (see Box 1). Still, with unemployment and underemployment persisting respectively at 7 and 20 percent in 2012, the number of jobs created was unable to accommodate the expanding labor force. Moreover, the Philippines remains highly dependent on outmigration and remittances (10 percent of GDP); with a large part of the population still vulnerable to shocks caused by natural disasters, as well as economic and health-related externalities.

2. **The slow expansion of the labor-intensive manufacturing sector, accompanied by weak productivity gains from agriculture and services, has curbed industrial growth potential compared to regional peers.** While out-migration and the services sector comprised a significant share of the labor force, the bulk of jobs in the service sector were created in low productivity informal sectors. A challenging regulatory and licensing environment, poor infrastructure, uncertain property rights notably for land, and high input costs have all constrained productivity growth and the major expansion of internationally competitive industries. One exception, however, has been the Business Process Outsourcing (BPO), which generated close to a million formal jobs over the past decade. Tackling extreme poverty and promoting inclusive growth will require transforming rural livelihood opportunities, as well as sustaining existing and new sectors of growth, including BPOs, tourism, services, and manufacturing.

3. **A number of structural challenges confronts the Philippines and constrains a trajectory of sustained and inclusive growth.** A significant body of analytical work has identified the challenges for achieving inclusive growth in the Philippines (see Box 1). The

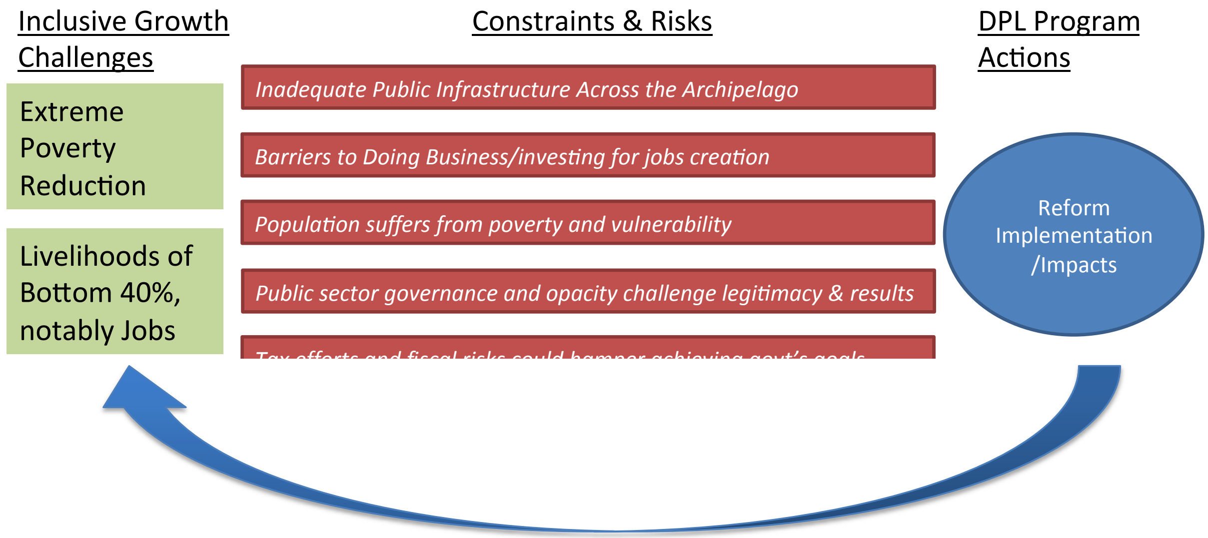
Philippine's authorities focus on fostering inclusive growth is squarely aligned to the World Bank's twin goals of extreme poverty reduction – including as measured by the USD 1.25 poverty line -- and the livelihoods of the bottom 40 percent of the population. Figure 1 also suggests that tackling inclusive growth bottlenecks and governance constraints will help reduce extreme poverty and promote shared prosperity though improved incomes among the bottom 40 percent. These objectives will require (i) meeting public infrastructure gaps, particularly enhancing connectivity throughout the archipelago and confront climate change and natural disaster vulnerability; (ii) addressing barriers to job creation by promoting private investment; (iii) enhancing the human capital of the poor while reducing their vulnerability to shocks; (iv) enhancing the transparency of public spending; and (v) enhancing tax effort to finance a significant scale-up of public infrastructure and social spending while managing fiscal risks from natural disasters, public enterprises, and PPPs. The devastating Bohol earthquake and typhoon Yolanda of 2013 have underscored the extreme vulnerability of the poor in the Philippines to natural disasters. The events have amplified the need to build physical and economic resilience, particularly among residents of rural areas, who account for 40 percent of the population.

Box 1: The Philippines Poverty Puzzle

The World Bank's new 2015-2018 Country Partnership Strategy (CPS) provides an in-depth analysis of the Philippines poverty reduction challenge. High economic growth in the Philippines over the last decade has not yet translated into significant poverty reduction. According to official statistics, poverty declined from 27.9 to 24.9 percent between 2012 and 2013. Indicators of recent declines reflect the impact of significant recent Government efforts to expand economic opportunities and social programs. Between 2003 and 2009, the bottom 40% became more educated as reflected by the gradually increasing share of their household heads entering and graduating from high school. Those in the bottom 40% who are employed in the industry and services sectors also increased, moving away from the seasonality of agricultural employment. Sustained investments in the human capital of the poor and near poor promised to support these developments. Geographic disparities are also associated with differences in public infrastructure and connectivity across the archipelago, including in access to markets.

World Bank staff analysis also suggests the need to address methodological issues in assessing the impact of reforms on extreme poverty reduction and shared prosperity. For example, using more consistent alternative poverty lines yield somewhat greater declines in poverty incidence, gap, and severity especially in recent years. At the Government's request, the World Bank will work with the newly established Philippine Statistical Authority to examine these issues and their impact on the poverty statistics as a priority in the early part of the CPS implementation period and DPL evaluation.

Figure 1: Meeting the Inclusive Growth Challenge in the Philippines



4. **The Aquino administration has made good governance and inclusive growth its cornerstone reform objectives.** The Social Contract with the Filipino People has served as the administration's roadmap since coming to office in mid-2010 for a number of reform efforts aimed at overcoming the legacy of economic underperformance. Indeed, elite capture and corruption have proven highly corrosive not only to public service delivery, but more fundamentally to the overall political and economic performance of the Philippines. The administration is harnessing both domestic coalitions and international mechanisms – such as the Open Government Partnership (OGP) -- to advance greater transparency and integrity around the use of public resources. Major institutional investments are taking place in public financial management systems, coupled with efforts to strengthen the demand side for information. These efforts are being tightly linked to both challenges and progress concerning priority frontline public investments & service delivery. The improved transparency, governance, and inclusive growth prioritization of public infrastructure delivery has become a major priority for the administration, notably in support of such areas as rural and tourism development. As it enters the second half of its term, the government continues to be committed on delivering on its priority reform initiatives notably those focusing on boosting public and private investments, improving governance, and fighting corruption. Greater transparency and accountability will be central to transforming the relationship between government and citizens, and sustaining inclusive policies in this administration and beyond.

5. **The proposed third programmatic DPL supports the implementation of the government reform program.** The operation seeks to institutionalize measures underpinning the reform change agenda. In effect while actions supported are streamlined to conclude the current programmatic DPL led reforms series initiated in 2010/11, they too prepare the ground for future DPL-type support for the remainder of the Aquino administration through mid-2016 (see Annex 4). These actions focus on tackling the binding constraints for an inclusive growth trajectory. Notably they push reforms aimed at (i) enhancing capital spending levels to match regional and income level peers; (ii) improving the quality of public investment in terms of sectoral and geographic targeting; (iii) reducing trading costs by enhancing connectivity across

the archipelago; (iv) boosting investments in human capital and social protection as to overcome the low human development outcomes in health and education; and (iv) tackling regulatory and licensing barriers that constrain private investments and raise business costs. Through job creation and inclusive growth, these reforms promise to have significant impact on reducing extreme poverty and sharing prosperity of the bottom 40 percent of the Philippines population.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

Real sector development

6. **Philippine economic growth decelerated to 5.7 percent in the first quarter of 2014 (Q1 2014), but continued to outperform other countries in the region.** After sustaining growth of above 6 percent for 8 consecutive quarters, growth slowed down due to weak government consumption and private construction on the demand side, and weak agricultural production on the supply side. While overall public infrastructure spending rose significantly, the reconstruction in Typhoon Yolanda areas (Box 2) had a slow start. The country's growth rate compares favorably to other countries in the East Asia region, surpassed only by China (7.4 percent) and Malaysia (6.2 percent).

7. **GDP growth remained consumption-led, while investments provided some support despite the contraction in private construction.** Private consumption, fueled by remittances, grew by 5.8 percent and contributed 4 percentage points (ppt) to overall growth. The growth of overall investment at 7.7 percent was driven mainly by domestic investment, as foreign investment declined.[1] The key drivers of investment were public infrastructure and durable equipment spending, with significant purchases of vehicles, airplanes, and machineries. Net exports recovered for the first time in 5 quarters and contributed 1.8 ppt to overall growth.[2] The contribution of private consumption, investments, and net exports, however, was muted by weak government consumption and the decline in private construction. Government consumption grew by only 2 percent due to higher spending in Q1 2013, given "one-time, non-recurring" expenditures.[3] Private construction contracted by 6 percent, suggesting that the real estate may be around its peak.[4]

8. **On the supply side, the services sector remained the main driver of growth, while the performance of agriculture was constrained by recent disasters.** The services sector grew

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[1] Foreign direct investment fell by 11.6 percent to USD 1.9 billion in Q1 2014.

[2] The recovery of electronics exports and the robust performance of services exports drove overall exports growth to 12.6 percent. This sharp recovery offset the 8.6-percent acceleration of imports, resulting in a lower trade deficit.

[3] Examples of "one-time, non-recurring" expenditures are i) the last of 4 tranches of salary increases under the Salary Standardization Law III, and ii) expenditures in the run-up to the 2013 general elections.

[4] Private construction had been decelerating for 5 quarters, from growth of over 40 percent in Q4 2012 to less than 2 percent in Q3 2013 before entering negative territory by Q4 2013. The number of building permits issued declined in 3 out of the past 5 quarters.

by 6.8 percent and accounted for 3.8 ppt of overall growth. All services subsectors grew, led by the real estate, renting, and business activities subsector. Meanwhile, manufacturing growth slowed down to 6.8 percent from 10.3 percent in 2013 as food manufacturing contracted. Its full impact was offset by higher growth in furniture and fixtures, and electronics, owing to the recovery of exports. In contrast, agriculture grew by 0.9 percent as the sector suffered from extensive damages brought about by various weather-related disasters in 2013.

Box 2: Typhoon Yolanda

Typhoon Yolanda, a category five typhoon that struck central Philippines in November 2013, inflicted severe damage on the social and economic fabric of the Visayas and the MIMAROPA region.[5] The typhoon displaced 4.1 million people and destroyed over half a million houses. Around 8,000 people died or are still missing. The loss of capital and assets, and disruption in electricity and irrigation services, have led to the collapse of local economies in the severely affected areas.

The long-term risks of the typhoon include an increase in unemployment and underemployment, a rise in poverty levels, and deteriorations in human capital indicators, in particular if education and health services are not quickly restored. The scale of potential job losses is significant: around six million workers were affected by the typhoon, of which around 2.6 million are vulnerable workers. And Eastern Visayas, where the entire population was reported to have been affected by the typhoon, has one of the highest poverty incidences in the country, at around 45 percent. With very limited savings capacity, the disruption in economic activity and incomes as a result of the typhoon is expected to bring severe hardship. Pre-typhoon, the poverty rate in the most affected provinces was about 33 percent. Because of the typhoon, an additional one million people could have been pushed into poverty.

The Government responded quickly to the typhoon by rolling out immediate humanitarian aid and preparing the "Reconstruction Assistance on Yolanda (RAY)," a strategic plan to guide recovery and reconstruction in the affected areas. The plan estimates the value of damaged physical assets, both public and private, at PHP 424 billion (3.7 percent of GDP) and recovery and reconstruction costs at PHP 361 billion (3.1 percent of GDP), of which around PHP 125 billion (1.1 percent of GDP) would be borne by the Government in 2013 and 2014. This initial estimate of recovery and reconstruction costs is likely to increase, as it covers only 85 percent of the estimated damage, whereas a "build back better" strategy suggests that recovery costs could be 30 percent higher than the estimated total damage. This takes into account the "new normal" of climate- change aggravated weather related shocks.

The National Government (NG) has secured adequate fiscal space (PHP 162 billion or around 1.4 percent of GDP) in the 2013 and 2014 budgets to support the reconstruction phase for areas affected by Typhoon Yolanda, the Bohol Earthquake, and other smaller disasters. The challenge now is to rapidly bring reconstruction projects on stream and to implementation status. Bottlenecks include i) the need to work across spheres and sectors of the Government, ii) the sheer magnitude of demand for technical appraisal, iii) the need for major land clearances, especially given vulnerabilities to surge and fault line areas, and iv) contractor capacity limitations. The challenge going forward will be to scale-up delivery in line with available fiscal space to stimulate demand and jobs in affected areas, while building resilience to future risks.

[5] MIMAROPA is a portmanteau of the names of its five Philippine provinces: Occidental Mindoro, Oriental Mindoro, Marinduque, Romblon, and Palawan.

The Government has committed itself to timely and public reporting of post-Yolanda reconstruction progress. The Office of the Presidential Assistant for Rehabilitation and Recovery (OPARR) was established in early-2014 to provide coordinated government wide support to public sector, private sector, civil society and development partner efforts at reconstruction. Five cabinet clusters were established to accelerate the implementation of sectoral efforts – infrastructure, resettlement, livelihood, social services, and support, and their action plans have been issues as part of a Comprehensive Master Reconstruction Plan. The government launched in early July a website providing monthly aggregate and project level reconstruction project updates and associated budget releases (openreconstruction.gov.ph). The website aims to provide a comprehensive and timely overview of proposed, approved, and ongoing reconstruction projects, including progressive geo-tagging and opportunities for public feedback. Through end-June 2014, the Department of Budget and Management (DBM) released PHP 32 billion, with physical works to ramp up considerably in H2 2014.

External accounts

9. **The country's current account remained in surplus, benefitting from resilient remittances, export of services, and a narrower trade deficit.** In Q1 2014, the current account surplus was recorded at 3.1 percent of GDP (US$2 billion), up from 2.7 percent of GDP in Q1 2013.[6] Sustained growth of remittances remained the key driver of the current account surplus. Supported by continued deployment of overseas Filipino workers, remittances grew by 5.8 percent in the first half of 2014 (H1 2014) and remained largely unaffected by slower growth in advanced economies. Export of services increased to US$4.8 billion in Q1 2014, 9.4 percent higher than the same period last year, driven by business process outsourcing (BPO) services.

10. **The Philippines experienced large capital outflows in Q1 2014, resulting in a large balance of payments (BOP) deficit and a decline in reserves.** The tapering of US monetary policy and developments in emerging markets, including slower growth and default risk in shadow banking in China, the devaluation of the Argentine peso, and increased political tensions in several middle-income economies, resulted in a significant outflow of portfolio investments in Q1 2014 (mostly in January). Net foreign selling of bonds was sizable, causing the BOP to reach a deficit of USD 4.5 billion (7 percent of GDP), the highest since the 2008 Global Financial Crisis. The outflow of capital also resulted in lower gross international reserves (GIR) by USD 3.2 billion, because the central bank intervened to smooth out excessive currency fluctuations. Nonetheless, the level of GIR at USD 80 billion remains at comfortable levels. Reserves are enough to cover around 11 months of imports or 6.8 times the value of short-term external liability by residual maturity.[7] With strong capital outflow, the peso depreciated by around 10 percent between Q1 2013 and Q1 2014 before regaining its strength beginning Q2 2014. Despite recent depreciations, the peso remains as one of the strongest currencies in real effective terms.

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[7] Short-term external liability by residual maturity, as defined by the central bank, refers to external debt with original maturity of one year or less, plus principal payments on medium and long-term loans of the public and private sectors falling due in one year or less.

Financial markets

11. **Capital inflow accelerated in Q2 2014 as overall investor sentiment continued to improve, helping the stock market to recover from the losses last year.** Like other emerging markets, Philippine financial markets experienced large volatilities in H2 2013 as investors respond to the planned tapering of the US stimulus program. The country's stock market was one of the hardest hit, along with Indonesia and Thailand, and experienced a decline in the Philippine Stock Exchange Index (PSEi) of more than 20 percent. However, in Q2 2014, inflow of portfolio investment began to accelerate, driven mainly by equity investment. In August 2014, the Philippine Stock Exchange index (PSEi) returned to the 7,000 level from 5,900 at the start of 2014, around 18-percent gain. This was driven by net foreign purchases, which totaled PHP 50 billion from January to July, 36 percent higher than the same period last year. On the other hand, bond prices[8] remained depressed given rising interest rates. In May, Standard & Poor's raised the Philippines' credit rating, putting the country 1 notch above the minimum investment grade level.[9]

Monetary policy

12. **Strong liquidity and credit growth, as well as higher food and energy prices, continue to exert upward pressure on inflation.** After 10 consecutive months of over 30 percent growth, money supply (M3) growth dipped below 30 percent in May and continued to ease through June at 23 percent (Figure 10). Strong credit expansion of over 21 percent in the real estate sector, continued to drive lending growth in Q1 2014, not including lending from shadow banks.[10] Higher lending to real estate increased the real estate exposure of banks to PHP 1 trillion in Q4 2013 (around 9 percent of GDP).[11] Given strong liquidity and credit growth, inflation accelerated to 4.3 percent in the first 7 months of 2014, from 3 percent in 2013. Food inflation reached 8.2 percent and was driven by increasing rice prices.[12] Meanwhile, non-food inflation was driven by higher electricity prices due to the simultaneous shutdown of several generation plants and weak reserve capacity. Prices of imported products, such as petroleum products, also increased due to the peso depreciation and higher commodity prices.

13. **To help mitigate risks from strong liquidity growth, some policy tightening were**

[8] This refers to the benchmark Republic of the Philippines (ROP) Government external debt papers.

[9] The country's long-term sovereign credit rating was raised from "BBB-" to "BBB." Outlook was maintained at "stable," indicating that the rating is unlikely to change in the next 12 months.

[10] See Philippine Economic Update (PEU) March 2014 edition for more discussion on shadow banking.

[11] Given increasing real estate exposure, the central bank has required all banks to undergo stress tests to ensure that they have sufficient capital to absorb any possible shock on their credit exposures. Under this framework, universal and commercial banks must meet the requirement of 10 percent capital adequacy ratio of qualifying capital. Their subsidiary thrift banks are also required to maintain a common equity tier 1 level of at least 6 percent of qualifying capital. Apart from macroprudential measures to contain exposure to real estate, other banking sector reforms are underway. The most notable reform is the full liberalization of the banking sector, which allows up to 100 percent foreign participation in the domestic banking industry.

[12] Since June 2013, retail rice prices have increased by 24 percent due to tight supply, weather-related disturbances, and delays in rice importation that was meant to fill production gaps.

enacted between January and August 2014. Both the reserve requirement ratio (RRR) and the special deposit account (SDA) rate were increased. The RRR was increased by 2 ppt to 20 percent while the SDA rate was increased by 25 bps to 2.25 percent. In July, policy rates were increased by 25 bps to 3.75 and 5.75 percent for the overnight borrowing and lending rates, respectively.

Budget and fiscal policy

14. **National Government (NG) spending was supported by strong growth in allotment to Local Government Units (LGUs) despite slowdowns in infrastructure and other spending categories.** In the first 5 months of 2014, government spending grew by 4.7 percent only, lower than 12 percent in the same period last year. This slow expansion was caused by higher spending in the same period last year, which was due to "one-time, non-recurring" expenditures such as the last of 4 tranches of salary increases under the Salary Standardization Law III, and expenditures in the run-up to the 2013 general elections. Spending for the infrastructure program also slowed down, growing by 3.5 percent only. This was due to lower disbursements by Department of Agriculture (DA), which are mainly allotted for farm-to-market roads, Department of Transportation and Communications (DOTC), and DPWH. Given higher Internal Revenue Allotment (IRA) shares this year, allotment to LGUs drove NG spending growth and accounted for 1.8 ppt.

15. **On the revenue side, overall tax collection continued to improve, allowing NG to secure adequate fiscal space for infrastructure and social services spending.** In H1 2014, total NG revenues reached PHP 934 billion, 11 percent higher than the same period last year. Tax collection improved to 13.3 percent of GDP in 2013 from 12.9 percent of GDP in 2012, thanks to increased revenue from excise taxes and improvement in tax administration. In the absence of tax policy reform, and the presence of built-in erosion from excise taxes and fiscal incentives, the increase in tax collection can be largely attributed to improvements in tax administration. Following the implementation of the "sin tax" law, incremental excise taxes on tobacco and alcohol reached PHP 51.5 billion (0.4 percent of GDP) in 2013, and amounted to PHP 23 billion in January to April 2014 (6 percent increase, year-on-year). In 2013, reforms in tax administration are estimated to have an impact of about 0.4 ppt of GDP, considering that customs revenue fell by around 0.2 ppt of GDP and the current tax structure is designed to lead to an average erosion of 0.2 ppt in GDP from fiscal incentives and un-indexed petroleum taxes. The BoC was subject to a change in leadership & management change with on-going restructuring since October 2013.

16. **Improvement in tax administration measures remained as one of the key vehicles for generating higher revenues.** Several tax compliance enforcement measures have been taken. These include (i) increasing in the coverage of the withholding tax system[13], (ii) the strict requirement of tax clearances prior to registering changes in property ownership[14], (iii) active filing of cases against tax evaders and closing down of businesses with unpaid tax liability, and

[13] Such as mandating hospitals and health maintenance organizations to withhold taxes from doctors.

[14] Part of the government effort to raise estate tax collections to PHP 50 billion by 2016.

(iv) targeting the increase of tax collection from the self-employed professionals and large businesses. These measures have also been accompanied by an active media campaign[15], civil society engagement [16], systematic information sharing within government entities, and administrative reforms in customs; all aimed at fighting tax evasion and corruption.[17]

17. **With improving public finances, the overall fiscal stance of NG remained broadly sustainable given low fiscal deficit and a manageable debt profile.** With 12-percent growth in spending in Q1 2014,[18] fiscal deficit in the same period increased to PHP 84 billion (3 percent of Q1 2014 GDP), compared to PHP 66 billion (2.5 percent) a year ago. In H1 2014, weaker government spending amid rising revenues resulted in a lower deficit of PHP 54 billion. NG debt, on the other hand, rose by 1.7 ppt of GDP in the same period to PHP 5.65 trillion, equivalent to 48.9 percent of 2013 GDP. The increase was driven mainly by the 3.7-percent growth in domestic borrowings. Despite the depreciation of peso, foreign currency denominated debt decreased by PHP 50 billion or 1.6 percent, given its declining share to total NG debt stock.[19] However, the overall debt trajectory continues to trend downwards and remains sustainable.

2.2 MACROECONOMIC OUTLOOK AND DEBT

18. **Strong macroeconomic fundamentals, along with sound fiscal and monetary policies, would continue to support growth in the near-term while further structural reforms would allow the country to sustain growth at above 6 percent in the medium-term.** The Philippines' strong macroeconomic fundamentals continue to provide an environment that is conducive to growth, despite the weak global economy and the impact of recent natural disasters. Building on this achievement through deeper structural reforms would allow the country to sustain its current high GDP growth rate, achieve more inclusive growth, create more and better jobs, and reduce poverty at a much faster rate.

19. **Given the slow start in Q1 2014, lower government spending in Q2 2014,[20] and some**

[15] "Tax Watch" campaign was launched in order to compare taxes paid by leading establishments and their popularity rankings, as well as taxes paid by various occupations, in a bid to raise tax compliance. An example of this is the "*Is your favorite restaurant a top taxpayer in Pasig City?*" ad in leading newspapers, also available in http://www.dof.gov.ph/?p=8090. Other recent updates on Tax Watch are available in the website of the Official Gazette, the official journal of the Republic of the Philippines: http://www.gov.ph/featured/tax-watch/.

[16] Encouraging citizens to report tax evaders. Citizens can report officials who are involved in graft, improper action, negligence, lavish lifestyle, and other illegal practices in DOF's portal at http://perangbayan.com/.

[17] To curb smuggling and corruption in the customs collections, new measures, such as the creation of import maps, limiting certain commodities to particular ports, upgrading of the IT systems, and appointing of new customs deputy commissioners, are now being implemented

[18] This is mostly due to the ramping up of public infrastructure.

[19] The share of foreign debt declined from 44 percent in 2009 to 34.3 percent in 2013 and to 34 percent in H1 2014.

[20] In Q2 2014, preliminary data from the Bureau of Treasury show that nominal government spending grew by 9.8 percent, lower than Q1 growth of 12 percent. In real terms, these are around 7.9 and 5.5 percent, respectively, for Q1 and Q2. For projected 2014 growth to remain at 6.6 percent, much higher public spending is needed in Q2-Q4 (around 13 percent in real terms). Given that Q1-Q2 real spending growth was around 6.7 percent (average of 7.9

monetary policy tightening, baseline growth projections are revised downwards from 6.6 to 6.4 percent for 2014 and from 6.9 to 6.7 percent for 2015. These revised growth projections are contingent on the ability of the Government to fully implement planned spending for typhoon reconstruction and planned expenditure programs. Delays in typhoon reconstruction and lags in the planned doubling of infrastructure spending to 5 percent of GDP by 2016 would hold back growth. In the worst case scenario, GDP growth in 2014 could decline to 5.5 percent should infrastructure spending growth fall below 10 percent and government consumption remain at its Q1 2014 growth of 2 percent.

20. **As in previous years, strong domestic demand would continue to drive overall growth.** Private consumption is expected to contribute more than half of the country's growth, supported by strong inflow of remittances. A temporary depreciation of the peso following more moderate capital inflows would increase the value of remittances in peso terms, thereby raising the value of private consumption. Timely implementation of ongoing and recently awarded public-private partnership (PPP) projects, with a total value of around PHP 174 billion (1.5 percent of GDP),[21] could more than offset the contraction in private construction over the next 2 years. Finally, an acceleration of the planned reconstruction spending to cover at least 50 percent of the total reconstruction cost in the next 3 quarters can limit the decline in 2014 growth.

21. **A number of domestic and external factors could pose risks to growth.** On the domestic side, the main sources of risk are slow reconstruction spending and domestic reform lags, in particular reforms to raise tax revenues.[22] The planned infrastructure investments are ambitious and will require sustained growth in revenues. External risks could come from a disorderly policy normalization in high-income countries and a disorderly adjustment in China's property market. Finally, political tensions in the Middle East and Eastern Europe, and territorial disputes with China can dampen external demand and FDI, and raise the country's import bill.[23]

22. **Monetary policy tightening and greater use of macroprudential measures would be warranted to buffer risks to price and financial stability.** CPI inflation is projected to reach the ceiling of the central bank's 3 to 5 percent target. Upward inflationary pressures would come from strong credit expansion and rising food and fuel prices. Food supply could remain tight throughout 2014 due to poor harvests on account of weather-related disturbances and could be

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and 5.5 percent), Q3-Q4 public spending growth must be at least 16.7 percent in real terms, if all other growth assumptions remain unchanged.

[21] As of July 10, 2014, projects that have been awarded are the i) Daang Hari-SLEX Link Road, ii) School Infrastructure Project (Phases I and II), iii) NAIA expressway Phase II, iv) Modernization of Philippine Orthopedic Center, v) Automatic Fare Collection, and vi) Mactan-Cebu International Airport. Total costs for these projects amount to PHP 62.6 billion. Projects for implementation, which include i) NLEX-SLEX Connector Road, ii) Skyway Stage 3, and iii) MRT Line-7, cost around PHP 111 billion. Finally, projects under bid evaluation, such as i) the Cavite-Laguna Expressway, and ii) LRT Line 1 Cavite Extension, are worth PHP 100.3 billion.

[22] See March 2014 edition of the Philippine Economic Update for more discussion on risks to growth.

[23] The main economic linkages between the Middle East and the Philippines are remittances and oil imports. The region is one of the top sources of remittances of the country, accounting for 20 percent of total remittances. China and the Philippines are linked through trade and tourism. See the Special Focus for more discussion. Meanwhile, the economic linkage between the Philippines and Eastern Europe is minimal.

exacerbated by droughts due to El Niño. In addition, because rice is a basic consumption necessity with inelastic demand, mistiming the importation of rice, which is controlled by the Government, could result in sharp increases in rice prices even in the presence of relatively small production shortfalls. Moreover, short-term depreciation of the peso and higher fuel prices are sources of inflation.

23. **Medium-term growth is dependent on the ability of the country to raise investment and implement structural reforms to boost potential growth.** Like other developing countries, Philippine output gap is close to zero,[24] which suggests limited capacity to sustain growth of above 6 percent in the medium term. Expanding potential output requires more investments in human and physical capital. In this regard, the Government's resolve to double infrastructure spending from 2.5 to 5 percent of GDP by 2016 is welcome. Moreover, the Philippine Development Report "Creating More and Better Jobs" estimates that the country needs to spend an additional 5 percent of GDP on health and education to boost labor productivity and the competitiveness of Filipino workers. This incremental increase in infrastructure and social services spending of 7.5 ppt of GDP would bring the NG spending level to around 25 percent of GDP, which is more in line with the spending patterns of the country's neighbors, and facilitate the creation of good jobs.[25]

24. **Higher tax revenues are crucial for a fiscally sustainable acceleration of public infrastructure and social services spending.** To support the required increase in public investments, additional tax revenues of around eight percent of GDP relative to 2010 would be needed in the medium-term. On tax policy, the government is prioritizing the enactment of a fiscal incentives rationalization law. This would allow the Government to plug systemic leakages in the tax system (which amount to at least 1.5 percent of GDP), level the playing field, and raise revenues by up to two percent of GDP over the long-term. On tax administration, current efforts to improve tax compliance need to be sustained while the overhaul of customs administration needs to be accelerated. In the medium-term, a comprehensive tax reform to lower tax rates, broaden the tax base, and simplify procedures is needed. Such a reform would enhance the equity, efficiency, and the administrative ease of the country's tax system and ensure long-term fiscal sustainability.

25. **The overall debt burden remains manageable as budget deficits are expected to be subdued**. A debt sustainability analysis projects that NG debt could continue to trend downwards, with a debt-to-GDP ratio of 46 percent by 2016, barring any unexpected shocks. Standard shocks on interest rates and growth (i.e., a 0.5 to 1.0 standard deviation), and on exchange rate (30 percent real depreciation) would increase the debt stock to between 48.7 and 53 percent of GDP (Figure 2), levels that are still broadly sustainable.

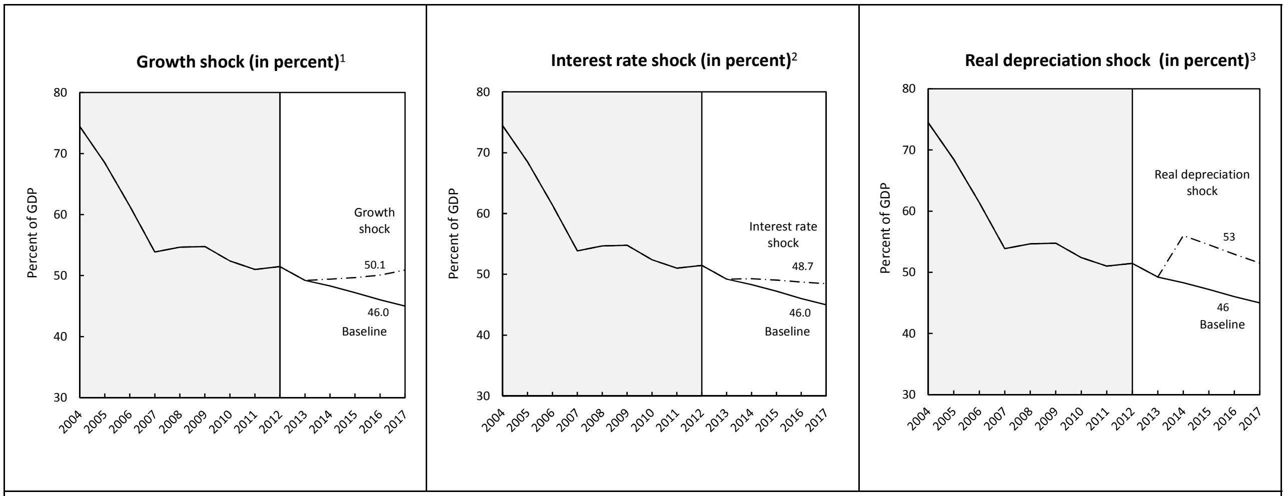
26. **The macroeconomic policy framework is adequate and suitable for the purposes of**

[24] In 2013, potential GDP growth was estimated at 5.5 percent while actual GDP growth reached 7.2 percent. As a percent of potential GDP, the gap between potential and actual GDP has declined from 6 percent in 2009 to 2.4 percent in 2013, and is projected to reach 1.8 percent in 2014 and 0.1 percent in 2016. This suggests that there is less room for higher growth in the medium-term unless the country accelerates investment.

[25] See the Philippine development report entitled "Creating more and better jobs" for more discussion.

this project. The main development challenge is how to translate macroeconomic stability into inclusive growth. Going forward, the government needs to focus its attention on generating higher, sustained, and more inclusive growth—the type that creates more and better jobs and reduces poverty. To do so, the productivity of the majority of the country's workers will have to increase. This requires increasing overall investments in human and physical capital. To ensure fiscal sustainability, such increased investment levels need to be accompanied by increased revenues (through a combination of tax policy and administrative measures) and improvements in the planning, execution and monitoring of the public expenditure and investment process. In addition, opening up the economy to new entrants from within and outside the country to create more competition is an equally essential part of the policy reform agenda. With reforms that secure property rights, foster competition, simplify business regulations, and increase investments in health, education, and infrastructure, the private sector will have the incentive to invest more and create jobs, and the country can attract more investment as rebalancing in the region takes place.

Figure 2. National debt to GDP ratio projection with shocks



Source: World Bank staff calculations
Notes: The shaded areas represent actual data.
1 Represents a one standard deviation shock to growth.
2 Represents a one standard deviation shock to interest rates.
3 One-time real depreciation of 30 percent, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator.

Table 1: Key Economic Indicators, 2011 – 2016

	2011	2012	2013	2014	2015	2016
	Actual			Projection		
Growth and inflation	(in percent of GDP, unless otherwise indicated)					
Gross domestic product (percent change)	3.6	6.8	7.2	6.4	6.7	6.5
Inflation (period average)	4.8	3.2	3.0	5.0	4.5	4.0
Savings and investment						
Gross national savings	23.1	22.3	23.2	22.9	24.7	26.4
Gross domestic investment	20.5	18.1	19.7	20.8	22.5	24.0
Public sector						
National government balance (GFS basis) [1]	-2.1	-2.4	-1.5	-2.1	-2.1	-2.1
National government balance (Govt Definition)	-2.0	-2.3	-1.4	-2.0	-2.0	-2.0
Total revenue (Govt Definition)	14.0	14.5	14.9	15.2	15.6	16.0
Tax revenue	12.3	12.9	13.3	13.6	14.0	14.3
Total spending (Govt Definition)	16.1	16.8	16.3	17.2	17.6	18.0
National government debt [2]	51.0	51.5	49.2	48.3	47.0	45.6
Balance of payments						
Merchandise exports (percent change)	4.1	21.2	-3.6	8.9	10.0	10.4
Merchandise imports (percent change)	9.5	11.3	-3.1	15.4	8.0	11.0
Remittances (percent change of US$ remittance)	7.2	6.3	7.4	6.1	5.6	5.1
Current account balance	2.5	2.8	3.5	2.0	2.2	2.4
Foreign direct investment (billions of dollars)	2.0	3.2	3.9	4.2	4.5	5.5
Portfolio Investment (billions of dollars)	3.1	4.2	0.4	2.0	2.0	3.0
International reserves						
Gross official reserves [3] (billions of dollars)	75.3	83.8	83.2	85.2	86.3	86.7
Gross official reserves (months of imports)	11.6	11.9	11.5	11.0	10.3	9.4
External debt [4]	30.1	28.1	28.0	27.8	27.3	26.7

Source: Government of the Philippines for historical, World Bank for projections

1 Excludes privatization receipts and includes Central Bank Board of Liquidators (CB-BOL) restructuring revenues and expenditures (in accordance with GFSM).

2 Refers to all loans and security issuances of the National Government (or central government). It includes National Government's bond sinking fund (BSF) but excludes debt of the central bank, LGUs, social security institutions, government finance institutions, and other government owned and controlled corporations (GOCCs). This differs from the total consolidated general govenment debt (mentioned in Annex 6), which excludes domestic intra-sector debt holdings and the BSF.

3 Includes gold.

4 Worldbank definition. The difference with central bank data is that it includes the following: (i) Gross--Due to Head Office/ Branches Abroad of branches and offshore banking units of foreign banks operating in the Philippines, which are treated as quasi-equity in view of nil and/or token accounts of permanently assigned capital required of these banks; (ii) Long-term loans of non-banks obtained without BSP approval which cannot be serviced using the foreign exchange resources of the Philippine banking; and (iii) Long-term obligations under capital lease agreements.

Table1: Key Economic Indicators, 2010 – 2016 (cont)

	2010	2011	2012	2013	2014
					WB proj.
	(in percent of GDP, unless otherwise stated)				
Revenue and grant	13.4	14.0	14.5	14.9	15.2
Tax revenue	12.1	12.3	12.9	13.3	13.6
Net income and profits	5.4	5.9	6.1	6.2	6.2
Excise tax	0.7	0.7	0.7	1.0	1.0
Sales taxes and licenses	2.4	2.4	2.7	2.7	2.8
Others	0.7	0.7	0.7	0.7	0.7
Collection from Customs	2.9	2.7	2.7	2.6	2.9
Nontax revenue[1]	1.3	1.6	1.6	1.6	1.6
Grant	0.0	0.0	0.0	0.0	0.0
Total expenditure	17.0	16.1	16.9	16.4	17.2
Current expenditures	13.8	13.3	13.6	13.3	12.9
Personnel services	5.2	5.1	5.1	5.0	5.2
MOOE	2.0	2.1	2.4	2.5	2.8
Allotment to LGUs[2]	2.4	2.4	1.9	2.1	2.0
Subsidies	0.2	0.5	0.5	0.6	0.1
Tax expenditures	0.5	0.3	0.5	0.2	0.2
Interest payment	3.4	3.0	3.1	2.9	2.6
Capital outlays	3.1	2.6	3.2	3.0	4.1
Net lending	0.1	0.2	0.3	0.1	0.2
Balance (GFS definition)	-3.6	-2.1	-2.4	-1.5	-2.1
Balance (GOP definition)	-3.5	-2.0	-2.3	-1.4	-2.0
Primary Balance (GFS)	-0.2	0.8	0.7	1.4	0.6
Memorandum items					
Privatization receipts (PHP billions)	0.9	0.9	0.0	0.2	0.0
CB-BOL interest payments (percent of GDP	0.1	0.1	0.1	0.2	0.1
Nominal GDP (PHP trillion)	9.0	9.7	10.6	11.5	13.1

Source: Department of Finance, Bureau of Treasury, and Department of Budget and Management, WB staff calculations

1 Excludes privatization receipts (these are treated as financing items, in accordance with GFSM).

2 Allocation to Local Government Units (LGUs) excludes capital transfers which are included in capital outlays.

2.3 IMF RELATIONS

27. **The Philippines does not have an ongoing program with the IMF.** The most recent IMF program expired at end-2000, and all obligations were fully repaid in 2006. Article IV Consultations Mission of the IMF are conducted on a standard 12-month basis. The last consultations were concluded in March 2014, with the final report still to be published. The World Bank team maintains a good working relation with the Fund. Exchanges on macro-fiscal

issues, public financial management reforms, financial sector updates, and monetary policy are conducted on a regular basis. The Bank and the Fund broadly share a similar assessment of the economic conditions of the Philippines (refer to the Article IV March mission's concluding statement in Annex 6).

3. THE GOVERNMENT'S PROGRAM

28. **The Aquino administrations Social Contract with the Filipino People puts better governance at the center of its reform program.** The 2010 Social Contract explicitly sets out the principles and core objectives for the government's six year term (see Box 3). The government's economic program highlights the challenge of tackling vested interests, scaling up public investments in ways to empower the poor and private sector, and above all strive to create adequate opportunities for jobs and livelihoods at home.

Box 3: Social Contract Economy Priorities

1. From government policies influenced by well-connected private interests to a leadership that executes all the laws of the land with impartiality and decisiveness.
2. From treating the rural economy as just a source of problems to recognizing farms and rural enterprises as vital to achieving food security and more equitable economic growth, worthy of re-investment for sustained productivity.
3. From government anti-poverty programs that instill a dole-out mentality to well-considered programs that build capacity and create opportunity among the poor and the marginalized in the country.
4. From a government that dampens private initiative and enterprise to a government that creates conditions conducive to the growth and competitiveness of private businesses, big, medium and small.
5. From a government that treats its people as an export commodity and a means to earn foreign exchange, disregarding the social cost to Filipino families to a government that creates jobs at home, so that working abroad will be a choice rather than a necessity; and when its citizens do choose to become OFWs, their welfare and protection will still be the government's priority.

Source: http://www.gov.ph/about/gov/exec/bsaiii/platform-of-government/

29. **The 2011-2016 Philippines Development Plan (PDP) and its 2014 update provides a detailed analysis of the challenges facing inclusive growth and the reforms required to achieve it**. Inclusive growth constitutes the core theme of the plan.[26] The latter indeed identifies a window of opportunity "of finally breaking out of its perennial condition of poverty, inequity, and lagging human development." The PDP's principal objective is to sustain growth between 7 to 8 percent. To achieve this target, the PDP projects that physical capital – both from public and private sources – needs to contribute to at least 22 percent of GDP. This means that the

[26] http://www.neda.gov.ph/PDP/2011-2016/. The update with revalidated results matrixes was issued April 2014

Philippines has to (i) scale-up significantly[27] capital expenditures; (ii) loosen barriers facing private investments – both domestic and FDI; and (iii) boosting TFP growth mainly through enhancing investments in human capital. On the other hand, the PDP sets an ambitious target for creating 1 million new jobs annually. While the bulk of the employment is expected to be generated by manufacturing, the plan recognizes the role of the agriculture sector in supporting the job creation and productivity increase agenda.[28] Moreover, the PDP focuses on cash-transfer programs as a tool to help increase access to health and education. Consequently, this is expected to help reduce poverty to a targeted level of 16.6 percent by 2015.[29]

30. **The annual State of the Nations (SONA) provides further articulation of continued economic priorities and affirms ownership of the reform program.** The President's Fourth SONA was delivered on July 22, 2013,[30] and was accompanied by a detailed technical report.[31] The SONA flagged key actions in boosting infrastructure provision, including for such priorities as tourism, agricultural development, and climate change resilience. The SONA recognizes the key challenge posed by prevailing licensing and regulatory burdens in facilitating private investments. In the medium term, these also include reforms to domestic transport logistics and land market reforms.

31. **The government's five Cabinet Clusters serve to advance key cross-cutting government priorities and policy dialogue.** The President serves as the Chair of the Good Governance and Anti-Corruption Cluster, with other Cluster chaired at the Secretary level.[32] The clusters and associated working groups also serve as the main vehicles for donor coordination, with the last major meeting held in Davao in February 2013.[33]

- *Good Governance and Anti-Corruption Cluster (President)*
- *Human Development and Poverty Reduction (Secretary of DSWD)*
- *Economic Development (Secretary of Finance)*
- *Security, Justice and Peace (Executive Secretary)*
- *Climate Change Adaptation and Mitigation (Secretary DENR)*

32. **The success of the government program hinges on addressing political and capacity downside risks**. The success of the reform agenda hinges on the ability of government to

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[27] The government's target in this regard is to raise capital investment from 2.5 to 5 percent of GDP starting 2013.

[28] The plan states that "the completion of agrarian reform, a resolution of property rights issues in agriculture and implementation of major infrastructure shall enable agriculture and agro-processing to come into their own again and begin to reabsorb labor".

[29] Data for the 2012 Family and Income Survey (FIES), which serves as the basis for the three yearly poverty line analysis, has just been released. The World Bank is working with authorities to validate the applied poverty line methodology, as well as a possible adjustments needed for consistent trend estimates.

[30] http://www.gov.ph/sona-2013/

[31] http://www.gov.ph/downloads/2013/07jul/20130722-SONA-Technical-Report.pdf

[32] http://www.gov.ph/2011/05/13/executive-order-no-43/

[33] http://www.pdf.ph

implement and institutionalize the proposed structural changes. However this process is confronted with political economy and capacity related downside risks. First while the current administration remains highly popular, less than three years remain till the end of its term. Since presidents are constitutionally bound by one term in the Philippines, the uncertainty over the medium and long term ownership of reforms remains a concern. Second, reforms in the Philippines are often undermined by a large number of vested interests. This has been tangible in recent corruption scandals including the high profile Priority Development Assistance Fund (PDAF) case.[34] Using considerable political capital, the government drive to crack down on corruption has gained them so far some clamor in the public arena. Finally, the implementation capabilities of the bureaucracy have also been compromised by years of staff attrition and a limited collective drive for performance. While tangible efforts have focused on modernizing the public administration, further technical assistance and training is still required to mitigate the risks of implementation capacity.

4. THE PROPOSED OPERATION

33. **The program's development objective (PDO) is to support sustained and inclusive growth and job creation.** The means to achieving this objective are through increasing physical and human capital investment; tackling regulatory barriers in land, labor, and capital markets; all in the context of ensuring fiscal sustainability and boosting fiscal governance and transparency. The operation's PDO consists of five pillars: (i) strengthening priority public investments implementation, (ii) reducing the cost of doing business for jobs creation and poverty reduction; (iii) developing the human capital of the poor; (iv) fiscal transparency and good governance; and (v) consolidating fiscal sustainability through revenue mobilization and risk management. The operation is the last among a three programmatic DPLs series supporting government reforms through 2014.

34. **The program series has been aligned to supporting inclusive growth priorities through the end of the Aquino administration in 2016.** Government has made it clear that it wishes to advance actions with short term impact, but above all to put in place solid foundations for inclusive growth in the next administration. The government also seeks to have cemented reforms that enhance the accountability relationships between government and citizens. While the current operation is the last of a three tranche series to achieve priority outcomes by end-2014, the programmatic series builds the foundation for further DPL operations envisioned for 2015 and 2016 (see Annex 4). The latter aim to further consolidate the priority reform program and therefore retains the overall PDOs and results indicators with some refinements. Furthermore, the current program incorporates lessons learnt in advancing the implementation of institutional reforms and seizing reform opportunities[35] (see World Bank 2014).[36]

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[34] The cased involved the diversion of so-called pork barrel fund allocations to legislators by means of bogus NGO payments. The Supreme Court declared PDAF unconstitutional in November 2013.

[35] To better align to the relative priorities of the government, the ordering of the indicators have been altered. The program now leads with enhancing public + private investments, and places revenue mobilization and fiscal risk management as a final/fifth "sustaining" factor.

35. **Ownership across government, civil society and private sector is key for the success of this programmatic DPL series.** The current operation has been extremely selective in supporting legislation and is focusing on prior actions with deep engagements of respective counterparts. This was the primary lesson learned from the DPL program that was discontinued under the previous government due to waning progress.[37] Therefore the current DPL design builds on widely endorsed policy programs such as the Social Contract, PDP and SONAs. It is also informed by the ongoing policy dialogue with the various cabinet clusters. In particular, the operation is informed by the discussions with the clusters on economic development, human development, and good governance and anti-corruption especially pertaining to the actions of the pillars on public infrastructure and private investment, human capital accumulation, and open government and PFM reforms.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

36. **The DPL program builds on comprehensive analytical underpinnings ranging from technical assistance projects, economic and sector work, and capacity building programs.** This includes both Bank and other development partner programs, alongside government assessments. Table 2 outlines each envisaged prior actions to be completed by mid-2014 and their analytical underpinnings. The actions have been selected to institutionalize reforms going forward with the next administration, while complementing the World Bank Group's engagements under its on-going AAA program and investment lending program. We discuss each proposed prior action and associated rationale for June 2014 in turn, as well as medium term strategic agenda. Detailed information for each pillar is discussed below, while the policy and results matrix is highlighted under Annex 1.

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[36] World Bank, Philippines Development Policy Loan for Inclusive Growth Interim Assessment: review of tranches 1 and 2, Mimeo, May 2014.

[37] Notably the implementation of revenues measures.

Table 2: DPO Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Operation Pillar 1: Strengthen Public Infrastructure Implementation	
Prior action #1: The implementation of the DPWH public infrastructure program has advanced: (i) contracting out over 80% of the combined 2012 and 2013 capital expenditure budget by January 1, 2014; and (ii) contracting out over 50% of the 2014 capital expenditure by June 30, 2014.	2011 PER, DPWH Governance Assessment, Sector Public Investment Notes
Prior action #2: DPWH, has delivered contract works under the TRIP network preparation process and resulting plan.	2011 PER, DPWH Governance Assessment, Sector Public Investment Notes, WB-USAID TRIP M&E TA
Prior action #3: The Borrower has issued the 2014 GAA requires: (i) that DPWH implement the Regular FMR Program; and (ii) that DA provides and discloses the network plan for Regular FMR Program projects.	Agriculture PER Update, Review Note for DBM
Operation Pillar 2: Ease of Private Investment for Jobs Creation	
Prior action #4: The DTI has improved online functionality of the PBR for national registration, including ePayments.	WB/USAID PBR Assessments
Operation Pillar 3: Developing the Human Capital of the Poor	
Prior action #5 The preparation for NHTS-PR II is advanced: (i) operational manual is revised to reflect lessons learned from the previous assessment; (ii) field workers are being hired and trained using standard training tools; (iii) IT-enabled data collection and encoding is developed and tested; (iv) arrangements for spot checks to monitor reassessment processes are in place.	Bank core ESW; Bank non-core ESW; Government analytical work; other analytical work: Programmatic AAA on Poverty and Shared Prosperity, CCT Benefit Incidence Analysis, PAAA on SP and Labor
Prior action #6: CCT coverage expanded to children up to 18 years of age.	
Prior action #7: NHTS-PR being systematically used to target three programs, , to the lowest 40 percent of the population with Philhealth achieving effective enrollment of poor and near poor in the bottom 40 percent of the population.	
Operation Pillar 4: Fiscal Transparency & Good Governance	
Prior action #8: The Borrower has adopted a unified Account Code Structure for accounting, budgetary and treasury transactions and implemented this as part of the 2014 budget preparation and implementation.	PERs, AusAID/PWC Design Studies
Prior action #9: The Philippines Open Data portal (data.gov.ph) is fully operational with full electronic access to over 600 datasets.	Open Government DBM TA/Note for DBM Program Evaluation
Operation Pillar 5: Fiscal Sustainability: Revenue & Risk Management	
Prior action #10: The Borrower has implemented the following revenue-related reforms: (i) a tobacco and alcohol excise tax reform; and (ii) the completion and on-line publication of a Tax Expenditure Statement (TES) concerning fiscal incentives for investment.	Sin Tax PSIA, Tax Report, PU March 2013
Prior action #11: 11. Fiscal risk management strengthened through disclosure of broad risks (Annual Fiscal Risk Statement) and explicit/increased contingency allocations in 2014 budget (Risk Management Program + NDRRF).	Fiscal Risk Statement
Notes: See Annex 1 for DPL 1-3 program.	

Operation Pillar 1: Strengthening Priority Public Investment Implementation

Prior Action 1: *The implementation of the DPWH public infrastructure program has advanced: (i) by January 1 2014, over 80 percent of the combined 2012 and 2013 capital expenditure budget has been contracted, and over 60 percent of these projects have been completed; and (ii) over 50 percent of the 2014 capital expenditure budget has been contracted by June 30, 2014.*

37. **Public infrastructure gaps are widely recognized as binding constraints to inclusive growth and equitable social development in the Philippines.** Enhancing both the quality and quantity of spending remains a priority challenge. Public infrastructure spending remains at less than 2.5 percent of GDP per annum in 2012, which government has vowed to double to 5 percent of GDP in the medium term. Even as the Aquino administration has committed to generating greater fiscal space for public investment spending, the partial execution of annual available budgets for public infrastructure remains challenging. This has been reflective of the constraints with realizing more timely public resource allocation for the creation of economically and socially beneficial infrastructure stocks across the archipelago that promote inclusive growth and jobs creation.

38. **With the objective of increasing the quality/prioritization and quantity of public investment, the government has focused on making DPWH the premier public infrastructure delivery agency.** This meant systematic and timely prioritization, and a close monitoring, of over 20 thousand contracts implemented annually by national, regional and district branches of the agency between 2011-2013. As part of convergence agendas, DPWH has become the delivery vehicle for implementing priority flagship programs from roads, bridges, clinics, and schools, along with the delivery of post-Bohol earthquake and Yolanda reconstruction. The proposed action encapsulates DPWH ability to provide timely reports on budget execution, to initiate contracts in a predictable manner early in the budget year, and to increase the standards of public infrastructure works. Historically agency capital budgets have often been subject to opaque "lump sum" allocations and protracted execution, rather than transparent plans structured around inclusive growth priorities and citizen's feedback. The timely and transparent contracting of capital budgets in the first half of the year represents a good measure of the abolition of lump sum spending in favor of better prioritized and monitored public infrastructure spending.

39. **Enhanced public investment management will be critical to enhancing perennial infrastructure gaps.** Delivering results around flagship programs will depend on addressing weaknesses across the planning, budgeting, execution, and monitoring cycle. Oversight agencies such as DBM have underscored the need to clearly identify clients/beneficiaries from investments, and then target programs, including notably infrastructure, in a transparent, timely and cost effective manner. Prioritization will also need to be effectively aligned to network plans that support connectivity for poverty reduction and shared prosperity across the Philippines to deliver tangible outcomes through the end of the Aquino administration. The DPL program supports institutional development actions that will have a significant impact towards achieving

results in particular areas, but also serve as demonstration cases for broader institutional reforms towards enhanced public infrastructure delivery. Through prior actions #2 and #3, DPL series focuses on tourism and rural connectivity infrastructure. Other priority areas such as disaster/climate change resiliency – using infrastructure management ("building better/building back better") for disaster reconstruction - or water and irrigation could be tackled in future operations.

Tourism Road Infrastructure

Prior Action 2: DPWH has delivered contract works under the TRIP network preparation process and resulting plan.

40. **Despite a range of natural endowments and a highly service oriented culture, overall tourist visitor numbers to the Philippines have been low.** The Aquino administration has set itself an ambitious target of increasing foreign visitor numbers of 10 million and domestic of 56 million by 2016, from the current 4.3 million and 41 million, respectively, in 2012.[38] As part of the 2012-2014 budgets, it has allocated PhP 36.4 billion (about USD 800 Million or ~0.3 percent of GDP) for its Tourism Roads Infrastructure Program (TRIP).[39] Further growth in the TRIP program is projected for 2015-6. The program is financing the upgrading of over 2000km of "last mile" roads notably on the local road network to help deliver tourism related demand, employment, and ultimately poverty reduction benefits. At the same time, government has undertaken reforms to liberalize international and domestic air travel, and is upgrading associated air and sea port infrastructure.[40]

41. **DoT's tourism program has been built on a number of innovative and progressive convergence partnerships with other agencies.** With the support of civil society organizations, the TRIP network was prioritized over the past two years to maximize connectivity impacts with national trunk roads. Under a DoT-DPWH convergence program now operating for over three years, DPWH implements road infrastructure to national standards based on a pre-defined network plan. Other recent convergence MoU's with DSWD - under the "One Step" program - are identifying ways of linking communities/households to potential demand benefits from the tourism sector, notably in rural/agricultural areas. The program has also provided full national disclosure of TRIP project and associated contract implementation by DPWH.

42. **The TRIP action serves to highlight continued progress in implementation, institutionalizing program governance and transparency initiatives, and expanding convergence partnerships.** The early preparation of the network plan prior to the start of each

[38] See DoT Secretary Jimenez presentation to Arangkada Philippines Second Anniversary Forum: Realize the Potential! on February 26, 2013 at the Rizal Ballroom, Makati Shangri-La - See more at: http://www.investphilippines.info/forum/national-tourism-development-plan-by-tourism-sec-jimenez/#sthash.Bj0i7f94.dpuf and Van der Weide 2010:20, http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1218567884549/5289593-1224797529767/5506237-1270138945775/DFSG04PhilippinesFR1.pdf.

[39] Presentation of DOT to the Tourism Coordinating Council. April 19, 2013.

[40] See World Bank, (2014), Philippines Economic Update: Pursuing Inclusive Growth Through Sustainable Reconstruction and Jobs Creation, 2014, Special Focus #1.

budget year also allowed DPWH to initiate contracts early, something which has been reflected in high execution rates, including given the fact that three quarter of the upgrades are on the sub-national road network.[41] The DoT-DSWD convergence program is focusing on demonstrating a more integrated approach to poverty reduction in five "banner" demonstration locations. DoT is also pursuing discussions with DA on enhancing tourism-farm linkages in municipalities in Tourism Priority Areas, as well as strengthening linkages on nodal air and seaport infrastructure over the coming years for enhanced tourism visit incomes and more importantly local jobs and poverty reduction.

Rural Connectivity Infrastructure

Prior action #3: The Borrower has issued the 2014 GAA which requires that: (i) DPWH implement the Regular FMR Program; and (ii) DA provide and disclose the network plan for Regular FMR Program projects.

43. **In general, inefficiencies along the agricultural supply chain result in higher postharvest transaction and distribution costs, and large post-harvest losses.** The Philippine logistics system has been characterized as being cost-inefficient, unresponsive to customers and market requirements, and unreliable. Compared to developed countries, distribution and processing costs in the country are 20 percent to 30 percent higher, with logistics costs accounting for almost 30 percent to 40 percent of total marketing costs (NEDA-UNDP, 2005). The ineffective logistics services, coupled with inappropriate postharvest handling, have likewise resulted in huge postharvest losses. For rice and corn, 14.8 percent and 7.2 percent of total production are lost during postharvest operations, respectively. Losses are even higher in horticultural crops, with losses in fruits ranging from 5 percent to 48 percent and those in vegetables falling within the range of 16 percent to 40 percent. These postharvest losses, when translated into monetary values, sizably reduce the income of farmers and their households (Bureau of Post Harvest Research & Extension (BPRE), 2010).

44. **The construction, rehabilitation or repair of farm-to-market roads (FMRs) for key production areas is central to relieving binding constraints for rural transformation.** Enhancing connectivity is a key priority for improving rural and agricultural productivity and consequently target poverty. As part of the Agricultural and Fisheries Modernization Plan (AFMP) for 2011-2017, the DA is supporting the construction and rehabilitation of FMRs within key production areas. This includes new lands under convergence initiatives, primary assembly areas such as major markets/trading posts and mariculture zones[42], and post-harvest facilities and processing zones/industries. These FMRs are expected to reduce the transport bottlenecks of agriculture produce, reduce postharvest losses and improve agriculture yields, promote agriculture-related activities, and enhance farmers' and fishers' livelihood and therefore increase their incomes.

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[41] The Philippines road network encompasses about 200 hundred thousand kilometers of road, of which 15 percent are declared as national roads under DPWH's responsibility. The government intends to fully pave and upgrade the national network by 2016. The remaining roads are under provincial, city-municipal, and barangay roads. The Philippines current does not have an integrated overall road network plan that includes sub-national roads.

[42] This includes fish landing sites, fishing ports, fishpond/fish cage areas.

45. **Institutional changes will have to be introduced to scale up the program implementation nationwide.** Over two decades ago, FMR construction and maintenance have been devolved to LGUs.[43] However, national agencies can also implement FMRs. Hence, FMRs and other rural infrastructure investments have not only served as the DA's means to improve sector productivity, competitiveness, and connectivity, but they also constituted the DA's operational platform for engaging and building the institutional capacity of LGUs in the delivery of public agriculture and fishery infrastructure investments and services. This comes in line with the country's legal framework on decentralization and the AFMP.[44] To scale-up the program and enhance both its geographical coverage and effectiveness, the oversight agencies have requested DPWH – as an institution specialized in infrastructure projects - to implement the program nationwide based on a validated network list of FMRs that the DA designed to maximize rural livelihoods impacts. As a result, the 2014 budget has assigned PhP 12 billion (US$273M) for DA's regular FMR program.[45] The funds are expected to be released directly by DBM to DPWH. The DPL supports this re-organization of institutional roles and responsibilities, and notably DA's transparent prioritization and disclosure of a package of FMRs to be implemented by DPWH.[46]

46. **The transfer of the regular FMR program to DWPH is expected to enhance the transparency, pace, and quality of rural road delivery in the Philippines.** The proposed measure expects DA to provide DPWH with a clear and transparent list of FMR's proposed for implementation. Under the GAA 2014 provisions,[47] DBM will release the respective budget for FMR implementation to DPWH. In August 2014, DBM and DA finalized an assessment of the GAA provisions having been met for an initial batch of 175 sub-projects through an associated budget release. These discussions included a definition of network plan, at least for an initial batch of proposed FMRs and associated budget release tranche (by means of a so-called SARO). In line with prevailing transparency laws, the bid and contract details of all these projects should then be publically disclosed (i.e., on both the DPWH and PhilGeps sites). The proposed transparency measures are also intended to be linked to such open government initiatives as geo-referencing. Over time, a significant agenda remains to clarify the roles and responsibilities for effective rural/FMR road implementation in the Philippines using national budget resources, notably across national government agencies (including DPWH and DA) and LGUs. A key goal will be to arrive at effective governance and technical arrangements to enhance the delivery,

[43] As per the 1991 Local Government Code which gives LGU the mandate and responsibility for public investment services.

[44] The plan DA envisioned the construction and repair of some 12,095 kilometres (kms) of FMRs. 5,956 kms were planned from 2011–2013 and another 6,140 kms are planned for 2014 to 2017. A total of about PhP 65 billion (US$ 1.5 billion) would be needed for the construction and repair of FMRs, of which PhP 24.2 billion was programmed for the period 2011–2013 and the remaining PhP 40.8 billion for the period from 2014 to 2017.

[45] A number of other programs, such as the Grass Roots Participatory Budget Program (GRPB) and the Philippines Rural Development Program (PRDP) also implement FMRs through DA, DAR, or LGUs. Smaller/lower traffic roads may often be non-concrete, whereas the emphasis of the DA-DPWH is on concreted roads.

[46] The 2014 GAA also provides PhP 150 million for third party monitoring of this regular FMR program.

[47] See Official Gazette, Vol. 109, No. 1, GAA 2014 (Republic Act No. 10633), including legal stipulations for DA Regular Program Implementation (see pages 26, fn 6)

operations, and maintenance of FMR roads in the Philippines. The primary contribution of the DPL program is currently to promote the transparency of the FMR network plan being implemented through national budget financing.[48]

Operation Pillar 2: Reducing the Cost of Doing Business for Jobs Creation and Poverty Reduction

Prior Action 4: *The DTI has improved online functionality of the PBR for national registration, including ePayments.*

47. **Business registration and licensing is a cumbersome process in the Philippines, posing obstacles to the development of small and medium enterprises.** Micro, small and medium enterprises (MSMEs) account for 99.6 percent of all enterprises in the Philippines. Over 95 percent of the labor force are either own account workers or work in MSMEs. A vast majority of those working in MSMEs work in very small firms. Only about 7 percent worked in enterprises with 50 -250 workers in the Philippines compared to 30 percent in Japan and about 20 percent in Korea and Germany. Creating an environment that helps MSMEs to grow is essential to create jobs in the economy. Business registration and licensing, including renewals of registration and various permits is cumbersome and costly in the Philippines.

48. **Collaboration with the IFC to promote the Ease of Doing Business for both sole proprietorships and corporates has been close.** The IFC, through its Advisory Services, has been providing TA for business registration streamlining at both the national and sub-national level. On-going work has demonstrated registration streamlining processes at the level of over a dozen local governments, which has helped reduce de facto registration times in these localities. The prior actions concerning the Philippines Business Registry under this operation were supported jointly by the IFC and the World Bank, and there is on-going follow-up to support reforms by both the DTI and SEC to support formal business registration and development in the Philippines.

49. **The government has envisioned rationalizing the registration of all commercial entities.** There are currently three main classes of formal enterprise in the Philippines: sole proprietorships, limited liability companies, and cooperatives. Through a DBM-DTI-SEC convergence initiative, government aims to launch a business.gov.ph under the Aquino administration, which can serve as a platform for the identification of all commercial juridical entities. The platform will interlink sub-platforms for sole proprietorship (headed by the DTI) and limited liability companies (headed by the SEC).

50. **While the Philippines registered notable gains in its overall 2014 Ease of Doing**

[48] While DPWH maintains a geographic information system (GIS) for the national road network for which it is responsible, the Roads and Bridges Information Application (RBIA), no comprehensive GIS exists for the 80 percent plus of the estimated 200 thousand km road network of provincial, city-municipal and barangay roads. This means that in practice rural road network investments across national agencies and LGUs are highly fragmented and lacked transparency. The establishment of an overall network map will remain a longer term objective in the Philippines, although a number of LGUs have already implemented this for their local planning and transparency purposes.

Business rating, it fell further behind to 170 of 189 in starting a new business.[49] According to Doing Business 2014 Report, which measures procedures for limited liability companies, it takes 15 different procedures compared to 7 average in East Asia and 5 in OECD to register a limited liability company, or a corporation in case of the Philippines. It takes on average 35 days to register a business in the Philippines compared to 6 in Malaysia. Sole proprietorships face similarly complex procedures. Simplifying and streamlining business registration process for MSMEs in the Philippines would not only support job creation by MSMEs, but also improve transparency and accountability of the various agencies responsible for each step in the business registration.

51. **An effective on-line platform for processing business registration and renewal applications stands to significantly reduce administrative burden on MSMEs and improve transparency.** Philippines Business Registry (PBR), managed by DTI is a platform for registering single proprietorships, accounting for vast majority of enterprises in the Philippines. The system aims to streamline issuance and coordination with various agencies involved in the business registration process and facilitates integration with the LGU business registration system. DTI has added an e-payment system that improves the functionality of the PBR. However, the PBR system access has been only partially accessible for full public on-line use. DTI management requires applicants to partially complete applications on line and then visit DTI offices and use DTI staff to register via PBR, or to register in the traditional paper-based way. Technically this reflects progress, but a key milestone will be to fully phase out paper based registration and the use of DTI offices (expect for kiosk access for those not having full internet access). DTI is testing the robustness of the PBR system before opening it to online registration. The final design will also need to facilitate easy access to the system by LGUs - a necessary part of the total registration process. Launch of a streamlined on-line registry and active use of the system by LGUs is essential to reduce the administrative burden on MSMEs. For 2014, the key reform action has been to accelerate implementation of the PBR with on-line functionality including ePayments for national level registration.[50]

52. **Policies for stimulating investments are still being debated in the Philippines.** While firms operating under the DTI-attached Board of Investments (BOI) Philippines Export Zone Authority (PEZA) regimes are eligible for special tax incentives[51], the most recent Tax Expenditure Statement (TES) reveals a lack of transparency on how such incentives are paying off in terms of new investments and job creation. While the DPL program has approached this to-date mainly as a revenue issue[52], it highlights the challenge of advancing more pronounced structural reforms aimed at boosting job creation through leveling the playing field for all

[49] World Bank Group/IFC, Doing Business 2014: Economy Profile Philippines (http://www.doingbusiness.org/data/exploreeconomies/philippines/~/media/giawb/doing%20business/documents/profiles/country/PHL.pdf)

[50] The overall DPL program has also focused on the roll-out of streamlined business registration processes under the authority of the LGUs. The current operation emphasizes the need to first consolidate the systems reforms at the national level, while supporting LGUs with incentives and instruments to streamline registration at that level.

[51] And registration procedures.

[52] Refer to Pillar 5 of the operation.

investors and encouraging competition. Moreover, despite a significant improvement in Ease of Doing Business ratings, FDI and formal start-up investments continue to lag in the Philippines. The DPL series recognizes the efforts made through the National Competitiveness Council (NCC) to champion improvements in the investment climate, and sees this as an area to be further advanced in the subsequent DPL program (refer to Annex 4 for more details).[53]

Operation Pillar 3: Developing the Human Capital of the Poor

Prior Action 5: The preparation for NHTS-PR II is advanced: (i) operational manual is revised to reflect lessons learned from the previous assessment; (ii) field workers are being hired and trained using standard training tools; (iii) IT-enabled data collection and encoding is developed and tested; (iv) arrangements for spot checks to monitor reassessment processes are in place.

Prior Action 6: Expand the CCT coverage to children up to 18 years of age.

Prior Action 7: NHTS-PR used to target at least 3 major government programs to the lowest 40 percent of the population, including evidence that PhilHealth has achieved effective enrollment of poor and near poor in the bottom 40 percent of the population.

53. This pillar objective is to support Government's policy and institutional development actions aimed at creating opportunities for an equitable development of the human capital of the poor, thus mitigating some of the key factors associated with high and persistent structural poverty that continues to affect generations of Filipino households.

54. **In the Philippines, similar to other countries, low human capital of the poor—both in terms of education and health—is one of the key factors associated with persistent poverty.** Households whose heads have low level of educational attainment are at significantly higher risk of poverty than households whose heads have at least a high school level education. In the Philippines, one-third of children aged 12 to 15 years old are not enrolled in high school, with a low secondary net enrolment rate of 64.6 percent in 2012. Consequently, only half of a beginning cohort in the first grade will graduate in Grade 10. Gender disparity remains, with boys continuing to lag behind girls. The challenge of poor educational access and low student learning is far worse for certain subgroups, including children from poor households, with a disability or belonging to Indigenous Peoples. According to the 2009 Family Income and Expenditure Survey (FIES) and the Labor Force Survey (LFS) data, around 70 percent of poor children are out of school by the age of 18 not acquiring education and skills level that is needed for higher productivity and better paid jobs. Therefore, their chances to break the cycle of poverty are slim at best.

55. **Similarly, poverty is associated with worse health status and access to care.** Health status indicators are way worse for poor households than for the rest of the population. Infant

[53] This will include the systematic monitoring of improvements in sole proprietorship and limited liability registration process across the Philippines.

mortality rate in the bottom income quintile is three times higher than in the top income quintile (46.9 vs. 15.2 infant deaths per one thousand live births). Similar disparity is observed with regards to the under-five mortality rate: 66.4 under-five deaths per 1,000 live births in the bottom income quintile of households vs. 19.2 in the top. Poor households experience significantly higher incidence of fever, acute respiratory infections and diarrhea than better off households. At the same time, poor households have less access to health services across the board. For instance, the difference between the bottom and the top income quintiles in the percent of births attended by a physician is stark: while 75 percent of births in the top income quintile were reported as attended by a doctor, this percentage in the bottom quintile was only 8.8 percent. Ill health is a major cause of an income shock and impoverishment or in many cases destitution, due to high out-of-pocket payments on health care, labor time lost, and death or disability of breadwinners.

56. **To create an environment that is conducive for the equitable development of the human capital of the poor and for a sustained poverty reduction over time, the Government has introduced several major interconnected and coordinated policy and institutional changes.** Those changes include a conditional cash transfer program, as well as universal health coverage for poor households and combine financial assistance with incentives to invest in human capital development. Effective implementation of these programs requires reliable, accurate identification of poor households. Therefore, as a first step, to identify the poor in a consistent, objective and equitable manner, as well as to deliver programs efficiently, effectively, and transparently, the Government established in 2009 the National Household Targeting System for Poverty Reduction – Listahanan (formerly NHTS-PR). Between 2009 and 2011 about 11 million households, or over 55 percent of all households in the Philippines were surveyed. In areas with high poverty incidence, as well as most of the rural areas a census method was applied (all households were surveyed). In urban areas with lower poverty rates, a demand driven method was used, e.g. households had to request to be assessed. In addition, to minimize a potential error of exclusion, any household that considered itself poor could demand to be assessed. Of all surveyed households 5.2 million were identified as poor based on the so called proxy means testing method (PMT), combined with the local community verification. The PMT method was developed using the FIES data. The method performance is enhanced through the community verification mechanism. To keep the registry of poor (and near-poor) households actual, it is critically important that it is regularly updated. In the Philippines, the update is envisaged to be conducted every 4 years and the second round of the household welfare assessment is being prepared for 2014. The update that is planned for mid-2014 will include almost 16 million households (or about 80 percent of all households). The census method will be applied in rural areas, and most of urban areas: e.g. 80 percent of the Philippines households will be visited. Similar to the first round, any household not included in the census could request to be assessed.

57. **To improve health and education status of poor households, a Conditional Cash Transfer (CCT) Program was introduced, providing a cash grant provided that the recipient household meets certain education and health requirements.** The CCT program was introduced in 2008 as a pilot and has grown rapidly into the third largest CCT program in the world: it currently covers almost 4.0 million households with children 0-14, reaching 93 percent of eligible poor households with children and 75 percent of all poor households identified as poor by the national targeting system. The conditionality compliance monitoring suggests high compliance rates with program requirements and the impact evaluation study has

found that the program is reaching its objectives. Encouraged by the results, the Government decided to extend the program to cover children 14-18 years old as well and thus address one of the major issues related to education of poor children – low enrollment in and completion of secondary education, particularly among boys. The DPL supports the expansion of the CCT programs to poor children up to 18 years of age, as an important step in fostering their human capital development with the objective of supporting their chances for the permanent exit out of poverty.

58. **To ensure that all Filipinos have access to quality health care, especially the poorest, while being protected from financial risk associated with health shocks, the Government has pursued a policy of universal health coverage (UHC).** This policy is based on the principle that every Filipino should have access to quality health care that is accessible, efficient, equitably distributed, adequately funded, fairly financed, and appropriately used by an informed and empowered public. Protection from the financial costs of health care is to be achieved primarily through mandatory enrollment in PhilHealth, expansion of benefit packages, reforming provider payments and enforcing no-balance billing. In implementing the UHC policy, the Philippines has significantly increased spending on health and it has expanded national government sponsored financial protection of the poor and near poor through PhilHealth. All CCT beneficiary households have automatically been enrolled in the PhilHelath. Using Sin Tax incremental resources, health insurance enrollment was expanded further in 2013 using the NHTS-PR (*Listahanan*) registry of poor and near poor households, reaching the bottom 40 percent of the population. To make sure that the potential coverage is effected, e.g. that the poor and near poor are aware of their benefits and use them, the CCT program family development sessions have been used to inform the CCT beneficiaries about their PhilHealth enrollment and the package of services they can access for free. The Government is planning a public information campaign in this regard. In combination with the information campaign about the PhilHealth as part of the family development sessions for the CCT recipients, the coverage is expected to result in the higher use of health care services by the poor, as well as to mitigate the catastrophic impact of health spending on poor households. The program's results framework seeks to capture effective enrollment through the extent to which the poor and near poor are both aware and use insured health services. For example, the claims rate (number of claims reimbursed by Philhealth/number of poor and near-poor people enrolled in the insurance scheme) has been increasing according to PhilHealth records. In 2012, the rate was 0.05, reaching 0.08 in 2013. This indicates that the bottom 40% of the population enrolled in the UHC scheme are increasingly using health services. The limitation of this indicator however is that it does not capture the utilization of primary health care services, for which PhilHealth pays based on capitation. Ultimately, over time, it is expected to result in better health status in the poor and near-poor population (e.g. in the bottom 40 percent of the population).

59. **Finally, to ensure consistency and transparency across different government interventions aimed at the poor, equal and fair treatment of households, and to maximize the programs synergy and efficacy, DPL supports the Government in its efforts to use the Listahanan registry to identify the beneficiaries of its various poverty targeted programs.** While different programs may have different program specific eligibility requirements, the lists of poor households should be drawn only from one source, e.g. the Government registry of poor and near-poor (vulnerable) population. If a household considers itself poor, but it is not on the Listahanan list of the poor, this household should be required to undergo the Listahanan

assessment mechanism and be and enrolled in any Government program only if it is assessed as poor. This should be applied to PhilHealth, the CCT program or any other poverty targeted program. Currently, about 850 entities - including central government agencies (the CCT program, Philhealth and the social pension program) - target their beneficiaries using the Listahanan data base (formerly NHTS-PR)), local government units and civil society organizations.

Operation Pillar 4: Fiscal Transparency & Good Governance

Prior Action 8: The Borrower has adopted a unified Account Code Structure for accounting, budgetary and treasury transactions and implemented this as part of the 2014 budget preparation and implementation.

Prior Action 9: The Philippines Open Data portal (data.gov.ph) is fully operational with full electronic access to over 600 datasets.

60. **The Aquino administration sees transparency around the use of public resources as fundamental to institutionalizing governance reforms.** Under its 2011 PFM Action Plan, government has been seeking to implement a series of system modernization reforms, including a GFMIS and TSA. An initial milestone of the TSA roll-out is the availability of a daily inventory of all Treasury and National Agency accounts by mid-2014. Following extensive preparatory work, the GFMIS implementation is expected to be contracted out in mid 2014, and be operational for a number of agencies by end-2015, and full government roll-out by 2016. A major milestone in achieving PFM reforms has been the adoption of a Unified Account Code Structure (UACS) for the 2014 budget, and the electronic submission all agency budget proposals according to this standard. For the first time, the UACS means that the classifications used by CoA for audit and DBM for budgeting and implementation are the same. The DBM has also spearheaded a number of reforms in the budget process, including tackling the issue of extensive continuing appropriations. The UACS is also seeing a revision of Program, Activity, and Project codes (P/A/P), notably as they are associated with outcomes rather than line based input budgeting. Enhanced clarity and transparency around business processes associated with these reforms promises to both improve managerial accountability and provide timely information concerning public resource allocation to the public. DBM and COA understand that full-fledged UACS execution reporting will depend on all agencies progressively improving their accounting systems in full compliance with UACS. Government clearly recognizes that these reforms reach well beyond implementing ICT projects, and has therefore also put in place an increasingly robust structure of change management, communications, and project management.

61. **The launch of the Philippines Open Data looks to consolidate a series of commitments toward greater government information disclosure**.[54] The DBM spearheaded enhanced information disclosure through the publication of a People's Budget. The Philippines also signed up to a series of commitments under the international Open Government Partnership (OGP). As part of these commitments, the government launched the Open Data Portal at data.gov.ph platform at a Governance Summit hosted by the President on Jan 15-17th, 2014. As

[54] http://www.opengovpartnership.org/country/philippines

part of this process, the Office of the President and DBM have worked closely with agencies across government to define data quality and disclosure protocols, and established the Open Data platform and repository. The work of the task force has significantly advanced inter-agency collaboration, technical discussions on data inter-operability, and increase peer pressure across agencies to adopt open standards in data disclosure. Going forward, the OpenData initiative will also seek to deepen a number of portals focused on budget execution transparency (e.g., OpenReconstruction, OpenTRIP, OpenLGU), notably also by linking enhanced budget classifications to the Program/Activity/Project (PAP) level with geo-tagging to better engage local demand side-accountability. A medium term focus of reforms will also be to improve the supply, timeliness and disclosure of statistical information.[55]

Operation Pillar 5: Consolidating Fiscal Sustainability: Revenue Mobilization and Risk Management

Prior Action 10: *The Borrower has implemented a series of revenue related reforms: (i) the implementation of a tobacco and alcohol excise tax reform, (ii) the completion and on-line publication of a Tax Expenditure Statement (TES) concerning fiscal incentives for investment.*

Prior Action 11: *Fiscal risk management strengthened through disclosure of broad risks (Annual Fiscal Risk Statement) and explicit/increased contingency allocations in the 2014 budget (Risk Management Program + NDRRF).*

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62. **The Philippines policy objective of increasing public infrastructure and human capital investments hinges on enhancing tax effort.** The debt to GDP ratios have declined steadily over the past decade, contributing to the favorable development of the sovereign ratings of the Philippines. With the anticipated scale-up in public investments in infrastructure and human capital programs, further tax efforts are needed to maintain fiscal consolidation and macro stability. As a result, the government has committed to raise the tax to GDP ratio by more than 3 percentage points by the end of the administration term.[56] This is expected through a mix of both policy and administrative measures aimed at widening the tax base and improving collection and compliance. For this purpose the DPL supports the passage of the Sin Tax on alcohol and cigarettes in late 2012, and its on-going implementation since the start of 2013, a major milestone in achieving the revenues target.

63. **The Department of Finance, together with BIR and BoC, continues to spearhead revenue reforms through on-going evidence based and transparency strategy.** The first publication of an annual Tax Expenditure Statement (TES) provides a systematic analysis of available revenue gaps due to investment incentives granted by BoI and PEZA based on BIR corporate returns. For 2011, these were estimated to be 1.49 percent of GDP.[57] The report

[55] A new law established the Philippines Statistical Authority (PSA) in 2014, which consolidate a previously fragmented set of agencies collecting statistical data. Going forward, future bank technical assistance and DPL operations may tackle institutional measures in support of this reform vision.

[56] The plan is to raise tax to GDP ratio from 13.3 percent to 16 percent in 2016.

[57] http://www.dof.gov.ph/wp-content/uploads/2014/04/PH-TES_ITI-2011-FINAL.pdf

recognizes the need to enhance the procedures by which fiscal incentives are granted and monitored, and therefore provides an important building block for on-going efforts at fiscal incentives reform. As noted in the discussion of Pillar 2, this area remains a government priority but subject to the need to strengthen consensus and reform coalitions inside and outside government. Other notable on-going initiatives going forward include the Department of Finance (DoF) initiatives with the Bureau of Internal Revenues (BIR) and Bureau of Customs to strengthen revenue administration, especially the (i) creation of a Fiscal Intelligence Unit (FIU) to monitor tax effort performance, (ii) the extensive public communications campaign on tax leakages (e.g., self-employed, estate taxes), and (iii) the customs reforms aimed at reducing smuggling and tax evasion, notably those with respect to special economic zones.[58]

64. **The Philippines has also taken important initial steps to advancing an integrated fiscal risk management strategy.** The publication of a series of Fiscal Risk Statements (FRS) has systematically outlined some of the key fiscal risks and risk management/mitigation strategies being pursued by the government. Nevertheless, the institutionalization of this process, the adherence to a specific timetable, and the prioritization of associated reforms actions are yet to be confirmed. Current fiscal risks in the Philippines stem from high exposure to natural hazards, and to contingent liabilities from GOCCs and public private partnerships.[59] The 2014 budget for the first time provides a PhP 20 billion line item for possible contingencies arising from PPPs (the Risk Management Program). The line budget item provides for both contingencies arising from both legacy projects and a new generation of PPPs launched under the Aquino administration. The 2014 budget also increases the size of what was previously the Calamity Fund and now establishes initial line of disaster-related financing as the NDRRF.

65. **The 2013 Bohol Earthquake and Typhoon Yolanda have underscored the need to strengthen natural disaster related risk management.** The GoP is considering a number of specific actions to reduce multi-hazard risks, notably those associated with greater weather shocks anticipated with climate change**.** The objective is to create tools allowing the Philippines to reduce the risks of undermining fiscal consolidation while allowing for an effective government response in the case of natural disasters. In this regard, the government has taken some concrete measures starting with the development of a disaster risk financing and insurance strategy (DRFI) that provides a roadmap for achieving fiscal resilience in time of calamities, as recently vividly accentuated by Typhoon Yolanda. Critical actions are needed within the upcoming year to enable DRFI implementation. Key elements of such an approach would include a "building better" investment program component and an insurance component. Complementary measures include ensuring the LGUs are insured for disasters, or tapping into international parametric risk insurance. The precise form and modalities of these measures

[58] Following the President's 2013 State of the Nation Speech, most of the prevailing middle management and collectors positions have been changed in BoC. This comes as part of the governance reform agenda adopted in the government national program.

[59] The Governance Commission for GOCCs (GCG) in the President's Office has continued to strengthen its performance oversight of the broader public sector. The GCG**,** whose creation was supported at the outset of the DPL series, has implemented balanced score-cards and a rationalization plan for public interest/subsidized GOCCs. Going forward, the role of the GCG can continue to enhance financial and performance oversight of a range of public service GOCCs, including for rural development and electrification

remains under discussion and are considered as the next level of reforms.[60]

4.3 LINK TO CAS AND OTHER BANK OPERATIONS

66. **The proposed DPL is consistent with the 2015-2018 CPS.[61]** The government has asked the Bank to frame its support by sectoral and geographic "problem definitions", notably as they relate to the poor and the generation of jobs. The new CPS starting July 1, 2014, is structured around five engagement areas: (i) Transparent and accountable government, (ii) Empowerment of the poor and vulnerable, (iii) Rapid, inclusive and sustained economic growth, (iv) Resilience to Climate change, environment, and disaster risk management, (v) Peace, institution building, and social and economic opportunity. The DPL program is fully aligned with results objectives in the first three pillars of the CPS. Annex 4/Table 3 provides a more detailed mapping of DPL pillars to EAs.

67. **The DPL builds on a number of on-going operations and TA to achieve the outcomes of the CAS/CPS.** In the area of public infrastructure, the Bank has supported the improvement of the national roads system under National Roads Improvement and Management (APL) Phase 2. Support for TRIP and rural road extends lessons from this operation notably to secondary/LGU roads. The Mindanao Rural Development Program (MRDP) Phase II - Natural Resource Management Component has already yielded significant lessons concerning farm to market roads. The Social Welfare and Development Reform Project and its Additional Financing operation reflect the Bank's core engagement on the CCT program, and the underlying NHTS-PR targeting system. The Bank has had an existing strong engagement in education through the PH-Support for Basic Ed. Sector Reform. In 2010, the Philippines had a CAT-DDO DPL which aimed to enhance the capacity of the Government to manage the impacts of natural disasters. Three key policy areas were pursued: (a) strengthening institutional capacity, (b) mainstreaming disaster risk management into development planning, and (c) management of the government's fiscal exposure to natural hazard impacts. Following Tropical Storm Sendong (Washi) and President Benigno S. Aquino III declaration of a state of calamity, the full balance of the loan proceeds (US$497,500,000) was disbursed to the Government of the Philippines on December 29, 2011. A DPL 2 Supplementary in late 2012 served to support the Philippines medium term reconstruction effort in the wake of Yolanda, including through multi-sectoral on-going TAs.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

68. **The principal mechanism of donor collaboration is the Philippines Development**

[60] This includes (i) the development of analytical tools on risk assessment and capacity building to link first-generation catastrophe risk model results and financial decision making; (ii) capacity building for key Government agencies to develop and maintain asset management databases; (iii) extending contingent liabilities assessment for both national and local levels of government; (iv) quantifying the fiscal impact of disasters in public debt management evaluations such as the Fiscal Risk Statement; and (v) strengthening institutional capacity and risk transfer mechanisms to ensure a sound implementation of the anticipated DRFI.

[61] The previous CAS ran from July 1, 2009 to June 30, 2012, but was extended through a CAS progress report submitted in mid-2011. The five Strategic CAS objectives, notably (i) Stable Macro Environment, (ii) Improved Investment Climate, (iii) Better Public Service Delivery, (iv) Reduced Vulnerabilities, and (v) Good Governance continue to align to the government strong reform program, and the actions supported under the DPL program.

Forum (PDF). The PDF and its sub-working groups align to the respective Cabinet Clusters. World Bank donor collaboration in a number of the areas of the DPL is close, including through joint diagnostic work. These include Australian DFAT (PFM, disaster risk management, education), USAID (infrastructure, health), JICA (infrastructure), EU (health), WHO (health), and ADB (post-disaster reconstruction). A government wide workshop was held in November 2013 with all counterpart agencies participating in the DPL 3 reform agenda. Government agencies notably DBM, have been proactive in engaging civil society in the monitoring and oversight of programs supported under this operation. A central focus of the DPL program has been to enhance transparency, participation, and accountability in the implementation of priority programs to foster inclusive growth. Open data/government initiatives associated with implementation of a number of the priority actions – public infrastructure investments, revenue mobilization, and fiscal risk disclosure – have been designed to enhance access and collective dialogue around a shared evidence based across government, civil society and development partners.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

69. **The operations actions are all fundamentally designed to enhance the long-term welfare of the poor and bottom 40 percent of the population.** For each of the proposed actions, analysis has been conducted so as to maximize the inclusive growth impact of the actions. Expanding tourism and provincial/municipal road infrastructure across the archipelago promises to provide economic opportunities to the bottom 40 percent and the extreme poor notably from a geographic perspective, with particular benefits for rural areas. Analysis shows that the poor are particularly vulnerable to weather related shocks, including those patterns emerging from climate change, as well as those from natural disasters such as earthquakes. Improving resilience of public infrastructure, and enhancing disaster related risk management, therefore stands to lead to large positive poverty and social impact. The actions using the NHTS-PR database target investments on notably the poorest parts of the population. Enhanced targeting for health and education, notably to promote secondary school completion among poor CCT beneficiary households will likely result to a significant positive impact. The updating of the NHTS-PR to encompass a full rural enumeration will also overcome any previous "errors of exclusion" of the poor due to the lack of enumeration of some households. The NHTS-PR also provides for a process for households that consider themselves eligible, including through point of service inscription for health, to avail of the proxy means test. The operation also builds on the analysis of the recent findings of the World Bank Country Gender Assessment. Interestingly, the assessment finds that gender gap in education in the Philippines tends to be the reverse of what is found in many other countries. The DPL actions in notably education and health will therefore seek to monitor the extent to which males are lagging behind females in respective outcomes. The actions related to high school completion among the poor owing to the CCT program (Prior Action #6) will also be closely measured for gender impact.

70. **The Sin Tax reform action benefitted from PSIA analysis both in the design and implementation phase.** A PSIA of the Sin Tax reform suggests that while the tax incidence on tobacco excises is slightly regressive, the commensurate health impacts and revenues used for

health programs are progressive given the impact particularly to the bottom 40 percent of the population. The design of the Sin Tax saw an earmarking of fund to promoting Universal Health Care (UHC), notably health insurance for the bottom 40 percent of the population. The Bank has supported the design of the Sin Taxes Implementing Rules and Regulations, including cessation programs that are particularly likely to benefit the poor. On-going TA is monitoring and providing for an Implementation Results Monitoring Framework, notably monitoring tobacco consumption among the poor and by gender.

5.2 ENVIRONMENTAL ASPECTS

71. **The DPL supports institutional measures for improved public infrastructure delivery, with robust country systems in place to mitigate environmental and social effects in the execution of actual projects.** According to the Philippines regulation, all infrastructure projects, notably highway and roads, are subject to an Environmental Impact Assessment (EIA). The latter through its project management office provides and Environmental Compliance Certificate (ECC) for individual projects prior to contracting and implementation. All new road construction in the Philippines is subject to DENR environmental approvals. Philippines network investments relate almost exclusively to the upgrading to road segments, rather than to the opening of new "greenfield" roads. These mandatory certificates ensure that the risk from potential adverse effects on the environment and natural resources coming from infrastructure projects are well accounted and mitigated. Such requirement is important notably in the case of the FMRs program. FMRs are indeed designed specifically to increase connectivity in rural and agriculture areas where the concentration of forest and environmental biodiversity is higher. The DPWH has been receiving technical assistance from various donors since 1996 for capacity building on environmental assessments. The ministry has also developed two manuals, the Social and Environmental Management System and the Infrastructure Right-of-Way, to facilitate and streamline environmental considerations and standards into infrastructure planning and construction. Associated land use regulations and zoning ensure that neither increased farm production or tourism development have adverse environmental impacts. A core focus of the Philippines National Tourism Development Strategy is on environmental tourism, and DoT and key stakeholders are actively seeking to enhance sustainable protection of existing natural resources.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

Fiduciary Aspects

72. **In general, the public financial management and public procurement systems are adequate for this operation.** The Bank prepared a PEFA assessment to document the current state of public financial management in the country and the actions being undertaken by the past and current Administrations to further increase public financial management and transparency. The 2010 PEFA assessment indicates that the Philippines' PFM system is reasonably capable of maintaining overall fiscal balance, but there is still scope for strengthening some dimensions, particularly in the areas of budget credibility and accounting/reporting, which limits efficient execution of priority programs.

73. **Progress has been made in implementing the PFM reform agenda, notably in the**

area of fiscal transparency. DBM and CoA have, in the past two years, pursued a number of measures to strengthen notably budget execution transparency, including mid-year budget reports. The Philippines achieved an overall Open Budget Index (OBI) ranking of 48 out of 100 in the Open Budget Initiative 2012, which was down from 55 in 2010. In 2014, the Philippines was one of the pilot countries for the IMF's revised Fiscal Transparency Code. The government is committed to pursue further Public Financial Management reforms, some of which would be supported by this operation, to enhance further fiscal transparency, through the timely and automated provision of information. In regard to financial sector risk, the Article IV Consultations mission of the IMF (see Annex 6) found that the financial sector withstood the recent global financial crisis well and that developments in recent quarters continue to support the January 2010 Financial System Stability Assessment that it remains sound.[62]

74. **The adequacy of the foreign reserves control environment in BSP is based on domestic assessments.** The Philippines does not have an active IMF program to develop safeguard assessments. The BSP is also not subject to international audit. However, BSP's financial statements are being audited by the Commission on Audit. The World Bank and IMF have been relying on the audited financial statements released by COA. The auditor's opinions in 2010 -2012 for BSP audited financial statements are unqualified, however, the audit opinions contain an "Emphasis of Matter" paragraph relating to deviation from Philippine Accounting Standards 21 relating to the booking of realized and unrealized gains and losses due to the change in exchange rates. The paragraph reflects the auditor's judgment that the matter is fundamental to users' understanding of the financial statements. However, the auditor's opinions are not modified in respect to the matter emphasized and remained unqualified.

Disbursement and Auditing

75. **The proceeds from the loan will be deposited into a deposit account in US dollars at the Central Bank or *Bangko Sentral ng Pilipinas* (BSP)**, once the loan becomes effective and the Bank is satisfied with the progress achieved by the Borrower in carrying out the Program and with the adequacy of the Borrower's macroeconomic policy framework. The equivalent local currency amount will immediately be transferred to an account of the government available to finance budgeted expenditures. After disbursement of the loan, the Government will ensure that the equivalent Peso amount of this loan amount is promptly accounted for (in Philippine Pesos) in the Borrower's budget system in the General Fund, and thereby be available to finance budget expenditures. The Borrower will provide to the Bank within 45 days a written confirmation that this accounting has been completed.

76. **Disbursement of the loan will not be linked to any specific purchases and no procurement requirements have to be satisfied**. The proceeds of the operation would not be used to finance expenditures excluded under the Loan Agreement. If, after being deposited in a government account, the proceeds of the loan are used for ineligible purposes as defined in the

[62] The IMF team found that banks' non-performing loan ratios have stayed low and capital adequacy ratios high, and welcomed the authorities' careful monitoring of two sources of vulnerability, namely interest rate and concentration risk. Though asset bubbles have not been a concern so far, asset price movements warrant careful attention in an environment of rising external inflows.

Loan Agreement, the Bank will require the Borrower to refund the amount directly to the Bank. The amount refunded to the Bank will be cancelled from the loan.'

5.3 MONITORING AND EVALUATION

77. **The Department of Finance is the main liaison with the World Bank on budget support operations, including this one**. However, policy dialogue and M&E of the program supported by this DPL are shared with the DBM, NEDA, DPWH, DoT, DA, DTI, DSWD, DepEd, DoH/PhilHealth, as well as the BIR and BoC (which are agencies of the DoF). The government has designated an Under-Secretary from each of these agencies to serve on a DPL coordination committee as the Bank's counterparts in the policy dialogue.

78. **The key results indicators are prepared as part of the country's mainstream statistical system, administrative data collection, and World Bank Group monitoring.** These include the indicators of public infrastructure investment as a percent of GDP, public infrastructure execution measures by DPWH (percent GDP, timing on contracts in budget year, # convergence programs implemented), the tax effort measured as a share of GDP for BIR and policy measures, and the contribution of GOCC to the annual public sector deficits, and # of major GOCC with performance contracts. Further measures include disclosure of fiscal risks and tax expenditures for fiscal incentives reform (as percent of GDP). GDP. The Ease of Starting a business indicator is constructed as part of the World Bank Group's Annual Ease of Doing Business Survey. The measure however pertains to sole propietorships firms for an illustrative firm according to the Cost of Doing business survey methodology. Additional monitoring is required for sole proprietorship firms, which are the bulk of newly registering firms in the Philippines. The World Bank is collaborating with the DTI and National Competitiveness Council (NCC) to provide Ease of Starting Business indicators for sole proprietorships with reference to both national and sub-national processes.

79. **A monitoring challenge is to better assess the quantity and quality of public and private investments as they relate to inclusive growth.** Periodic economic updates provide for a more detailed analysis of the components and likely growth and jobs impacts of particular components of investments. To better capture the quality of public investments, the Bank is focusing on public infrastructure investments by DPWH, which accounts for the bulk of investments. The DPWH also has developed a stronger project and contract monitoring system, which allows for a detailed analysis of the execution of annual investments budgets. The World Bank is working closely with USAID to develop an impact evaluation of TRIP investments over the 2013-2016 period. Similar efforts will be advanced for the impacts of climate change-disaster mitigation efforts, and rural investments. The program has also emphasized that the transparency of public expenditures is a critical objective towards enhancing PFM and accountability for service delivery. Towards this end, the Bank is supporting government's efforts to strengthen the monitoring of flagship programs and timely disclosure of their development as part of the OpenData/Government platform. The teams have also engaged in a period review of treads on specific PEFA indicators, specifically those associated with budget execution, with a full update of the PEFA in progress for 2014. A follow-up DPL series through the remainder of this DPL series will also focus on deepening and extending reforms to foster inclusive growth initiated under this series (see Annex 4).

80. **The outcomes of public investments in human capital will depend on program enrollments and coverage.** The NHTS-PR provided a robust platform for identifying the poor through means tests for various beneficiary programs. This platform will be further strengthened with the roll-out of NHTS-PR II. A recent impact evaluation has also assessed notably outcomes associated with the CCT program. Concerns about secondary school completion of children in poor households have also informed the actions proposed in the operation. A particular monitoring challenge will be to assess effective coverage of programs, notably as it relates to enrollments in the PhilHealth UHC insurance coverage. While NHTS-PR households approaching 40 percent of the poor and near poor population are now enrolled, effective coverage would entail that households are both informed of their benefits and are able to avail of zero-balance services. The PP-CCT program is engaged in a proactive program of informing poor households through the family planning sessions, while PhilHealth is engaged in more general outreach. The Bank's HD team and partners are supporting a number of special survey assessments of effective coverage and targeting efficiency in the various NHTS-PR related programs.

6. SUMMARY OF RISKS AND MITIGATION

81. **The principal challenge for the Philippines remains to be the effective implementation of reforms that will contribute to inclusive growth in this administration and beyond 2016.** While the government of President Aquino enjoys a high degree of popularity in the second half of the administration, including a strong legislative election showing in the May 2013 Senate and Congressional elections, reform implementation has historically faced challenges in the Philippines. Reforms are often blocked by a variety of vested interests, and implementation is dependent on actions across levels of government and agencies. Bureaucratic implementation capacity in the past has frequently been compromised through a dearth of managerial staff, managerial information systems, and corruption. For example, delays in fiscal incentives reform and business registration supported since the outset of the program reflect the fact that a number of reforms, particularly on structural economic reforms, have proven far more challenging and protracted than initially envisioned.

82. **The operation is managing implementation risks by choosing reform objectives that have a very high degree of government ownership.** The DPL builds on an on-going process of close dialogue across lead policy makers in the administration, which have provided on-going guidance concerning the specific areas of support under the program. The fact that the DPL requires review and sign-off by the President accentuates on-going effort to ensure that the program fully aligns with core priority reforms of the administration. The team has also engaged in an extensive process of dialogue with agency champions at the Under and Assistant Secretary level. A particular emphasis of the program remains on convergence agenda, namely those that require on-going collaboration across two or more agencies. Frequent exchange, often underpinned by interagency MoUs (e.g., PFM, Open Data, TRIP) and Executive Orders, are serving to cement collective accountability for implementing the actions supported by the program.

83. **The DPL program is being very selective in supporting inclusive growth actions that require legislative approval.** Past operations have shown that legislative approval of particular

actions can be highly uncertain (e.g., initial attempts early in the administration for passage of a fiscal incentives rationalization bill). Lack of progress concerning fiscal incentives reforms has underscored the need to build a consensus across implicated national government agencies (e.g., DoF and DTI), developing reform constituencies across both the private sector and civil society, and effectively framing the reform imperative to the legislative. Government continues to pursue more fundamental fiscal incentives reform, but recognizes the need to pursue both executive and legislative reform measures. To the extent possible, the government has therefore sought to fully exploit measures that can promote inclusive growth through executive/bureaucratic action. In the case of the Sin Tax Reform, government acted on a long-standing recognition that tax policy, in addition to administrative measures, were needed to meet the tax effort target. It was also recognized that the reform would serve as an important demonstration reform. Key lessons of this successful reform were needed to build strong coalitions across the executive, legislative and civil society in the passage of the bill, as well as an effective communications strategy centered on good governance and inclusive growth objectives. Going forward, government intends to build on these lessons for priority legislative reform measures, including those notably relating to a level playing field for private investment, including a new fiscal incentives rationalization effort.

84. **Through on-going TA and operations, significant implementation support and a communications strategy are being aligned to the DPL program.** The past DPLs have highlighted that in addition to strong ownership, a continuous and responsive policy dialogue across agencies and sector teams is critical to supporting the government in the implementation of its priority reforms. In many cases this has involved just in time and strategic support to draw in global experience to advance reform tracks. The teams have also learnt that reforms need to be programmatic, but most importantly clearly articulated in terms of the contribution they make to reducing extreme poverty and shared prosperity. Finally, the DPLs cross-cutting theme of institutionalizing transparency measures across a variety of government programs stands to serve as an important anchor for sustaining reform initiatives and associated demand-side constituencies beyond the term of this administration.

85. **The sustainability of reforms supported under the DPL beyond the present administration in 2016 presents a major priority for the World Bank Group in the Philippines.** The cross-cutting role of transparency reforms, including Open Data and Open Government initiatives, will be critical in the medium term to support the institutionalization of reforms beyond this administration. Fostering demand side constituencies that will work to lock in reforms will be critical to sustaining recent trends in improved governance and public sector delivery. However, the Philippines reform and inclusive growth trajectory clearly remains subject to a number of political economy risks. As reforms, including in the area of public spending, begin to truly impinge on vested interests, these may seek to organize strong lobbies and coalitions for reversal. A number of recent high profile indictments and arrests of notable Senators have underscored the anti-corruption drive of the prevailing administration and the functioning of the judicial process. While the challenge of sustaining existing reforms for inclusive growth remains, the DPL has been structured to advance both implementation and institutionalization.

ANNEX 1: POLICY AND RESULTS MATRIX

Policy Areas/Pillars[i]	Measures Taken by March 2011 (DPL1)	Measures Taken by September 2012 (DPL2)	Measures Taken by June 2014 (DPL3)	Expected Outcomes by End-2014*[*]
A1. Addressing public infrastructure bottlenecks	PPP Center was restructured and attached to NEDA (EO No. 8), and a permanent Executive Director has been appointed. To promote the development of new PPP projects, the 2011 Budget (GAA) includes P12.5 billion for the PPP Strategic Support Fund, and EO 8 allocates P300 million for the Project Development and Monitoring Fund.	Government has review process in place to effectively manage contingent liabilities of new generation PPPs **DPWH has strengthened project preparation and implementation methodologies, quantified performance targets, including completing over 90 percent of project bids for the 2012 GAA allotments in the first semester.** The Tourism Convergence action plan to deliver priority infrastructure for tourism development for 2012/13 has been jointly approved by DOT and DPWH; and DBM has allocated P5 billion for the 2012 program, and included P12 billion for the 2013 program in the 2013 NEP.[ii]	**The implementation of the DPWH public infrastructure program has advanced: (i) by January 1 2014, over 80 percent of the combined 2012 and 2013 capital expenditure budget has been contracted, and over 60 percent of these projects have been completed; (ii) over 50 percent of the 2014 capital expenditure budget has been contracted by June 30, 2014**. **DPWH, has delivered contract works under the TRIP network preparation process and resulting plan[iii]** **The 2014 GAA requires that DPWH implements the Regular Farm to Market Road (FMRs) Program, with DA providing and disclosing the Network Plan for these projects**	**Public Infrastructure Investment Increased to over 3.5 percent of GDP per annum (from <2.5 percent)** [iv v]. **DPWH Public Investment Project Portfolio Prioritization improved, as measured by percent value of budgeted contracts bid in first half (to over >50 percent)** **Spatial targeting clarified and project selection transparency enhanced as evidenced by operational network plans and implementation by DPWH for two major priority road programs (0→2) selected road connectivity programs**
B1. Improving the investment climate by reducing the cost of doing business	**The new web-based Enhanced Business Name Registration System adopted by DTI has reduced the average time required for a business name registration to 15 minutes.** 43 LGUs with good potential for generating investments are using streamlined procedures for new	**The Philippine Business Registry (PBR) has been uploaded on-line and is functioning; and has been linked with the online Business Permit and Licensing Systems (BPLS) of two (2) LGUs.**[vi]	**The DTI has improved online functionality of the PBR for national registration, including ePayments.**	**The average number of days required to register a sole propiertorship business has been reduced to under 10 days for selected cities, building on the Doing Business methodology for starting a business.**[vii]

Policy Areas/Pillars[i]	Measures Taken by March 2011 (DPL1)	Measures Taken by September 2012 (DPL2)	Measures Taken by June 2014 (DPL3)	Expected Outcomes by End-2014*[*]
	business permits and renewal applications under the BPLS Streamlining Program.	An additional 50 priority LGUs are using streamlined procedures.		
C1. Strengthening the basic education sector	The Department of Education budget allocation (GAA) for 2011 increased by 18.5 percent from the 2010 GAA. **The medium term expenditure framework of DepEd has been updated to reflect the resources required to implement its policies, programs and strategies, including the K to 12 program.** **The GASTPE budget allocation that funds the Education Service Contracting (ESC) program of DepEd has been increased by 48 percent in 2011 compared to 2010.**	**The actual spending (adjusted for inflation) of DepEd in 2011 has been equal to or greater than its spending in 2010**.[viii] The Development Budget Coordination Committee has evaluated the basic education MTEF, and is completing the process of approval subject to refinements/changes. **The per-student subsidy provided to participants in the ESC[ix] program has been increased to enable greater participation in the program by students from low income households, based on a program review conducted by DBM and DepEd.**[x]	**The preparation for NHTS-PR II is advanced: (i) operational manual is revised to reflect lessons learned from the previous assessment; (ii) field workers are being hired and trained using standard training tools; (iii) IT-enabled data collection and encoding is developed and tested; (iv) arrangements for spot checks to monitor reassessment processes are in place.** **Expand the CCT coverage to children up to 18 years of age.**	**Reductions of the (i) Students-to Teacher ratio and the (ii) Students-to-Classroom ratio at the top 25th percentile point of their respective distributions.** Baselines (2010/11):40.37 and 43.80 respectively for public elementary schools, and 42.03 and 59.98 for public secondary schools. **Net enrolment ratios increase.** Baselines (2009/10): 88.1 percent (elementary) and 59.6 percent (secondary). Targets (2013/14): 94 percent (elementary) and 76 percent (secondary)
C2. Strengthening the health sector	**PhilHealth has adopted Board Resolution No. 1479 for the implementation of the partial insurance premium subsidy program for the Near-Poor.** PhilHealth adopted Board Resolution No. 1478 and joint implementation guidelines have been drafted by DBM, DOH and PhilHealth for enrolling poor households identified under the	**Households receiving conditional cash transfers under the CCT Program have been enrolled in the NHIP for receiving an enhanced package of PhilHealth benefits** [xi] PhilHealth implements partial NBB and case-payment policy in all public hospitals (achieved), (ii) PhilHealth to issue policy circular mandating all LGUs receiving	**NHTS-PR used to target at least 3 major government programs to the lowest 40 percent of the population, including evidence that PhilHealth has achieved effective enrollment of poor and near poor in the bottom 40 percent of the population.**[xii]	**Number of NHTS-PR individuals/families covered by Philhealth (100% of those defined eligible in millions)** **Number of NHTS-PR families enlisted with a primary care benefit (PCB) provider** (9.54 million or 65% of total, from 0). **Number of claims by NHTS-PR families at Philhealth-accredited**

Policy Areas/Pillars[i]	Measures Taken by March 2011 (DPL1)	Measures Taken by September 2012 (DPL2)	Measures Taken by June 2014 (DPL3)	Expected Outcomes by End-2014*[*]
	National Household Targeting System (NHTS) in 2011.	PhilHealth funds to establish a trust fund where earning from PhilHealth can be deposited by facilities and used to achieve NHIP objectives of quality and effective coverage for NHIP members.		**providers in the previous year (>27 % share)**
D1. Improving public financial management, budget transparency and accountability	The MOA between COA, DBM, and DOF/BTr to create an Inter-Agency Committee (IAC) and cooperate in developing the Government Integrated Financial Mgmt. Information System (GIFMIS) has been reconfirmed and the PFM Reforms Roadmap has been approved by DBM, DOF, and COA. **To strengthen transparency and accountability, the 2011 General Appropriations (Act No. 10147), adopted by Congress has mandated that the implementation status and fund utilization of major programs and projects be posted by departments and agencies on their official web-sites and that DBM post on its website all releases and realignments under the Priority Development Assistance Fund (PDAF).** DBM issues circular requiring all central Government agencies to report obligated expenditures of the 2011 Budget no later than 10 days after the end of each quarter.	**IAC has approved an action plan to implement the PFM Reform Roadmap, including the adoption of a Unified Account Code Structure for budgetary, accounting, treasury transactions, and auditing.** The DBM has issued instructions detailing the format and timing of website posts mandated by the 2011 Budget and posts on its website the allotment/SARO releases of SPFs covered by the Electronic Transparency and Accountability Initiative Lump-sum System – Phase 1 (e-TAILS-1) for PDAF (Congressional Allocation), DepEd School Building Program and IRA. **DBM has published, not later than two (2) months after the end of each quarter, the obligated expenditure data for the 2011/2012 budget required from line agencies of the Borrower, as well as gaps from those that have not submitted such data.**[xiii]	**The Borrower has adopted a unified Account Code Structure for accounting, budgetary and treasury transactions and implemented this as part of the 2014 budget preparation and implementation.** **The Philippines Open Data portal (data.gov.ph) is fully operational with full electronic access to over 600 datasets.**	**Enhanced budget transparency through the existence of a unified Account Code Structure, including the Chart of Accounts, and the timely publication of budget execution data.** **Improvement in the following PEFA indicators score (2010 base year):** **PI5 – classification of budget (D in 2010).** **PI10 – Public Access to key fiscal information (C in 2010).** **PI24 – Quality and timeliness of in-year budget reports (D in 2010).**

Policy Areas/Pillars[i]	Measures Taken by March 2011 (DPL1)	Measures Taken by September 2012 (DPL2)	Measures Taken by June 2014 (DPL3)	Expected Outcomes by End-2014*[*]
E1. Strengthening public revenue mobilization	**The Government has commenced restructuring the Large Taxpayer Service (LTS) under the approved LTS rationalization plan has approved its Revenue Regulation No 17-2010 (dated November 16, 2010), which broadens the selection criteria for large taxpayers, and has added about 747 taxpayers to the LTS as of Jan 1, 2011.** DBCC has approved, in principle, a plan to shift from the tax credit certificate system to a cash refund system to improve the VAT refund mechanism. **The Government has submitted a revised Fiscal Incentives Rationalization Bill to Congress and has identified it as a priority bill.**	The staffing of LTS with auditors meeting the qualification standards is on course to be completed according to the LTS rationalization plan. **BIR has adopted a strategic plan for 2011-2016 and an agency-level set of key performance indicators (KPIs) (that conform to good international standards of tax administration,) and has collected baseline data for the year 2011.**[xiv] A cash refund mechanism for VAT is established[xv] BIR has required explicit declaration of fiscal incentives as part of 2011 tax returns[xvi]	**The Borrower has implemented a series of revenue related reforms: (i) the implementation of a tobacco and alcohol excise tax reform, (ii) the completion and on-line publication a Tax Expenditure Statement (TES) concerning fiscal incentives for investment.**	**Tax admin gains by BIR yield 1 percentage point net gain in revenues (from 9.1 percent of GDP 2010 baseline)** [xvii] **Excises from alcohol and tobacco increases from 0.5 to 0.9 % of GDP between 2010 and 2014.**
E1. Strengthening public revenue mobilization	**The DBCC has published a Fiscal Risks Statement as a reference for the 2011 Budget.** DOF has designed a new web-based financial monitoring framework for GOCCs.	An updated Fiscal Risks Statement has been published and made available jointly with the 2012 Budget. **DOF has implemented a web-based financial monitoring framework for GOCCs**	**Fiscal risk management strengthened through disclosure of broad risks (Annual Fiscal Risk Statement) and explicit/increased contingency allocations in 2014 budget (Risk Management Program + NDRRF).**	**Enhanced evidence based stakeholder awareness of key tax expenditures and fiscal risks (PPP, natural disasters, GOCCs)**[xviii] **GOCC contribution to net annual government deficit (reduced to 1.5 %)**

Policy Areas/Pillars[i]	Measures Taken by March 2011 (DPL1)	Measures Taken by September 2012 (DPL2)	Measures Taken by June 2014 (DPL3)	Expected Outcomes by End-2014*[*]
	Senate Bill No. 2640, whose objectives are, among other things, to promote financial viability and fiscal discipline in Government Owned and Controlled Corporations, in part through temporary delegation of reform powers from Congress to the Executive, has been filed in Congress.			**Majority of top 20 GOCCs as measured by government transfers between 2010-2013 are subject to completed GCG Performance Evaluation Contracts for 2013/14 (0 to >75 percent)**

Sources & Notes

[i] The pillar titles were modified in order and some wording from the DPL 1 Program Document to reflect the evolution of the program.
[*] Compared to DPL 1-2, eight indicators were dropped as being too aggregate/inadequate/not measurable: (i) (% of private plus public investment, (ii) # of PPPs, (iii) health utilization among poor and near poor, (iv) reduced out of pocket expenditures among insured poor and near poor, (iv) total tax to GDP ratio, (vi) total debt to GDP ratio, (vii) sovereign debt ratings, (viii) share of tax revenues collected by BIR large tax payer unit. These were substituted with 15 more specific sub-indicators, now enumerated in the last column. Annex 3 provides a more detailed presentation of results indicators and baselines. See Annex 3 for DPL 3 results matrix & indicators.
[ii] DPWH Project Monitoring Group, Overall Report and Tourist Destination Projects Infrastructure Program As of June, 2012.
[iii] As set out in DoT's TRIP network plan through the 2014 budget, and DPWH monthly contract implementation reporting associated with this network plan. As of July 2014, the network plan encompasses 268 projects just over 700 contracts (see opentrip.ph).
[iv] Using the 2000 Base Year GDP series. This updates the 15.7 percent figure from the 1985 Base Year series used at the start of the program.
[v] See NEDA PDP Midterm Update, pp. 171, Figure 10,3
[vi] The two LGUs refer to the cities of Quezon and Valenzuela.
[vii] Note this is different from the Doing Business report that measures limited liability companies based on specified legal steps for registering a business. The indicator will be measured by the M&E system of the PBR/BPLS for operational LGUs.
[viii] To adjust for inflation, education spending in nominal Pesos will be deflated by the Philippine Consumer Price Index for program monitoring purposes.
[ix] The Education Service Contracting (ESC) program under the Government Assistance to Students and Teachers in Private Education (GASTPE) wherein the government contracts with private schools to enroll students in areas where there is a shortage of places in public high schools
[x] As documented by (i) DepED Order No. 31 series of 2010 Section 4 Part B which indicate the policies and guidelines in the implementation of the ESC program: which indicates that the per student ESC subsidy in non NCR areas is PHP 5,000, (ii) DepED Order No. 8 series of 2011 Section 4 Part B which indicate the policies and guidelines in the implementation of the ESC program: which indicates that the per student ESC subsidy in non NCR areas was increased to PHP 5,500, (iii) DepED Order No. 35 series of 2012 which indicates that the per student ESC subsidy in non NCR areas was increased to PHP 6,500, (iv) Financial reports of DepED to DBM , which are mainly based on the financial reports submitted by the administrator of the ESC funds, the Fund for Assistance to Private Education (FAPE) to the DepED, (v) MEDIUM TERM SPENDING PLAN FOR BASIC EDUCATION, 2012-2017:ENROLLMENT PROJECTIONS AND COST SIMULATIONS UNDER ALTERNATIVE SCENARIOS (December 2011)
[xi] Definitions: enrolled: Received the card and informed of benefits. Enhanced package of PhilHealth benefits: enhanced inpatient and outpatient package cost at PHP 2,400 per household.
[xii] Effective enrollment captures the notion that the national government is not only paying for health insurance coverage of the poor and non-poor, but that this group is both aware and showing use of this coverage. The term "effective enrollment" was selected to elaborate on a potential ambiguous historical use of sponsored enrolment by national and local government, which subsidized the purportedly poor and non-poor with Philhealth. This resulted in the inflation of the government sponsored number of Philhealth members. For DPL purposes, "effective enrollment" is synonymous with the way that Philhealth currently uses the term "coverage" and is equivalent to the number of people included in the Philhealth database as members who are eligible to receive benefits, based on a 100 percent premium subsidy payment by the national government. The DPL 3 indicators selected capture the spirit of the original DPL 1-2 indicators on health utilization and out of pocket payment reductions, but are measurable by PhilHealth in relation to program beneficiaries. The revised indicators are also aligned to discussions with government for Sin Tax monitoring, which provides a significant part of the earmarked financing for the scale-up of this program.

Sources & Notes (cont)
The coverage indicator is included as one of the monitoring indicators proposed by Philhealth to the Governance Commission for GOCCs (GCG) under its Performance Evaluation Contracts (PECs), the primary oversight body for Government Owned and Controlled Corporations such as Philhealth. The PECs for GOCCs are also a outcome indicator under Pillar V of the DPL operation, further lending confidence that data on this indicator will be regularly collected. Further, eligible NHTS-PR enumerated families will soon receive cards identifying them as such, which will increase awareness of entitlement among this group. The concept of effective enrollment is captured by a combination of three monitoring indicators, which in turn can be normalized as 40% of the poorest opulation:

(i) Number of NHTS-PR families covered by Philhealth. This refers to the number of poor families included in the Philhealth database as eligible for the Philhealth benefit package, and is equivalent to the number of families deemed to be poor by DSWD's NHTS-PR enumeration.

(ii) Number of NHTS-PR families enlisted with a primary care benefit (PCB) provider. This indicator is a measure of access to, and utilization of, primary (outpatient) care. During the enlistment process, family medical histories and clinical measurements are obtained.

(iii) The share of NHTS-PR families that used inpatient hospital services at Philhealth-accredited providers in the previous year. This is a measure of utilization of inpatient care.

Taken together, these indicators capture both eligibility for the Philhealth insurance package, and utilization of the primary care and inpatient Philhealth benefits. The first two indicators are included in the set of monitoring indicators proposed by Philhealth to the Governance Commission for GOCCs (GCG) under its Performance Evaluation Contract (PEC). The PECs for GOCCs are also a outcome indicator under Pillar V of the DPL operation, further lending confidence that data on this indicator will be regularly collected. Further, Philhealth has indicated that eligible NHTS-PR enumerated families will soon receive cards identifying them as such, which will increase awareness of entitlement among this group.

[xiii] Obligated expenditures are defined as liabilities legally incurred and committed to be paid for by the government either immediately or in the future.

[xiv] Revenue Memorandum Orders 30 and 31, July 2011 (http://www.bir.gov.ph/iss_rul/ord2011.htm), and updates as per most recent update of Performance Governance system.

[xv] As denoted by EO 68 (3/2012) and evidence of refund allocations.

[xvi] All data from electronic and manual submissions of BIR 1702 analyzed as per April 15th 2012 filings.

[xvii] The revised measures for tax effort under DPL 3 focus (i) net contributions by BIR tax administration improvements, and (ii) policy measures (i.e., the alcohol and tobacco excise tax reform of 2012). These developments can be most directly linked to the actions supported under the program. This is calculated as BIR revenue collections to GDP for 2010 to 2014, net of gains attributed to policy measures (i.e., the 2012 Sin Tax). Aggregate tax effort trends would include changes in revenue effort by the BoC, which were not supported under this program. Total tax to GDP baseline for 2010 is now 12.1 percent, with BIR's tax effort contribution was 9.1 percent. Note that the DPL 1 reported a total tax effort baseline of 12.8 percent, given that the previous GDP estimates were lower (see Annex 3, and NEDA PDP Update, p. 23, Table 2.1).

[xviii] Baseline is no availability of information (e.g., as % of GDP) to measurement and public disclosure through a fiscal risk and tax expenditure statement.

ANNEX 2: Updates to DPL 3 Prior Actions (from DPL 2 Program Document)

Policy Areas/Pillars	DPL3 Triggers (Proposed in DPL2)	Proposed DPL3 Prior Actions	Comments
A1. Addressing public infrastructure bottlenecks	*DPWH has utilized and disbursed 95 percent of capital outlay allocation in 2012 budget.*	**The implementation of the DPWH public infrastructure program has advanced: (i) by January 1 2014, over 80 percent of the combined 2012 and 2013 capital expenditure budget has been contracted, and over 60 percent of these projects have been completed; and (ii) over 50 percent of the 2014 capital expenditure budget has been contracted by June 30, 2014.**	The prior action was refined to reflect progress over the full 2012-3 and partial 2014 period. The second component adds an emphasis on signing contracts early in the year for implementation, and above all credits DPWH bi-weekly tracking of projects under its Project Management System (PMS), recently renamed the electronic Project Life Cycle (ePLC) system.
	Infrastructure component of TCP under the 2012 budget of DPWH is 95 percent completed, and 90 percent of project bids in 2013 budget has been completed	**DPWH has delivered contract works under the TRIP network preparation process and resulting plan.**	The action recognizes the process by which the DoT-DPWH convergence initiative has generated a network upgrading plan, using clear results objectives and local participatory processes, and advancing this in terms of implementation.
		The Borrower has issued the 2014 GAA which requires that: (i) DPWH implement the Regular FMR Program; and (ii) DA provide and disclose the network plan for Regular FMR Program projects.	Action on rural was added to respond to oversight agencies emphasis on advancing shared prosperity in rural sector, including building on the TRIP convergence program lessons.
B1. Improving the investment climate by reducing the cost of doing business	*The DTI has further streamlined PBR for national registration with additional features such as ePayments for full on-line functionality.*	**The DTI has improved online functionality of the PBR for national registration, including ePayments.**	Wording was clarified in response to LEG comment at PCN stage.

C1. Strengthening the basic education sector		**The preparation for NHTS-PR II is advanced: (i) operational manual is revised to reflect lessons learned from the previous assessment; (ii) field workers are being hired and trained using standard training tools; (iii) IT-enabled data collection and encoding is developed and tested; (iv) arrangements for spot checks to monitor reassessment processes are in place.**	Action reflected (i) use of NHTS-PR as targeting platform, and (ii) need to update this list.
	A study of the ESC is carried out to evaluate the impact of per-student subsidies on student participation from lower income households.	**Expand the CCT coverage to children up to 18 years of age.**	Complete action had more tangible direct impacts, and flowed from close analysis/impact evaluation of CCT program.
C2. Strengthening the health sector	**Households identified as poor by NHTS are enrolled in NHIP and the partial subsidy program is being implemented in at least 60 provinces**	**NHTS-PR used to target at least 3 major government programs to the lowest 40 percent of the population, including evidence that PhilHealth has achieved effective enrollment of poor and near poor in the bottom 40 percent of the population.**	Revised action highlights use of NHTS-PR as targeting platform, and prominence of PhilHealth program (especially as Sin Tax revenues are main financing source for this program.
D1. Improving public financial management, budget transparency and accountability	**The Government has adopted a unified Account Code Structure for accounting, budgetary and treasury transactions and implemented this as part of the 2014 budget preparation.**	**The Borrower has adopted a unified Account Code Structure for accounting, budgetary and treasury transactions and implemented this as part of the 2014 budget preparation and implementation.**	
		The Philippines Open Data portal (data.gov.ph) is fully operational with full electronic access to over 600 datasets.	Reflects advances in this area, and GoP’s strong emphasis on transparency.
E1. Strengthening public revenue mobilization	**Government has implemented revenue policy reform measures in the areas of fiscal incentives rationalization and tobacco and alcohol excises taxes**	**The Borrower has implemented a series of revenue related reforms: (i) the implementation of a tobacco and alcohol excise tax reform, (ii) the completion and on-line publication of a Tax Expenditure Statement (TES) concerning fiscal incentives for investment.**	Specifies what has been achieved in terms of measures.

	The Government publishes a report on the size of tax expenditures from fiscal incentives as part of its budget submission to Congress.		
	The Government/GCG has developed action plans to significantly reduce fiscal risks for 3 GOCCs	**Fiscal risk management strengthened through the disclosure of broad risks (Annual Fiscal Risk Statement) and explicit/increased contingency allocations in 2014 budget (Risk Management Program + NDRRF).**	The 2013 natural calamities reflects the need to encompass broader fiscal risks.

Annex 3: DPL3 Summary Results Matrix

Program Development Objective (PDO):

Program Development Objectives (PDO)

The PDO is defined as fostering inclusive growth by:
Pillar 1: Strengthening Priority Public Investment Implementation
Pillar 2: Reducing the Cost of Doing Business for Jobs Creation and Poverty Reduction
Pillar 3: Developing the Human Capital of the Poor by Strengthening the Basic Education and Health Sector
Pillar 4: Fiscal Transparency & Good Governance
Pillar 5: Consolidating Fiscal Sustainability: Revenue Mobilization and Risk Management

Pillar outcome indicators mapped to this PDO measure progress against these objectives.

DPL Program Pillars	Pillar Results/outcomes	Pillar Outcome indicators	Baseline (2010)	Actual ((2013)	Target (2014)
1. Public infrastructure Investment	Improved competitiveness and increased infrastructure investment	**Public Infrastructure Investment**	<2.5%	2.5%	>3.5%
		DPWH Public Infra Investment (%GDP)	1.1%	1.5%	>1.5%
		DPWH Program Contracts Signed in H1 (by value)	31%	51%	>50%
		#Major DPWH Convergence Infrastructure Programs w/ Poverty & Jobs Targeting[i]	0	2	4
2. Ease of Private Investment for Jobs Creation	Increased firm start-ups & jobs creation Enhanced competition	**The average number of days required to register a sole propiertorship business**	>10 days (national + local)	>10 days (national + local)	<10 days
3. Human development investment	Enhanced targeting of social protection, health, and education programs	**Student Teacher Ratio, Top 25th Pct, Primary**	40.37	40.36	<40.37
		Student Teacher Ratio, Top 25th Pct, Secondary	42.03	34.6	<42.03
		Students-to-Classroom ratio, Top 25th Pct, Elementary	43.8	33.88	<43.8
		Students-to-Classroom ratio, Top 25th Pct, Secondary	59.98	48.91	<59.98
		Net Enrollment (Primary)	88.1	95.24	>94
		Net Enrollment (Secondary).	59.6	64.61	>94

DPL Program Pillars	Pillar Results/outcomes	Pillar Outcome indicators	Baseline	Actual	Target
3. Human development investment (cont)	Enhanced targeting of social protection, health, and education programs (cont)	**Number of NHTS-PR individuals/families covered by Philhealth (millions)** (ii)	22.1	21	47.8 (100% NHTS-PR eligible)
		Number of NHTS-PR members/families enlisted with a primary care benefit (PCB) provider (millions)	0	2	9.54 (65% of total)
		Number of claims by NHTS-PR families at Philhealth-accredited providers in the previous year (share of total)	20%	27%	>27%
4. Fiscal Transparency and Good Governance reforms	Improved transparency and accountability in budget execution	**(i)PEFA indicators score for:** **a) PI5 – classification of budget** **b) PI10 – Public Access to key fiscal information** **c) PI24 – Quality and timeliness of in-year budget reports**	(i) PEFA scores in 2010 (a) PI5 – D (b) PI10 – C (c) PI24 – D		2 Scores Improve
		(ii) existence of a unified Account Code Structure, including the Chart of Accounts, and the timely publication of budget execution data.			Acceptable budget execution data
5. Fiscal sustainability: Revenues and risk management	Enhanced fiscal sustainability/space through increased revenue mobilization, enhanced access to development finance, and risk resilience	**Tax admin gains by BIR yield 1 percentage point net gain in revenues (from 9.1 percent of GDP 2010 baseline)** *BIR Tax Collections (% GDP)* *Note:* Total tax revenues as % of GDP (incl. BoC)	* 9.1% 12.1% (2010)	1 10.8% 13.3% (2013)	(1.0 ppt increase)
		Policy Impacts: Excises from Alcohol & Tobacco (%GDP gain)	0.5%	0.9%	(0.4 ppt increase)
		Enhanced evidence based stakeholder awareness of key tax expenditures and fiscal risks (PPP, natural disasters, GOCCs)	Low/NA	Basic(iii)	Basic
		GOCC Contribution to Consolidated Public Sector Deficit (% GDP) (iv)	4%	1.5%	1.5%
		Majority of top 20 GOCCs as measured by government transfers between 2010-2013 are subject to completed GCG Performance Evaluation Contracts for 2013/14 (0 to >75 percent) (iv)	0	…	15

Sources & Notes

i) TRIP, FMR, Schools, Health Facilities. Based on evaluation of prioritization plans, geographic targeting, and implementation monitoring.

ii) Public reports by PhilHealth identify the sponsored category as including national and local government-sponsored members, as well as those sponsored by other bodies (e.g., churches). The DPL focuses national financing/NHTS-PR targeting. The second two indicators are typically framed, and reported by Philhealth, as encompassing all sponsored. For the purposes of DPL monitoring, Philhealth will be requested to generate NHTS-PR-specific numbers. The PCB program started in 2012, hence the baseline is 0.

iii) As defined by score of (i) public availability of quantitative estimates (Y/N), times (ii) an awareness score based on interviews with (i) Development Budget Coordinating Committee (DBCC) members, (ii) selected broadsheet/business media, (iii) legislative members.

iv) As per GCG Annual Reports (cf 2013, Table 14)/website (gcg.gov.ph) and NEDA 2014 PDP Mid-Term Update & Results Matrix.

ANNEX 4: CPS & Medium Term DPL Program Indicative Priorities

i. **The DPL 1-3 (2011-2014) program will have made significant contributions to the Aquino administrations priorities for realizing the Social Contract and delivery on inclusive growth.** In conjunction with the 2014 update of the Philippines Development Plan 2011-2016, and the preparation of an Implementation Completion Report (ICR) of the DPL 1-3 program for inclusive growth, an on-going dialogue is already taking place to further strengthen reform objectives by deepening and further institutionalizing existing reform tracks, and seizing new reform opportunities to deliver on reform objectives.

ii. **The new FY 2015-18 CPS serves to re-calibrate the results framework and priority actions of the follow-on DPL program under the Aquino administration.** The new DPL operations series envisioned for 2015 and 2016 ("DPL 4 & 5 for Inclusive Growth") would build on the existing programmatic series and carries forward the five reform pillars. These are: (i) public investments for jobs, (ii) private investments for jobs, (iii) human development investment, (iv) transparency and good governance reforms; and (v) ensuring fiscal sustainability through revenues and risk management. The government has underscored the continued emphasis it is placing on advancing reforms in these pillars, and building institutional legacies into the next administration for reform tracks initiated under the DPL 1-3 program. Table 3 provides the alignment of the continuous pillars with CPS engagement areas, and identifies indicative future areas of reform support briefly outlines below.

iii. **The public infrastructure gap is an impediment to growth and job creation in the Philippines, thus boosting public investment remains a high priority for the government.** The DPL 1-3 series has focused primarily on tourism and rural connectivity infrastructure. Other priority areas such as disaster/climate change resiliency or water and irrigation could be tackled in future operations. Going forward to 2015-2016, the DPL program will focus its attention on measures to better prioritize and implement public infrastructure provision for shared prosperity, notably to reducing vulnerability from climate and multi-hazard disaster risks ("building better/building back better"), including through the adaptation of enhancing building standards. Moreover actions to enhance both the quantity and quality of priority public infrastructure investment from one hand, and the institutional delivery capability and implementation metrics of DPWH from the other will be supported, including M&E for shared prosperity/geographic impacts.

Table 3: DPL 4-5 Indicative Priorities and CPS Linkages

DPL Program Pillars	Priority Results	CPS Alignment/Results	Priority Reform Areas
Strengthening public infrastructure investments	Public Infrastructure Delivery (percent GDP per annum) Prioritization and Execution M&E of Priority Programs	Strengthening Economic Policy (EA 3.1) Strengthened Public Sector Institutions (1.2) 4 Resilience to Climate Change, Environment and Disaster Risk Management (EA 4)	Institutionalization of public infrastructure delivery reforms, improvements in irrigation delivery, building better and disaster/climate change resilience measures, consolidation of national infrastructure network planning and upgrading
Improving the investments climate, logistics, and land reforms	Increased firm start-ups & jobs creation Enhanced competition	Improved Investment Climate, including Greater Access to Finance (3.2) Increased Economic Growth, Productivity and Employment in Rural Areas (E3.3)	Cabotage reform, land markets, competition policy
Human development investment	Enhanced targeting of social protection, health, and education programs	Empowerment of the Poor and Vulnerable (EA 2)	NHTS-PR Targeting
Transparency and good governance reforms	Improved transparency and accountability in budget execution	Strengthened Pressure for Government Accountability (1.3)	Institutionalizing transparency & open government
Ensuring fiscal sustainability through revenues and risk management	Enhanced fiscal sustainability/space through increased revenue mobilization, enhanced access to development finance, and risk resilience	Strengthened Public Finances, Fiscal Transparency and Financial Accountability (EA 1.1), also EA 4	Institutionalizing risk management as part of annual budget process, fiscal incentives transparency and management reforms, Climate Change Resilience Fund & Insurance Mechanisms

Source: CPS FY 2015-18 Board Document, Counterpart Dialogue

iv. **The upcoming DPL supports reforms aimed at increasing private investments to boost private sector growth and consequently job creation in both urban and rural areas.** Reforms aimed at reducing the cost of doing business in the Philippines will further be advanced in the DPL series of 2015 and 2016. Emphasis will continue to be made on starting businesses, whether sole or limited proprietorship; and increasing local competiveness as to boost job creation through private sector growth. Complementary regulatory reforms and service delivery support will also be needed to have transformational impact in rural areas. With 50.9 percent of the Philippines population living in rural areas, creating jobs and helping businesses grow in these areas is highlighted as a priority in the government program. DPL 4 and 5 will tackle these issues through reforms focusing on (i) transport logistics including inter-island shipping reforms that allow for effective and cheaper distribution of key commodities; (ii) land reforms tackling weak governance in the areas of property rights recognition, land use planning and management, and property valuation and taxation, all of which are expected to bring more security into land asset ownership - notably for the poor, stimulate agriculture productivity, yield tax revenues, and stimulate private investment; (iii) reducing market interventions and non-tariff barriers in food crops market, notably for rice, and allowing for greater participation of the private sector in importation as to improve productivity and performance of the agriculture sector.

v. **Support for the government policies aimed at creating equitable opportunities for the development of the human capital of poor will continue throughout DPL 4-5.** Similar to the previous series, the new DPL operations (2015-2016) will continue to endorse amendments to CCT coverage rules as to improve efficiency and coverage from one hand and, and tackle education attendance and attainment of poor children from the other. The new series will also continue the support for reforms tackling the PhilHealth program notably in improving its administrative capabilities and push towards a larger coverage and better services for its beneficiaries. Supporting such actions will be essential to mitigate key factors associated with high and persistent structural poverty that continue to affect Filipino households.

vi. **Transparency and good governance reforms remain at the core of DPL 4-5 series.** Future Bank technical assistance and DPL operations may tackle institutional measures in support of the government efforts to improve the supply, accuracy, timeliness, and disclosure of fiscal, budgetary and statistical information. Reforms supported in this area are broad and could include efforts to procure and implement a GFMIS system, further improve procurement transparency by implementing GPBB requirement of geo-tagging all subprojects prior to bidding, institutionalize complaint mechanisms, and improve poverty monitoring systems especially at regional level.

vii. **Ensuring fiscal sustainability through improving revenues and risks management is a cornerstone reform pillar supported by future operations.** The prevailing practice in the Philippines grants a number of investment promotion agencies/special economic zones the right to grant fiscal incentives, effectively outside the purview of the national tax code or accountability to DoF. As part of DPL 1-3, reforms have enabled DoF to account for these and to publish a tax expenditures statement. Going forward, the DPL 4-5 series will focus on advancing the fiscal incentives reform agenda pursued by DoF. The series will tackle the legal framework for fiscal incentives and will push for regulatory changes to eliminate the distortionary effects of exemptions on the tax system. The objective is to provide corporations with a level playing field for taxes and eliminating redundant exemptions. Moreover, the DPL 4-5 intends to enhance the government capabilities in fiscal risks management. Notably the operations will aim at supporting actions to take stock, manage and ultimately mitigate the fiscal implications of various shocks such as global macro shocks, natural disasters & climate change, contingent liabilities arising from the PPP agenda, and fiscal risks aligned with GOCC operating losses.

ANNEX 5: LETTER OF DEVELOPMENT POLICY

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.

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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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ANNEX 6: Fund Relations Annex

Press Release No. 14/388, August 08, 2014

On July 8, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Philippines and considered and endorsed the staff appraisal without a meeting.[2]

The Philippine economy has continued to perform robustly. GDP grew by 7¼ percent in 2013, supported by strong remittances from overseas workers and accommodative monetary and financial conditions. Due to its occurrence late in the year, super-typhoon Yolanda's impact on 2013 growth was limited, but a somewhat greater effect is likely in 2014. Growth is expected to ease in 2014 also in response to normalizing domestic financial conditions. Growth already slowed in the first quarter of 2014, in part due to temporary factors. Inflation remained below the bottom of the target band (4±1 percent) for much of last year, but picked up since late 2013 and is currently around 4½ percent because of pass through of the weaker peso, typhoon-related disruptions to food production, increases in rice prices and higher electricity prices. The current account surplus rose to 3½ percent of GDP in 2013 on a narrowing trade deficit. Risks to the growth outlook are tilted to the downside, and could stem from both domestic and external sources.

Strong GDP growth in recent years has translated into improved social conditions. Growth has become less employment intensive, but still reduced the elevated under- and unemployment rates. Poverty incidence, although declining, remains high, and a large share of the population remains vulnerable to falling into poverty as a result of natural disasters and other shocks.

On the policy front, domestic interest rates have been compressed by loose monetary policies abroad and ample domestic liquidity, partly reflecting the BSP's decision to restrict nonbanks' direct access to its Special Deposit Account (SDA)—one of its main sterilization instruments. Raising banks' reserve requirements by 2 percentage points earlier this year helped absorb part of the earlier net injection. Monetary and financial conditions have also been tightened by the more recent increase in the SDA rate by ¼ percentage point. In the banking system, financial soundness indicators signal continued strong performance, and capital adequacy ratios stand well above newly-introduced Basel III requirements. Bank credit growth recently accelerated to 21 percent and loan exposure to real estate has risen.

The level of public debt has moderated to 39 percent of GDP, alongside improvements in the maturity and currency composition. For 2014, the budget is targeting a deficit of 2 percent of GDP—up from the 1.4 percent of GDP achieved in 2013—that will accommodate post-disaster reconstruction spending. The government aims to double public infrastructure spending to 5 percent of GDP by 2016, financed by additional tax revenue, while keeping the deficit unchanged.

Executive Board Assessment

In concluding the 2014 Article IV consultation with the Philippines, Executive directors endorsed staff's appraisal, as follows:

The Philippine economy continued to perform robustly in 2013. Strong macroeconomic fundamentals and financial sector buffers, together with the authorities' flexible policy response to evolving external conditions, cushioned the impact of volatile capital flows. However, domestic monetary and financial conditions are now very accommodative. Notable progress was also achieved in lowering the poverty rate, although the incidence of poverty and under and unemployment remain elevated.

Macroeconomic prospects are expected to remain favorable going forward. Reconstruction from super typhoon Yolanda, infrastructure spending and remittance-driven private consumption will support rapid GDP growth, but the pace is likely to ease somewhat on more restrictive financing conditions that would help to temper inflation, narrow the positive output gap, and enhance financial stability. The current account surplus is forecast to decline gradually, with the real effective exchange rate moving in line with structural flows.

This favorable outlook could be buffeted by external and domestic events. Abrupt exit from exceptionally loose monetary policies abroad, a sharp slowdown in China or other emerging markets, or a major geopolitical incident could impact global or regional trade and capital flows and adversely affect the Philippine economy. On the domestic front, rapid credit growth or a disproportionate flow of resources to the property sector could boost short-term growth but heighten volatility thereafter, impacting overleveraged households and corporates.

The challenge is to deliver high-quality growth. Better realizing the Philippines' potential for rapid, sustained and more inclusive growth calls for further reducing bottlenecks to investment and formal sector employment that may be discouraging broad-based business activities. A more diversified production structure would strengthen resilience to economic shocks, which unduly impact the poor. Favorable demographics are a missed opportunity if the economy cannot effectively absorb the growing working-age population. Better domestic job opportunities would reduce poverty, thereby curtailing outward migration and the accompanying social hardships and sustained remittance inflows that can complicate macroeconomic management in the absence of compensating productivity gains.

The economy is well positioned for a more restrictive policy setting, together with a needed rebalancing of the policy mix towards an expansionary fiscal policy. The large buildup of reserves in recent years by leaning against the wind of sustained inflows suggests the external sector is moderately stronger than warranted by medium term fundamentals. Incomplete sterilization and exceptionally loose monetary policies in advanced economies compressed domestic interest rates to low levels. A tighter overall policy stance is now needed to maintain macrofinancial stability, with a rebalancing of the policy mix in order to accommodate fiscal spending for post-typhoon reconstruction and infrastructure upgrading.

Continuing to proactively tighten monetary conditions would address both potential inflation and generalized financial stability risks. With market interest rates well below the policy rate, the Bangko Sentral ng Pilipinas (BSP) decisions to withdraw liquidity by drawing down reserves and raising reserve requirements earlier this year were appropriate. Additional tightening of monetary and financial conditions is needed with a focus on measures that would not encourage a further shift in financial intermediation to nonbanks, including by raising official interest rates. Providing the BSP with suitable instruments to undertake sterilization would improve the effectiveness of monetary policy. With official reserves more than adequate, the exchange rate should adjust more fully to structural balance of payments flows, while symmetrically smoothing the effect of cyclical capital flows.

Additional targeted action is needed to contain specific risks to the financial system. Early adoption of Basel III capital requirements, monitoring a broader definition of banks' real estate exposure, standardizing "contract to sell" financing arrangements for developers, and establishing the Financial Stability Coordination Council were appropriate preemptive responses to deepening financial intermediation. Taking further measures is advised to contain risks in the property sector and to improve oversight and better manage risks from large exposures. Therefore, the recently announced bank stress tests for real estate exposure are commendable. Widening the BSP's mandate to include financial stability would help prevent diversion of systemic risk to the shadow-banking sector and strengthen powers for managing risks associated with greater cross-border financial integration.

Continuing to focus on mobilizing stable sources of revenue would ensure room for structural spending priorities while preserving fiscal prudence. Increasing the national government deficit to 2 percent of GDP in 2014 and maintaining it thereafter is appropriate to continue to build fiscal buffers and moderate the debt ratio. To achieve sustainable and inclusive economic growth, larger public spending is needed for disaster remediation, infrastructure upgrading and to support improved social outcomes. Meeting these spending demands requires a sizable tax effort, which should focus mainly on broadening the tax base by reducing exemptions and allowances and adopting a new mining strategy, supported by improvements in tax administration.

Further reforms to attract investment and create new employment would help sustain vibrant economic growth and make it more inclusive. Relaxing limits on foreign ownership, reducing red tape, and limiting tax holidays that tend to favor incumbents and distort the tax system would increase market contestability, support execution of public-private partnerships and better position the Philippines to benefit from the growth and employment opportunities of deeper regional integration. Increasing job creation in agriculture and in micro and small firms calls for establishing clear property rights for small-scale farms, expanding access to formal credit, and reducing labor market rigidities.

Source: http://www.imf.org/external/np/sec/pr/2014/pr14388.htm

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IBRD 33466R4
PHILIPPINES
SELECTED CITIES
PROVINCE CAPITALS
REGION CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PROVINCE BOUNDARIES
REGION BOUNDARIES
INTERNATIONAL BOUNDARIES
I Ilocos
1 Ilocos Norte
2 Ilocos Sur
3 La Union
4 Pangasinan
CAR Cordillera Admin. Reg.
5 Abra
6 Apayao
7 Benguet
8 Ifugao
9 Kalinga
10 Mountain Province
II Cagayan Valley
11 Batanes
12 Cagayan
13 Isabela
14 Nueva Vizcaya
15 Quirino
III Central Luzon
16 Aurora
17 Bataan
18 Bulacan
19 Nueva Ecija
20 Pampanga
21 Tarlac
22 Zambales
NCR National Capital Reg.
IV-A CALABARZON
23 Batangas
24 Cavite
25 Laguna
26 Quezon
27 Rizal
IV-B MIMAROPA
28 Marinduque
29 Mindoro Occidental
30 Mindoro Oriental
31 Palawan*
32 Romblon
V Bicol
33 Albay
34 Camarines Norte
35 Camarines Sur
36 Catanduanes
37 Masbate
38 Sorsogon
VI Western Visayas
39 Aklan
40 Antique
41 Capiz
42 Guimaras
43 Iloilo
44 Negros Occidental
VII Central Visayas
45 Bohol
46 Cebu
47 Negros Oriental
48 Siquijor
VIII Eastern Visayas
49 Biliran
50 Eastern Samar
51 Leyte
52 Northern Samar
53 Samar
54 Southern Leyte
IX Zamboanga Peninsula
55 Zamboanga del Norte
56 Zamboanga del Sur
57 Zamboanga Sibugay
--- Zamboanga City
X Northern Mindanao
58 Bukidnon
59 Camiguin
60 Lanao del Norte
61 Misamis Occidental
62 Misamis Oriental
XI Davao Reg.
63 Compostela Valley
64 Davao del Norte
65 Davao del Sur
66 Davao Oriental
XII SOCCSKSARGEN
67 North Cotabato
68 Sarangani
69 South Cotabato
70 Sultan Kudarat
XIII Caraga
71 Agusan del Norte
72 Agusan del Sur
73 Dinagat Islands
74 Surigao del Norte
75 Surigao del Sur
ARMM Autonomous Reg. in Muslim Mindanao
76 Basilan
77 Lanao del Sur
78 Maguindanao**
79 Sulu
80 Tawi-Tawi
** Shariff Aguak (Maganoy) and Sultan Kudarat serve as co-capitals of the province.
* Executive Order 429, May 23, 2005, provides for the transfer of Palawan province (#31) from Region IV to Region VI; Administrative Order 129 holds EO429 in abeyance until an implementation plan is approved by the President.
Luzon Strait
Babuyan Channel
Luzon
Philippine Sea
Samar
Mindoro
Sibuyan Sea
Visayan Sea
Panay
Cebu
Negros
Bohol
Leyte
Mindanao
Palawan
Sulu Sea
Celebes Sea
Moro Gulf
Davao Gulf
MALAYSIA
MANILA
0 50 100 150 Kilometers
0 50 100 Miles
20°N
10°N
5°N
120°E
125°E
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