SECTOR ASSESSMENT (SUMMARY): PUBLIC MANAGEMENT – INVESTMENT CLIMATE

A. INTRODUCTION

1. This updated assessment provides the background to the constraints on and threats to competitiveness, as well as the government's priority reforms to improve competitiveness to attract investment. Creating jobs, especially for the young, has become one of the government's top priorities for the remaining 2 years of the Philippine Development Plan (PDP), 2011–2016. To support job creation, the assessment focuses on key crosscutting strategic themes such as competition policy and regulatory efficiency, and creation of an efficient market for infrastructure through public–private partnership projects. It also touches on the need to implement structural policy reforms sector by sector. Labor market policies in support of job generation and skills matching are also discussed. The assessment draws on and updates the sector assessment for Public Sector Management: Investment Climate, 2011–2016*,* and several Asian Development Bank (ADB) diagnostic studies and other published reports.[1]

B. SECTOR ASSESSMENT: CONTEXT AND STRATEGIC ISSUES

1. Context

2. **Employment problem.** The Philippines is creating good jobs. For example, full-time wage employment has expanded by an average 3.7% per annum since 2010, well above the growth rate in total employment of 2.5% per annum. Wage employment accounted for 42.0% of total employment in 2013, up from 37.2% in 2000. The employment problem arises because this growth in wage employment is insufficient to absorb all new job seekers or make a dent in the number of workers crowded into the informal sector. For example, between 2000 and 2013, just over 50% of (net) new labor market entrants found wage employment, 37.0% found work in the informal sector (37.0%), and 11.0% entered unemployment. Wage growth has been insufficient to reduce the high rate of young people "not in employment, education, or training" (NEET), which is currently at 25.0% of total youth population. The employment situation reflects both insufficient growth in the demand for labor and a serious mismatch of skills in the labor market. Thus, while sustained economic growth above 6.5% is necessary to generate more quality jobs, it is insufficient. Structural policy reforms, including to the labor market, and effectively targeted public provisioning of employment services to help young people find jobs are also necessary to reduce the youth NEET rate.

3. **Structural change.** The economy is going through structural change that provides immense opportunities for lifting the potential growth rate above the estimated 5.0% growth rate per annum. Since 2005, on the production side of the national income accounts, the service sector has driven economic growth. Within services, communications, information technology, and the related business process outsourcing industry have become leading business areas. Finance and tourism have also exhibited robust growth since 2010. These services are labor intensive, some are highly skill intensive, and all exhibit important positive externalities with the rest of the economy.[2]

4. The structural change is reflected in shifts in employment from agriculture and industry to services, with services accounting for 53.0% of total employment in 2013, up from 40.3% in

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[1] ADB. 2010. *Public Sector Assessment (Summary): Investment Climate*. Manila.
[2] K. Bird. 2014. *The Philippines Youth Employment Problem*. Manila (forthcoming).

1995. The structural change is also reflected in the changing composition of occupations, with an increased demand for skilled workers in the information technology and communication sectors. A 2007 report prepared by the International Monetary Fund noted the prospects of service-led growth in the Philippines and pointed to the higher economic growth rate achieved between 2000 and 2004 on the strength of total factor productivity growth in the service sector.[3] The service sector in the Philippines continues to hold significant promise for growth and employment generation, but to keep adding value means to overcome significant hurdles such as the emerging shortage of skilled labor.

5. **Low investment rate.** The ratio of private and public investment to gross domestic product was slow to recover from the Asian financial crisis of 1997. The investment rate reached 24.0% of gross domestic product in the mid-1990s but declined thereafter and bottomed out at 13.0% in 2005. It recovered to 16.8% by 2008 and reached 19.4% in 2012. Still, that rate is much lower than in most other Southeast Asian economies, such as Indonesia (33.2%), Malaysia (25.7%), and Thailand (28.5%). A consequence of this lower investment rate has been a lower long-term economic growth potential of around 5.0% per annum. Much higher investment is necessary to sustain the current average growth rate of 6.5% per annum. In particular, the Philippines continues to underinvest in infrastructure.

6. **Weak competitiveness**. There has been a marked improvement in the rankings of the Philippines in key global competitiveness surveys since 2010, indicating significantly improved perceptions about the investment climate and the government's reform efforts. For example, compared with 2013, the Philippines jumped 30 places in the World Bank's 2014 Doing Business report to become 108th out of 189 economies, and gained six places in the World Economic Forum's 2014 Global Competitiveness Index to reach 59th place out of 148. The Philippines also jumped 25 places in the Heritage Foundation's 2014 Index of Economic Freedom to rank 89th out of 179, up from 114th place in 2010. Even so, more needs to be done to improve competitiveness. ADB diagnostic studies carried out under the Development Policy Support Program, completed in 2009, and at its Economic Research Department highlight key areas for improvement.[4] The 2009 Philippines: Reforming Investment Incentives reiterated the key constraints to investment attractiveness in the Philippines relative to its neighboring economies, such as excessive red tape, anticompetitive practices in selected industries, and tax policy. At the same time, a stable macroeconomic environment, skilled labor, and competitive labor costs are seen as important location factors for investors considering the Philippines. The 2007 Philippines: Critical Development Constraints report highlighted inadequate infrastructure, competition policy, and industry-related skills as major constraints to private sector investment and growth. Most recently, ADB's working paper on the Philippines' private sector development reiterated these constraints.[5] A common thread of the diagnostic studies is the need for a competition policy with both an economy-wide and a sector-by-sector approach.

2. Strategic issues

7. **Competition policy and regulatory efficiency**. While the Philippines is an open economy with a limited presence of state-owned enterprises, regulatory restrictions on entry and competition, incumbent capture of regulatory boards, and anticompetitive practices in the

[3] IMF. 2007. *Philippines: Selected Issues*. Country Report No. 07/131. Washington, DC; and IMF. 2006. *Article IV Consultations*. Staff Report No. 7/062. Washington, DC.
[4] ADB. 2009. *Philippines: Reforming Investment Incentives*. Manila. ADB. 2007. *Philippines: Critical Development Constraints*. Manila.
[5] A. Haydarov. 2011. *Philippines: Private Sector Development Challenges and Possible Ways to Go*. Manila: ADB.

service sector are prevalent. There is also community demand for a more robust competition policy framework. The Philippines does not have a competition law, although the government has prioritized the competition bill in its legislative agenda for 2015. The government recognizes that strengthening its competition policy framework is critical for improving competitiveness in the economy. It is taking both a crosscutting approach and a sector-by-sector approach to competition policy. The crosscutting approach includes enacting a competition law and institutionalizing regulatory review processes in government. The Department of Justice (DOJ) has set up and operationalized the Office for Competition as a precursor to Congress eventually passing a competition law. The government has also piloted regulatory impact assessments (RIAs) in the Department of Tourism (DOT) and the Department of Labor and Employment (DOLE). Both departments have established RIA focal persons and begun reviews of regulations that restrict investment and employment. Following on from ADB's approach in Cambodia and the Lao People's Democratic Republic, the National Economic Development Authority (NEDA) has established a new division, Governance Staff, which is responsible for the governance agenda of the government. Its functions include championing RIA in the executive government. NEDA is preparing a draft presidential order to mandate RIA practices in government.

8. **Sector-by-sector competition policy**. The government has slowly been chipping away at regulations and other arrangements that constrain competition in several areas, including domestic aviation, shipping, oil distribution, and electricity. Under subprogram 1 the government further relaxed entry to domestic aviation and, under subprogram 2, abolished the 3% common carrier tax on foreign airlines' passenger revenues, which is considered an anticompetitive tax.

9. The Philippines' tourism sector performs poorly in global surveys of competitiveness. The World Economic Forum's tourism competitiveness report for 2011 ranked the Philippines 94th out of 139 countries because of its poor regulatory framework, business environment, tourism infrastructure, and service standards. Restrictions on foreign carriers competing in the domestic aviation market, and unequal tax treatment of foreign airlines), outdated tourism standards, a poorly implemented quality assurance and accreditation system, and skills mismatches in the sector have contributed to the Philippines' poor standing in the competitiveness report. The shortcomings have also contributed to lower international tourist arrivals and tourism revenues compared with its regional peers. The government is aware of these structural and policy constraints to longer-term sustained growth in the tourism sector. The Tourism Development Plan for 2011–2016 prioritized implementing the "open skies" policy, abolishing the common carrier tax on foreign airline cargo and passenger revenues, carrying out a regulatory review of the sector, implementing modern standards for hotels and a mandatory accreditation system consistent with regional peers, establishment of public–private partnerships (PPPs) in industry skills development and promoting PPPs in infrastructure. Reforms in the sector are bearing fruit. The 2013 tourism competitiveness report moved the Philippines 12 places up in the global ranking, although it still pointed to the cost of regulations as a major drag on the sector's competitiveness.

10. **Tax policy.** Tax policy remains inefficient in promoting investment and achieving economic growth. Tax incentives have proliferated and ADB estimates that at least 50% of them could be redundant. At the same time, income tax rates are relatively high compared with regional peers. The National Internal Revenue Code acts as a disincentive for firms to invest in staff training and human capital development. Although abolished in June 2013, the common carrier tax of 3% on foreign carriers' passenger revenues had deterred foreign airlines from operating in the Philippines. The value-added tax (VAT) refund procedures up to 2012 were expensive for firms and particularly hurt exporters of manufactured goods. Until 2012,

enterprises received tax credit certificates for VAT rebates, instead of cash refunds commonly used elsewhere in the region. While the certificates could be traded, they often incurred a significant discount. With technical assistance from the Japan International Cooperation Agency, the government reviewed this policy and in 2011 agreed to introduce cash refunds in 2012.

11. **Strengthening the market for infrastructure.** The Philippines was one of the first developing countries with a dedicated PPP legislation and institutional frameworks adopted in the mid-1990s. However, the enabling policy and legal and regulatory framework are not entirely clear or not consistently applied. The government recognizes these inadequacies in the implementation of the Build–Own–Transfer Law and has made development of a world-class PPP framework its priority. Since 2011 it has introduced major institutional, regulatory, and policy reforms by (i) establishing the PPP Governing Body to oversee policy development related to PPPs, (ii) setting up the PPP Center under NEDA to effectively promote and help government agencies implement PPP projects supported by a Project Development and Monitoring Facility (PDMF), and (iii) amending the Build–Own–Transfer Law to align it with the new PPP framework. The government is developing ways to fund the government's share in PPP projects and the mechanisms to provide guarantees and fiscally responsible subsidies for appropriate PPPs. Consequently, the government made substantial allocations in 2012 and 2013 to the Strategic Support Fund to ensure funding of the government's share in PPP projects, and allocated P20 billion to the PPP Contingent Liability Fund to cover risks arising from PPPs in 2014. With ADB technical assistance, the government is strengthening the PPP Center to ensure that it has the necessary technical capacity and authority to optimally perform its role as the government's central PPP unit.[6]

12. Increasing the employment gains from the recent economic expansion and further reforming competitiveness will require both structural reforms to the labor market and targeted public provisioning of employment programs to assist young people at risk. ADB analysis indicates that the high cost of dismissals arising from the Labor Code has made employers averse to hiring workers on a regular or long-term basis. Consequently, the incidence of short-term employment (less than 12 months) is high in the Philippines. ADB estimates that almost 30% of workers are in short-term employment compared with an average of 18.0% in developed countries. Thus, reforming the dismissal regulations is necessary to boost employment and create more longer-term jobs. At the same time, many young people are at risk of not being integrated in the labor market. Thus, targeted youth employment programs providing career guidance, life skills training, technical skills training, and placements with employers are essential. DOLE recognizes these constraints and is reviewing several labor regulations that affect employment and is piloting the youth employment program JobStart in four local government units.

C. GOVERNMENT'S SECTOR POLICY AND PLANNING FRAMEWORK

13. **Philippine Development Plan, 2011–2016.** The PDP has been updated to make job creation, investment in education, infrastructure, and a better investment climate for the private sector the four top priorities of the economic program. Improving the competitiveness of industry and services is another core component of the PDP. The PDP is supported by sector strategies with detailed time-bound actions and clear ministerial responsibilities.

[6] ADB. 2011. *Republic of the Philippines: Strengthening Public–Private Partnerships in Infrastructure.* Manila.

14. The government has prioritized the competition bill in its 2014–2015 legislative agenda. Supported by ADB, the Government of Australia, and the Government of Canada, it also has established a PPP framework and has proposed amendments to the Build–Own–Transfer Law. These reforms and capacity development activities have produced concrete, measureable results. As of August 2014, contracts amounting to about P63 billion have been awarded under seven PPP projects, another two PPPs in road construction (P100 billion) have bidding in progress, and four more PPP projects (P153 billion) are tendering for bids.[7]

15. The government also recognizes that reducing red tape is important to lower business compliance costs and to promote investment. NEDA, DOT, and DOLE are implementing RIA pilots, and DOT and DOLE have started a regulatory review program. NEDA has established its Governance Staff division, which includes RIA responsibilities.

16. The government (through DOLE) is also looking at ways to effectively target public programs to help young people at risk stay in college, acquire new skills, and find quality jobs. DOLE is implementing the JobStart pilot in 2014 and is preparing a 5-year nationwide rollout program. DOLE has also increased funding to its Special Program for the Employment of Poor Students to improve school retention rates of this group.

D. ADB's Sector Experience and Assistance Program

17. ADB has long supported reforms to the investment and business climate in the Philippines through a variety of instruments such as knowledge products, technical assistance (TA), policy-based lending, and investment projects. ADB's strategic focus has been on the energy sector, capital market development, and rural infrastructure development. The Development Policy Support Program had operationalized the country strategy by providing an umbrella operation that complemented and reinforced ADB's sector program loans and projects from 2006 to 2009.[8] The current program builds on from the earlier one, with a focus on competitiveness and employment. It also has two TA projects attached, funded by the Government of Canada for $12.5 million, to help DOLE implement JobStart and help DOT implement its skills development program, and to support the RIA pilots at NEDA, DOLE, and DOT.[9] ADB is supporting the PPP environment through TA cofinanced by the Government of Australia and the Government of Canada (footnote 6). The TA aims to increase private sector investments in infrastructure by boosting the government's capacity to promote, develop, and implement PPP projects.

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[7] www.ppp.gov.ph

[8] ADB. 2011. *Technical Assistance Completion Report: Development Policy Support Program in the Philippines*. Manila.

[9] ADB. 2013. *Employment Facilitation for Inclusive Growth*. Manila; and ADB. 2013. *Improving Competitiveness in Tourism*. Manila.

Sector Results Framework

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Sector Outcomes with ADB Contribution	**Indicators with Targets and Baselines**	**Sector Outputs with ADB Contribution**	**Indicators with Incremental Targets**	**Planned and Ongoing ADB Interventions**	**Main Outputs Expected from ADB Interventions**
Improved investment Improved competitive-ness of selected sectors	Increase in wage employment of youths by at least 5% per annum (2010 baseline) Philippines' ranking in global surveys of competitive-ness, doing business, and Heritage Foundation Index of Economic Freedom improved by 15 places (2010 baseline) Cost of rules and regulations for key licenses reduced by 15% (2012 baseline) Philippines ranking in global survey of logistics improved by 8 places	Structural policy reforms to promote competitiveness implemented An efficient market for infrastructure through PPP projects created Competitive labor markets promoted	At least 3 complaints of anti-competitive practices investigated RIA piloted at 5 ministries, and at least 50% of RIA focal persons are women At least 50% of stakeholders consulted through the RIA process are women All value-added tax refund credits eliminated and all refunds made in cash At least 5 line agencies have PPP units and 100 staff trained on PPP Number of institutionalized PESOs at LGU level increased to 200. (2011 baseline: 89) Establishment of tourism industry skills development program Pilot hospitality quality assurance and accreditation system	**Ongoing projects with approved amounts** CDTA: Strengthening Public–Private Partnerships in the Philippines ($9.7 million) PATA: Strengthening Institutions for an Improved Investment Climate ($1 million) in 2011 **Pipeline projects with estimated amounts** Increasing Competitiveness for Inclusive Growth, Subprogram 1 ($350 million) in 2012 Subprogram 2 ($350 million) in 2014 Capacity development TA for improving competitiveness in the tourism sector ($7.0 million grant) and TA for improving employment for inclusive growth ($5.5 million grant) financed by Government of Canada	No. of persons who found jobs through institutionalized PESOs increased by 10% per annum (2010 baseline: 1,000 persons per PESO) At least 1,600 youths placed in internships through the pre-tested JobStart program At least 5,000 persons accessed skills development through the Tourism Development Fund, and at least 55% are women (2010 baseline: 0) At least 500 tourism professionals achieved mutual recognition under the ASEAN agreement 100 hostels accredited under the national quality assurance system At least 15 RIAs completed by all pilots 6 competitively tendered PPP projects, of which 2 are gender-responsive, are implemented

ADB = Asian Development Bank, ASEAN = Association of Southeast Asian Nations, CDTA = capacity development technical assistance, LGU = local government unit, NEDA = National Economic Development Authority, PATA = policy and advisory technical assistance, PESO = public employment service office, PPP = public–-private partnership, RIA = regulatory impact assessment.
Source: Asian Development Bank.