Moving full speed ahead: Accelerating reforms to create more and better jobs

_Philippine economic update_  
April 2016 edition

Karl Kendrick Chua,  
Senior country economist  
Macroeconomics and Fiscal Management Global Practice
Contents

1. Recent economic and policy developments

2. Growth prospects and risks

3. Policies to create more and better jobs
Recent economic and policy developments

Philippine economic growth accelerated in H1 2016 and was the strongest performer in the region.

- Coming from a slow start in H1 2015, GDP growth accelerated in H1 2016 to 6.9 percent, driven by robust consumption, fixed investment, and public spending.
- Private consumption, driven by low inflation and supported by sustained remittance growth, remained the engine of growth.
- Meanwhile, the services sector continued to drive growth, while agriculture continued to struggle due to lingering effects of El Niño.
Recent economic and policy developments

Low oil prices and subdued food inflation kept inflation at a 21-year low.

- Timely importation of food kept food inflation low despite El Niño, while crude oil prices declined by an average of 53 percent between 2014 and June 2016, providing a relief to the import-dependent economy.
- As a result, inflation decelerated to 1.3 percent in H1 2016.
- Supportive monetary policy and low inflation helped to stabilize money growth.
Government spending continued its strong pace in H1 2016. However, revenue effort increased only marginally.

- Government spending increased by 14 percent in H1 2016 as the government continued to ramp up infrastructure spending and benefited from election-related spending.
- However, tax effort improved marginally to 14.3 percent of GDP, indicating the need for further tax policy reforms to sustainably finance the inclusive growth agenda.
- As a result, the government recorded a deficit of PHP 120 billion (1.7 percent of GDP) in H1, a sharp reversal from the budget surplus of PHP 14 billion recorded in the same period last year.
Growth prospects and risks

Philippine growth projections are maintained for 2016 and 2017, as prospects remain strong for the country.

- Global growth projections are downgraded in the June 2016 Global Economic Prospects:
  - In 2016: From 2.5 percent to 2.4 percent.
  - In 2017: From 2.9 percent to 2.8 percent.

- In East Asia:
  - In 2016: From 5.8 percent to 5.7 percent.
  - In 2017: From 5.8 percent to 5.7 percent.

- In the Philippines, GDP growth projections are unchanged:
  - 2016: 6.4 percent (no change).
  - 2017: 6.2 percent (no change).
  - 2018: 6.2 percent (no change).

- These projections incorporate a number of risks, which have remained broadly the same since the October 2015 PEU.
Growth prospects and risks

Risks come from both domestic and external fronts, but low inflation, especially from oil, can further support growth.

- **On the external front**
  - Uneven recovery of high-income economies
  - China’s economic rebalancing
  - Financial volatilities
  - Slower remittance growth as oil prices remained subdued

- **On the domestic front**
  - Lagged effect of El Niño and stronger typhoons
  - Delays in PPP projects
  - Changing priorities under the new government

- **Opportunities**
  - Low commodity prices, in particular, oil, can stimulate manufacturing on the supply side, and consumption on the demand side
  - A window of opportunity to enact game changing reforms
The Philippines’ inclusive growth challenge

Despite recent improvements, the central policy challenge remains the same: how to accelerate inclusive growth?

Growth may be necessary but is not sufficient to ensure poverty reduction…

How broadly based growth is—i.e., how pro-poor the distribution of growth is—also matters…

Raising the returns to labor—the main asset of the poor by…

...increasing value-added per worker in agriculture

...moving workers out of agriculture to higher value-added activities in manufacturing and services

...as does how resilient growth is and the extent to which poor and vulnerable households are protected from shocks

Putting in place appropriate social protection schemes

...and raising human capital endowments

Putting in place appropriate social protection schemes

...and raising human capital endowments
The Philippines’ jobs challenge and its causes

Significant progress was made in job creation but still a long way to go. Structural reforms needed to create more and better jobs.
Necessary conditions for inclusive growth are present

- The country’s strong macroeconomic fundamentals and substantial fiscal space provide the necessary conditions for inclusive growth.

These allowed a considerable ramping up of spending, including on programs that benefit the poor directly.
The structural reform agenda

The Philippines now needs to pursue policies to enable it to undertake a more successful structural transformation to create more and better job.

- The development of the rural sector is the crucial first step for the country to provide more and better jobs to the poor.
- In manufacturing, the country needs to address investment climate issues and connect to global value chains.
- In services, as a start, the country needs to continue supporting the fast-growing, internationally competitive business process outsourcing industry.

---

[Graph showing sector share to GDP over time, with data sources cited as NSCB.]
Accelerating the economic reform agenda

The government has begun to address decades-long constraints that have held back the potential of the private sector to create a more inclusive growth pattern.

- Key economic reforms addressed by the government include:
  - Fostering more domestic competition by simplifying business registration and passing an overarching competition policy law.
  - Opening up the economy to more foreign competition by allowing foreign transshipment of goods and by allowing 100 percent foreign ownership of banks.
Moving forward, reforms to focus on the following

- Enhancing competition
- Simplifying business regulations
- Securing property rights
- Ramping up investments through a simpler, fairer, and more efficient tax system characterized by low rates and broader base that encourages investment, job creation, and poverty reduction.
Enhancing competition

- Further open up the economy to more competition by reducing the investment negative list.

- The following sectors are likely to provide the largest gains:
  - Telecommunications
  - Shipping
  - Construction
  - Rice

- Rice trade policy needs to be liberalized to lower prices.
  - Replace the import quota with an import tariff say at 30 percent.
  - Allow full importation by private sector.
  - NFA to focus on emergency buffer stocking and disaster mitigation programs to reduce risks brought about by climate change.
Simplifying regulations

- Further simplify and automate key business registration processes.
- Fully implement the Philippine business registry and the regulatory simplification program.
- Introduce alternative payment systems such as online and mobile payments.
- Reduce the frequency of renewals of government licenses, permits, and clearances for employment purposes.
- Adopt a risk-based approach for issuing business permits.
- Simplify the tax regime for micro and small business to reduce compliance costs and encourage movement to the formal sector.
Securing property rights

- In rural areas:
  - Over the short-term, accelerate administrative and systematic adjudication of property rights beginning in areas of high agricultural potential.
  - Over the medium-term, complementary reforms in land administration are needed, including passing a Land Administration Reform Act.

- In urban areas:
  - Accelerate implementation of the residential free patent law.
  - Ensure timely and proactive update of comprehensive land use plans, including developing a zoning plan for all types of land.
  - Generate a comprehensive mapping and database of land parcels describing categories, land use, and property boundaries with the aid of a unified land information system at the LGU level.
  - Improve efficiency and equity of real property taxation.
A huge investment deficit of 7% of GDP (almost PHP 1,000 billion)

**Investment deficit (percent of GDP)**
- Infrastructure: 2.7
- Social services: 4.3

**Tax revenues needed to fund the investment deficit (percent of GDP)**
- Tax administration reform: 3.0
- Tax policy reform: 4.0
Raising revenues simply, equitably, and efficiently

A simpler, more equitable and efficient tax system is needed to sustainably finance an investment-led growth.

- First, focus on broadening the base:
  - Rationalize tax incentives by making them more targeted, transparent, performance-based, and temporary.
  - Index tax rates and valuations which have not kept up with inflation, such as petroleum excise taxes and property valuations.
  - Removal of VAT exemptions that have no clear economic rational and use CCT-like programs to protect vulnerable groups.

- Then, lower tax rates and further broaden the base.
  - Reduce the top income tax rate to 25 percent.
  - Reduce the gap between regular and special corporate income tax rates (25 percent for regular CIT and 10 percent for special CIT in lieu of the GIE tax).
  - Simplify tax regime for micro enterprises to just 6 percent of turnover in lieu of the income, business, and VAT/percentage tax.

- Only if new revenues are raised should tax rates be reduced.
Achieving inclusive growth is within reach, now more than in any previous period.

- Recent trends show an improvement in the country’s growth-poverty elasticity (from -0.1 to -0.4) – which means growth is becoming more inclusive.
- If the Philippines sustains high growth and accelerates structural reforms, the country can eradicate poverty within one generation.
THE WAY FORWARD

WE CAN WORK IT OUT

- SECURE PROPERTY OWNERSHIP
- FAIR COMPETITION
- INVESTMENTS IN HEALTH, EDUCATION AND INFRASTRUCTURE
- SIMPLE REGULATIONS

LABOR       BUSINESS

GOVERNMENT  CIVIL SOCIETY

WORLD BANK GROUP
Thank you