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**PHILIPPINES**

# PARTNERSHIP FOR GROWTH

Concept Notes on Regulatory Quality, Rule of  
Law, Anti-corruption, and Fiscal Performance



Philippines  
2012-2016



September, 2011

# Partnership for Growth: Philippines 2012-2016

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# Partnership for Growth: Philippines

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Under U.S. President Barack Obama's Presidential Policy Directive on Global Development, the Partnership for Growth (PFG) initiative provides a new framework for deepening and strengthening U.S. Government (USG) engagement with the Government of the Philippines (GPH) to promote and support broad-based economic growth as the primary development objective. Based on the results of a constraints analysis (CA) conducted by a joint USG-GPH technical team, poor governance and narrow fiscal space were identified as the chief binding constraints to more competitive, inclusive growth in the Philippines. In support of the PFG, USAID/Philippines submits concept notes which divide the CA into four inter-related themes: (i) Regulatory Quality, (ii) Rule of Law, (iii) Anti-corruption, and (iv) Fiscal Performance. Each of these proposals provides activity descriptions, their related program mechanisms, sequencing rationale, expected impacts, and notional budgets.

## I. Facilitating Investments and Trade (FIT) *Concept Note on Regulatory Quality*

### A. Overview

Within the poor governance constraint, the **Facilitating Investments and Trade (FIT)** Program will directly address weak regulatory quality, in which private enterprises and new investments are hindered by regulatory inconsistency and the poor policy formulation, ineffective implementation, or weak enforcement of economic policies. This initiative aligns with the GPH's goal to boost national competitiveness that contributes significantly to increased trade, investments, job generation, and inclusive growth. As outlined in the Philippine Development Plan (PDP), the GPH seeks to create a better business environment by promoting a "consistent, coherent, cohesive, predictable, and responsive policy environment."<sup>1</sup>

In the Philippines, ineffective policies, regulatory bottlenecks, restrictive barriers to market entry, and discriminatory provisions to investment in key priority sectors have limited the country's otherwise strong economic potential. Since many are not statutorily independent, many regulatory agencies fall prey to sometimes arbitrary political interference, creating added risks and uncertainties to the overall business climate. Regulatory quality also suffers from (i) overlapping and conflicting functions of government authorities and (ii) poor coordination between national and local governments – which both negatively impact regulatory consistency needed for investor confidence. As a result, perceptions of the Philippine investment climate have eroded in all major rankings of international competitiveness.<sup>2</sup> These rankings influence the levels of investment (foreign and domestic) in the country, where the perception and the reality of the business climate negatively reinforce each other.

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<sup>1</sup> See Government of the Philippines. *Philippine Development Plan 2011-2016*, Strategic Framework, Goal 1: Create a Better Business Environment, p 74.

<sup>2</sup> For an overview of the Philippine international competitive landscape, see Joint Foreign Chambers of Commerce, *Arangkada Philippines 2010: a Business Perspective*, pp. 36-55.

As the name suggests, this Program will improve the poor regulatory quality inhibiting investments and trade. The USG, primarily through USAID's FIT Program, will support measures to ease restrictions on market entry, improve the investment climate, reduce the cost of doing business, and unlock innovation through an enhanced intellectual property rights (IPR) regime. Within the five-year timeframe of PFG, FIT will support the implementation of related priority policy reforms outlined in the 10-point Agenda of the PDP Strategic Framework for Industry and Services.<sup>3</sup> By promoting a stable, consistent, and transparent policy environment needed to boost investor confidence, the Program will assist GPH efforts to boost trade and increase investments in priority sectors identified by the PDP, including infrastructure, tourism, mining and agribusiness sectors.

The FIT Program will support GPH efforts to implement trade and investments reforms, focused on addressing economic governance and macroeconomic constraints, to ensure an environment attractive for investment, trade, and private sector growth. The flexible, demand driven Program encompasses several components and will respond to GPH identified needs to improve the overall trade and investment climate. Given the multiple USG agencies involved in administering foreign assistance and the unique policy initiatives in which the PFG Initiative is engaged, USAID will coordinate the implementation of the FIT Program closely with the US Trade Representative (USTR), the US State Department, Treasury Department, Commerce, and other relevant USG agencies responsible for US international trade and investment policy.

## B. Goals and Objectives

The goal of PFG is to assist the Philippines achieve broad-based and inclusive economic growth by creating a competitive climate for trade and investment. FIT Program objectives aim to improve the investment, trade, and business climate by:

- Increasing levels of domestic and foreign investment for higher levels of employment in priority sectors;
- Advancing eligibility to enter into the Trans-Pacific Partnership Agreement;
- Reducing the cost of doing business involving both national and local level regulations and processes; and
- Supporting the fulfillment of Philippine obligations under the ASEAN Economic Blueprint.

As envisioned by FIT, efforts to enhance regulatory quality require a multifaceted approach aimed at strengthening and rationalizing the functions of GPH agencies to improve administrative efficiency to attract private sector investments and promote trade. This government reform should reduce the overall regulatory burden on businesses by cutting red-tape, streamlining government permit requirements, simplifying licensing requirements, and reducing unnecessary administrative discretion

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<sup>3</sup> This Agenda targets an improved business environment, increased productivity and efficiency, and enhanced consumer welfare with policy reforms designed to (1) Improve Governance; (2) Strengthen Economic Zones; (3) Strengthen National Brand/Identity Awareness; (4) Intensify the Culture of Competitiveness; (5) Focus Interventions to Increase Exports/Investments/Tourism; (6) Provide Firm-Level Support to Potential, New and Existing Micro, Small and Medium Enterprises; (7) Expand Industry Cluster Development; (8) Increase Market Access through Global And Regional Integration; (9) Encourage Consumer Products and Services Satisfaction ; and (10) Improve Supply Chains of Basic and Prime Commodities.

that deter economic competitiveness. These initiatives promise to enhance regulatory transparency, consistency and predictability – all crucial to improving the investment climate and reducing the risk premium of doing business in the Philippines.

In line with improving the regulatory quality for competitiveness, the FIT Program will also support priorities set by the Philippine National Competitiveness Council, particularly areas that seek to strengthen government capacity and inter-agency coordination in investment planning, development, and promotion at all levels of government (national and local). In addition, the Program will assist GPH efforts to improve economic integration and meet the country's commitments under the ASEAN Economic Blueprint and trade and investment-related policy reform needed to qualify for entry into the Trans-Pacific Partnership (TPP) agreement.<sup>4</sup>

## C. Program Components

Geared towards improving the economic climate, the FIT Program encompasses several inter-related components: Commerce, Infrastructure, Business, and Competition.

### 1. FIT - Commerce: Promoting Exports and High Growth Industries

#### 1a. FIT - Industries: Supporting Priority Growth Sectors and Geographical Hubs

As part of the 10-point Agenda contained in the PDP Strategic Framework for Industry and Services, the GPH seeks to promote trade and investment in high potential industries such as tourism, business-process outsourcing, electronics, mining, housing, agribusiness and forest-based industries, logistics, ship-building, and infrastructure. FIT-Industries will support the implementation of priority policy reforms outlined in this agenda and facilitate trade and investments in priority growth sectors. The Program will improve the capacity of businesses to integrate into domestic and international markets through increases in productivity, improvements in corporate governance, and the development/application of modern technology and marketing practices.

USAID has been promoting the economic hub concept in order to improve competitiveness through the Economic Growth Hubs Project. A complementary objective would seek to spread development and economic growth away from Metro Manila, in order to broaden the benefits of development more widely in the Philippines. The FIT-Industries component will provide technical assistance to identify and facilitate new investments and business activities in priority sectors and areas. This strategy will assist GPH in the preparation, coordination and execution of trade and investment planning and promotion activities. It can develop and build the network of Investments Promotion Agencies and National Economic Research and Business Assistance Centers across the country as it implements the Philippine Investments Promotion Plan and the Export Development Plan. USG may support strengthening the administrative capacities of enterprise zones and other free ports, including the establishment of zones for domestic investors.

FIT-Industries will also support sector-specific initiatives, such as the implementation of the National Tourism Act of 2009. Other activities will seek to ensure an enabling, credible, transparent investment

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<sup>4</sup> In such areas of intellectual property rights, standards conformance, government procurement, trade and investment policy.

rules under the Tourism Infrastructure and Enterprise Zone Authority in order to generate more investments in the tourism sector. This component also envisions supporting stronger local linkages with agriculture and communities for community-based tourism. FIT-Industries will support the Export Development Council achieve targets in the Export Development Plan.

Illustrative activities:

- Support market studies for key priority sectors
- Support standards compliance measures for key export products
- Provide TA for the development of tourism cluster plans
- Provide TA to support network of investment promotion agencies and National Economic Research and Business Assistance Centers
- Support training and workshops for trade and investment promotion and planning officers at local and national level
- Provide business advisors for enterprise development activities in key priority sectors
- Provide resident investment advisors in domestic economic zones and growth hubs

*Anticipated impact:* Increased investment in key priority sectors; Increased tourist arrivals and expenditures; Increased exports.

#### **1b. FIT - Customs: Facilitating Cross-border Trade**

Improvements in trade facilitation are important in attracting investment and promoting international commerce. In the World Bank's Doing Business report, the Philippines ranks 61<sup>st</sup> in the costs and procedures involved in importing and exporting, far behind its regional peer Thailand (12<sup>th</sup>).<sup>5</sup> The Philippines also trails behind Thailand in the customs element of the World Bank's Logistical Performance Index.

The GPH recently acceded to the World Customs' Organization (WCO) Revised Kyoto Convention (RKC) which seeks to standardize and harmonize customs policies and procedures according to WCO standards. The GPH seeks to introduce a new Customs and Tariff Modernization Act to comply with the RKC. In general, the changes in the customs laws, regulations and procedures should result in reduced cost and delays of clearing customs through simplification and automation of customs procedures and introduce greater transparency and predictability in the disposition of customs cases.

The GPH has also committed to implementing a National Single Window (NSW), integral to the country's obligations under the ASEAN Economic Blueprint.<sup>6</sup> With the FIT-Customs component, the USG through USAID will support GPH efforts to facilitate GPH compliance with RKC provisions as well as other international treaties including the WTO customs valuation agreement and regional trade agreements. In coordination with the USTR, the Project will also support trade facilitation through greater use of

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<sup>5</sup> World Bank. Doing Business 2011: Making a Difference for Entrepreneurs.

<sup>6</sup> The NSW system is designed to enable the single submission, and synchronous processing of data, and single decision-making for the release and clearance of imports and exports by the Bureau of Customs. This interconnection will provide the ability to share and counter-check permits and clearance across a total of 50 agencies online and in real-time. In doing away with spurious permits, licenses and clearances from these regulatory agencies, the NSW would contribute to trade facilitation and a reduction of opportunities for corruption.

automated systems and electronic means to reduce paper bureaucracy and person-to-person interactions at the Bureau of Customs and improve coordination between government departments under the NSW. USG assistance may also improve customs compliance through more sophisticated targeting and risk management systems.

Illustrative activities:

- Provide TA and limited commodities to assist RKC-compliance measures
- Support standards conformance with the WTO and other international trade agreements
- Provide TA and limited commodities to implement NSW and connect to the ASEAN Single Window
- Provide resident adviser to the BOC on RKC compliance
- Support IT systems to improve risk management and post-entry audit
- Other activities to be identified in pre-TPP consultations

*Anticipated outcome:* Import and export clearance time reduced; Customs procedures simplified; Increased trade as a percentage of GDP.

#### **1c. FIT - Skills: Facilitating Cross-border Trade**

Poor regulatory quality extends to the education sector as well. Faced with poor skills development, low investment in research and development, and low levels of intellectual property commercialization, the GPH seeks to improve productivity and efficiency by developing human resources and implementing technical projects in priority sectors to boost innovation and competitiveness. The state of the higher education sector remains precarious, suffering from substandard quality and producing graduates lacking basic skills and cognitive abilities sought by the private sector. This mismatch of skills supply and market demand has many causes: poor quality of faculty; flawed regulation of private educational institutions; blurred or overlapping mandates in managing public sector educational institutions; high politicization in the creation of locally-funded institutions, leading to inappropriate deployment of resources; weak linkages between industry and academe; and lack of research for innovation in high-value areas.

FIT-Skills, through USAID, will provide assistance in strengthening higher education to serve as a driver for sustained economic growth. This Project seeks to support the GPH in developing quality instruction for post-secondary education to improve competitiveness. FIT-Labor comprises three areas: organizational restructuring, academic-industry linkages, and university-to-university ties. First, the Project will provide technical assistance to rationalize the number, size and roles of public higher education institutions and regulate private sector provision more effectively and efficiently. Second, FIT-Labor will promote stronger links between academe and industry, in order to address supply-demand mismatches in skills. Finally, the Project will establish ties between U.S. universities and their Philippine counterparts as well as the private sector. These linkages will strengthen faculty development, accelerate transfer of technology, spur collaborative research that lead to innovation, support establishment of patent officers in universities, and support patent commercialization of the Intellectual Property Office.

Illustrative activities:

- Support networking and matching forums for universities and industry
- Provide advisory services and limited commodities to set up and strengthen patent offices in universities
- Support venues for innovation competitions and performance awards
- Support linkages and reverse exchanges with key US universities
- Strengthen the business advisory services of the Intellectual Property Office
- Set up support fund for research and development aimed at value chain efficiency and product innovation in high growth sectors.

*Anticipated impact:* Better match between skills required by the private sector and its domestic supply; Higher investment levels in research and development; More patents obtained for locally produced IPR.

## 2. FIT – Infra: Developing better Infrastructure

Businesses have repeatedly identified infrastructure weaknesses as a key obstacle to investment in the Philippines. Infrastructure ranks as one of the top challenges facing the Philippine economy, second only to corruption.<sup>7</sup> And like corruption, poor infrastructure adversely impacts economic competitiveness. The poor state of – coupled with low levels of investment in – infrastructure has exacerbated the cost of doing business and adversely impacts the perceived competitiveness and attractiveness of the country as a business destination. Several factors constrain infrastructure development in the Philippines: (1) lack of public financing; (2) weak institutional capacity of government agencies to develop and prepare related- infrastructure feasibility studies; (3) unstable and inconsistent political and regulatory environment; and (4) a lack of transparency and competitiveness in the procurement and contracting process. By some estimates, public spending of at least 5 percent of GDP is needed to meet basic infrastructure requirements. Priority infrastructure needs include investments in seaports, airports, road and rail transport, and energy. Given the fiscal constraints faced by the government, the country needs to encourage greater private sector participation in infrastructure development.

The GPH continues to promote public-private partnerships (PPP) as a flagship program to stimulate infrastructure development. The government has set up a PPP Center under the NEDA and released a list of priority projects that will be undertaken through a solicited mode. The GPH is also seeking to amend the Build-Operate-Transfer (BOT) Law and provide clearer guidelines for joint ventures as well as address right-of-way issues. The GPH will establish policies for risk allocation, right-of-way delivery and financial support for the viability PPPs for infrastructure investment. To promote PPPs, the government also seeks to make the approval and procurement processes more transparent and open as well as improves inter-agency coordination and approvals including in the awarding of franchises.

Through FIT-Infra, the USG will support measures to ensure the viability of the administration's flagship PPP infrastructure program, particularly for transport, energy and water. Activities will (i) encourage greater transparency in public spending for infrastructure development and (ii) support the development of business cases and feasibility studies for priority infrastructure. These efforts will improve project identification, appropriation, implementation and monitoring and evaluation.

Illustrative activities:

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<sup>7</sup> See Joint Foreign Chambers of Commerce, *Arangkada Philippines 2010: a Business Perspective*, Part 3: Infrastructure.

- Support the development of business cases and feasibility studies for PPP priority infrastructure
- Support the tendering and bidding process for PPP projects
- Provide transaction advisers to assist in negotiations for PPP bids
- Provide TA to set up a monitoring system for on-going PPP projects
- Provide risk guarantees through DCA facilities
- Provide guarantees for private sector funding of right-of-way acquisitions
- Support private sector oversight of PPP program

*Anticipated outcome:* Higher infrastructure spending as a percentage of GDP; Increased number of solicited and competed PPP infra projects

## **2a. FIT- Transport: Strengthening Transport-related Infrastructure**

Given the archipelagic nature of the country, the Philippine economy depends on air and maritime transport for both commerce and passenger travel. The trade and tourism sectors highly depend on air transport for the movement of people and goods. Yet, the transport sector is beset by inefficiencies contributing to high logistics costs that impede economic development and constrain growth and competitiveness. In the maritime industry, inefficient port facilities and high cost of port services contribute to increased logistics costs. For the air transport sector, deficiencies in airport facilities to accommodate increased number of travelers and goods constrain growth in international tourism, which lags significantly behind regional peers. Since the passage of the first BOT law in 1990, PPP projects in transport-related infrastructure, unlike those for water and power, have fared poorly due to the lack of transparency in the bidding process and consistency in the procurement rules.

As part of its revitalized PPP program, the GPH seeks to improve the quality and capacity of transport infrastructure through private investment. Under the Open Skies regime and Roll-On, Roll-Off (RORO) policy, the GPH also encourages increased competition in the air and maritime transport sector. EO 29 allows market forces to determine supply and demand of seats to secondary gateways throughout the country by ensuring an open and competitive international aviation sector. EO 170 seeks to improve inter-island connectivity RO-RO shipping.

With FIT-Transport, the USG through USAID will support the effective implementation of EOs 29 and 170, particularly in its support for investment in priority sectors of tourism, agribusiness, infrastructure, and logistics. Assistance will ensure the effective implementation of EO 29 to provide for an open and competitive international aviation sector.<sup>8</sup> The FIT-Transport will also support measures to expand domestic RORO (ferry) network and encourage the establishment of ASEAN RORO connectivity.

### **Illustrative activities:**

- Support feasibility studies for the expansion of RORO networks
- Support the development of business cases and feasibility studies for airport infrastructure development in key international ports
- Support the tendering and bidding process for airport tenders

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<sup>8</sup> This EO promises to allow local and foreign air carriers the ability to expand their operations, maintain a strong aviation industry, and ensure international connectivity.

- Provide key experts on ICAO standards compliance

*Anticipated outcome:* Lower transport and logistics costs

## **2b. FIT – Energy: Improving the Retail Market for Reliable Power and Lower Electricity Costs**

Within infrastructure, unreliable and expensive electric power compounds the high cost of doing business and hampers economic growth in the Philippines. Electricity in the country ranks among the most expensive in the world. In 2010, the Metro Manila area averaged about \$0.18 per kilowatt-hour for residential electricity rates, higher than even Japan and Singapore.<sup>9</sup> Industry analysts claim that electricity prices are much higher than the cost of generation. Technical estimates reveal that institutional and financial arrangements – not economic forces – determine Philippine power prices.<sup>10</sup>

Over the past decade, the introduction of private generation into a partially reformed electricity sector has compounded market inefficiencies, limiting new investments in power generation and exacerbating high electricity tariffs. As manifested by rotating power outages, supply shortages already exist in the Mindanao and Visayas power grids. The Luzon grid can expect shortages possibly in the next two years. A lack of investments in the sector magnifies these acute shortages, with a resultant power crisis on the near-term horizon.<sup>11</sup> Lack of diversification in the power generation market contributes to these market distortions. The development of merchant plants in the Philippines faces many obstacles: limited pool of interested investors with knowledge of Philippine energy sector, high entry barrier, uncertain legal environment for contract enforcement, and overall high operating risks.<sup>12</sup>

Unreliable and expensive electric power exacerbates the high cost of doing business and hampers economic growth in the Philippines. The World Economic Forum's Global Competitiveness Survey of the quality of electricity supply paints a gloomy picture of the Philippines, which ranks a dismal 101 out of 139 countries.<sup>13</sup> Power supply continues to be an impediment to attracting investments, both foreign and domestic. High tariffs and poor quality constitute the two primary concerns for industrial and commercial customers with respect to electricity supply. In the semiconductor industry, electricity and energy account for a staggering 20-45% of operating expenses (OE), with labor second at about 20-25%. In the textile industry, the OE figure for electricity and energy reaches 30%, compared to only 12% for counterparts in Indonesia.<sup>14</sup>

FIT-Energy aims to improve the retail market for reliable power and lower electricity costs. The Project will achieve this goal through three reinforcing approaches. First, FIT-Energy will strengthen competitive market-enhancing measures in the electricity sector. Second, the Project seeks a more enabling environment for new investments in power generation capacity. Finally, FIT-Energy will advocate stronger regulatory and consumer oversight of the electricity market. Because of the complex nature of

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<sup>9</sup> Data from International Energy Consultants

<sup>10</sup> Asian Development Bank, *Proposed Loan – Republic of the Philippines: Acquisition and Rehabilitation of the Masinloc Coal-Fired Thermal Power Plant*, p. 5.

<sup>11</sup> Wallace, Peter. "All Lights Out: Coping with (Yet Another) Power Crisis," *The Wallace Business Forum*, August 2010.

<sup>12</sup> Arangkada, p. 128.

<sup>13</sup> World Economic Forum, *Global Competitiveness Report 2010-2011*.

<sup>14</sup> ADB survey of 716 business establishments in the Philippines, as reported in the Sectoral Assistance Program Evaluation of the Asian Development Bank to the Philippines Power Sector, ADB Operations Evaluation Department, Manila (2005), p. 33.

the power sector, the Project will map out the multiple factors and players in the power sector, in order to understand the best path towards achieving the GPH's development goals. Strong vested and economic interests collide in the power sector, which requires active engagement, deep industry knowledge, technical expertise, and political acumen to navigate effectively.

Illustrative activities:

- Provide training, resident experts, and commodities needed to reinforce more competitive markets for power generation
- Identify, simplify, strengthen, and reform existing regulations and administrative procedures in the electricity sector
- Develop institutional capacity to undertake widespread regulatory reforms in the energy industry
- Strengthen the independence and effective oversight function of the Energy Regulatory Commission
- Strengthen the Wholesale Electricity Spot Market
- Identify and promote incentives to power generation investments
- Support the efforts of watchdog electricity consumer groups

*Anticipated outcome:* Competitive market mechanisms reinforced; Institutional governance bolstered; New investments in power supply incentivized; Accountability and oversight strengthened; Cost of electricity reduced and supply made more stable and reliable.

### **3. FIT – Business: Streamlining Business-related Regulations for Competitiveness**

This component seeks to address the high cost of doing business, lower transactions costs, and improve the overall business climate. Component activities will improve the Philippines' relative position in international measures of business climate, including the World Bank's Doing Business Report.

Cumbersome business procedures and inefficient regulations are some of the main reasons for lack of private sector investment in the Philippine economy. For instance, starting a business in the country remains lengthy and cumbersome. The process to register a business takes 15 steps, more than twice as many as Thailand, and as long as 38 days. Registering property can take 8 steps and 33 days in the Philippines, while businesses in Thailand accomplish this task with only two steps in two days. There exist wide differences in business procedures across the country with no one standard in local requirements and procedures.

The GPH has committed to (i) streamlining business procedures at the national and local levels to make them predictable, reliable and efficient for those who want to invest and (ii) improving the overall business climate through reforms in governance. The Department of the Interior and Local Government and the Department of Trade and Industry jointly launched the Nationwide Streamlining of Business Permits and Licensing System Reform Project to streamline the processes of getting business permits and licenses from city and municipal governments. The GPH is likewise pursuing the implementation of the Philippine Business Registry (PBR) system that establishes an on-line system for national business registration requirements and the Anti-Red Tape law.

The USG will support GPH initiatives to streamline, reduce or eliminate regulations that constrain the business environment. Assistance can be provided to support the streamlining of procedures and reducing the cost of obtaining business-related permits and licenses, in obtaining construction permits and land titles, easing the burden of labor-related regulations, and facilitating trade. Areas of possible support may include the effective implementation of the Anti-Red Tape law and the Residential Free Patent law, the PBR, and setting up of business one-stop-shops for investors in key priority sectors.

Illustrative activities:

- Support activities focused on business process re-engineering
- Provide TA to support roll-out to local government units (LGUs) and connection of LGUs to national systems
- Provide training, resident experts and commodities for IT systems needed to streamline approvals for investments in priority sectors
- Provide TA to support inter-agency coordination efforts
- Support automation and inter-connection of business regulatory processes
- Provide advisory services for the setting up and strengthening of Land Management Offices
- Provide TA support for labor policy reform
- Support the participation of trade and business associations to improve economic governance through meaningful policy dialogue

*Anticipated outcome:* Lower regulatory compliance costs; Increased business start-ups.

#### **4. FIT – Competition: Easing Barriers to Market Entry**

Fostering competition in key sectors, particularly where monopolies and oligopolistic market power thrives, remains crucial to improving the investment climate. High concentration of ownership, along with cross-ownership, in several industries inhibits effective competition, innovation, and dynamism in the domestic economy. Reforms should aim to improve competition by reducing rules and regulations most prone to rent-seeking behavior. These efforts should seek to encourage greater transparency, predictability, and consistency of regulatory and judicial decisions that impact on business.

Easing barriers to entry by removing impediments to investment, particularly in transport, power, banking, and telecoms, will also foster competition. Strengthening regulatory independence aimed at addressing conflicts of interest can also have a transformational effect.

The GPH has made the enactment of a new Anti-Trust/Competition Law a legislative priority. It has already, by executive action, created a precursor Office of Competition in the Department of Justice. The new law promises to establish, fund, and empower the Philippine Fair Competition Commission to penalize anti-competitive agreements, the abuse of dominant power, and anti-competitive mergers. GPH also proposes to address unfair competition by separating dual operational and regulatory functions of various government agencies. This regulatory separation will require amending charters of regulatory authorities in port, water, and transport sectors.

The US Department of Justice envisions providing material support to the GPH in facilitating the passage of the Anti-Trust Law. The FIT – Competition Project will provide technical assistance to enforce the Anti-Trust Law and strengthen capacity of the Fair Competition Commission as well as strengthen other

regulatory institutions dealing with anti-competitive behavior. The Project will also provide assistance to strengthen regulatory capacity and independence in support of stronger competition measures. Assistance will be extended to strengthen and rationalize the functions of regulatory agencies, including the Philippine Ports Authority, water regulatory authorities, Energy Regulatory Commission, and other relevant entities.

Illustrative activities:

- Support resident expert and limited commodities for the Office of Competition
- Provide advisory services to ensure national law and administrative issuances conform to international best practice
- Support study tour to US FTC of commissioners to the Office of Competition
- Support regulatory impact studies and administrative reform studies
- Support the development of a knowledge bank on competition-related cases and regulatory rulings

*Anticipated impact:* Improved competitive economic environment conducive to more business investments (both large and small) capable of generating productive employment and income for more inclusive growth.

## D. Expected Results

Overall, FIT Program activities expect to contribute to the following strategic objectives:

- Enhanced Domestic Investment Climate (by 2016)
- Share of regional foreign direct investment (FDI): increased from 1.7% in 2009 to over 4%
- FDI (% of GDP): increased from 1.2% in 2009 to 3%
- Gross capital formation: increased from 14.6% in 2009 to 22%
- Global Competitiveness Index: increasing or on par with leading regional and emerging market peers
- Index of Economic Freedom (overall score, Business, Investment): increasing or on par with regional and emerging market peers
- Doing Business Ranking and Related Indicators: improving or on par with regional and emerging market peers
- Business Start-ups: increased in key sectors (agribusiness, business process outsourcing, creative industries, infrastructure, manufacturing & logistics, mining, and tourism)

The Program's contribution to increased trade and investment include:

- Number of legal, regulatory, or institutional actions taken to improve implementation or compliance with international trade and investment agreements due to support from USG-assisted organizations; and
- Number of changes made to business enabling environment.

## E. Level of Resources Required

Subject to further refinement, total required USG funding for the FIT Program over the next four (4) years is estimated at \$ 125 million.

| Partnership for Growth: Philippines 2011-2015    |                  |                   |                   |                   |                   |                    |                   |                    |
|--|------------------|-------------------|-------------------|-------------------|-------------------|--------------------|-------------------|--------------------|
| Facilitating Investments and Trade (FIT) Program |                  |                   |                   |                   |                   |                    |                   |                    |
|  | 2011             | FY2012            | FY2013            | FY2014            | FY2015            | Total USG          | GPH In-kind       | Total Assistance   |
| <b>TOTAL ESTIMATED PRICE - FIT PROGRAM</b>       | <b>2,000,000</b> | <b>31,129,450</b> | <b>30,939,450</b> | <b>30,914,450</b> | <b>30,109,450</b> | <b>125,092,800</b> | <b>41,280,624</b> | <b>166,373,424</b> |
| <b>1. FIT - Commerce</b>                         | <b>2,000,000</b> | <b>15,867,600</b> | <b>15,817,600</b> | <b>15,792,600</b> | <b>15,377,600</b> | <b>64,855,400</b>  | <b>21,402,282</b> | <b>86,257,682</b>  |
| a. FIT - Industries                              | 2,000,000        | 4,624,600         | 4,574,600         | 4,549,600         | 4,284,600         | 20,033,400         | 6,611,022         | 26,644,422         |
| b. FIT - Customs                                 |                  | 2,278,000         | 2,278,000         | 2,278,000         | 2,128,000         | 8,962,000          | 2,957,460         | 11,919,460         |
| c. FIT - Skills                                  |                  | 8,965,000         | 8,965,000         | 8,965,000         | 8,965,000         | 35,860,000         | 11,833,800        | 47,693,800         |
| <b>2. FIT - Infrastructure</b>                   | <b>-</b>         | <b>10,370,000</b> | <b>10,370,000</b> | <b>10,370,000</b> | <b>10,130,000</b> | <b>41,240,000</b>  | <b>13,609,200</b> | <b>54,849,200</b>  |
| a. FIT - Transport                               |                  | 6,165,000         | 6,165,000         | 6,165,000         | 5,925,000         | 24,420,000         | 8,058,600         | 32,478,600         |
| b. FIT - Energy                                  |                  | 4,205,000         | 4,205,000         | 4,205,000         | 4,205,000         | 16,820,000         | 5,550,600         | 22,370,600         |
| <b>3. FIT - Business</b>                         |                  | <b>2,383,850</b>  | <b>2,383,850</b>  | <b>2,383,850</b>  | <b>2,383,850</b>  | <b>9,535,400</b>   | <b>3,146,682</b>  | <b>12,682,082</b>  |
| <b>4. FIT - Competition</b>                      |                  | <b>2,508,000</b>  | <b>2,368,000</b>  | <b>2,368,000</b>  | <b>2,218,000</b>  | <b>9,462,000</b>   | <b>3,122,460</b>  | <b>12,584,460</b>  |

## F. Program Timeline by Component

Component timeline and project roll-out will be developed in more details with program design. All component activities can be implemented immediately, subject to available funding. FIT Business, FIT Infrastructure, and FIT Industries encompass activities prioritized by the GPH, with continuing support from USAID, through the LINC-EG, Economic Growth Hubs, and INVEST Projects. To maintain momentum in these economic reform areas, continued funding will prove crucial to the overall success of the PFG. For activities not yet started (under FIT Customs, FIT Competition, and FIT Skills), immediate work will be essential to lay the groundwork for policy changes in anticipation for their effective implementation (e.g. Anti-Trust/Competition Law, Customs and Tariff Modernization Act).

| Component Timeline for Implementation, Facilitating Investments and Trade (FIT) |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
|---|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|
| FIT Component Activities  | FY2012 |    |    |    | FY2013 |    |    |    | FY2014 |    |    |    | FY2015 |    |    |    | FY2016 |    |    |    |
|   | Q1     | Q2 | Q3 | Q4 |
| <b>1. FIT - Commerce</b>  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| a. FIT - Industries   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| b. FIT - Customs  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| c. FIT - Skills   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>2. FIT - Infrastructure</b>  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| a. FIT - Transport  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| b. FIT - Energy   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>3. FIT - Business</b>  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>4. FIT - Competition</b>   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |

## II. Strengthening the Rule of Law (ROL)

### *Concept Note on the Rule of Law*

#### A. Overview

Based on the results of a constraints analysis conducted by a joint USG-GPH technical team, poor governance and constrained fiscal space were identified as the chief binding constraints to more competitive, inclusive growth in the Philippines. Within the poor governance constraint, the **Program to Strengthen the Rule of Law (ROL)** will directly address the need for speedy, predictable and consistent resolution of economic and commercial disputes or violations, as well as the even and timely enforcement of anti-corruption laws. This initiative aligns with the GPH's goal to achieve good governance anchored on the rule of law, and provide an enabling environment for national development. As outlined in the Philippine Development Plan (PDP), the GPH seeks to improve good governance and create a better business environment by promoting the "impersonal and impartial application of stable and predictable laws, statutes, rules and regulations, without regard for social status or political considerations."<sup>15</sup>

Weak rule of law has severe negative effects on investments and presents a central challenge in the Philippines. As a manifestation of weak governance, this binding constraint adversely affects development in multiple areas and sectors. In the specific context of PFG, whether one is talking about intellectual property violations, non-enforcement of contracts, flawed tenders or corrupt practices, impunity is the common thread which allows perpetrators (particularly those with resources and connections) to routinely go unpunished. A weak rule of law characterized by interminable court delay and inconsistency, and a high reward, low risk environment for fraudulent and corrupt practices erodes stability and hurts the economy. Potential investors are deterred by the lack of predictability and increased costs of doing business.

A democratic society requires a legal and judicial framework that protects legal rights, especially, property and contractual rights. Such framework consists of legal rules that are well-defined and a judiciary consisting of honest, competent, and independent judges who administer the legal rules conducive to the attainment of mutually beneficial trades. The impact on growth is profound.<sup>16</sup> If people under these legal rights can appropriate the returns from their business activities, they are motivated to save and invest, creating employment, income, and wealth in the process. Meanwhile, government failure to provide a credible framework can go a long way in keeping a country in a state of economic backwardness.

Laws and customs, formal and informal, supply the framework through which individuals conduct business and other relations. The more costly this legal framework is to implement and use – in terms of time and expense, including costs related to managing risk, uncertainty, and lack of trust – the more likely the legal system is to inhibit development. By contrast, an effective justice system, as a foundation

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<sup>15</sup> See Government of the Philippines. *Philippine Development Plan 2011-2016*, Strategic Framework, Goal 7: Good Governance and the Rule of Law, p 206.

<sup>16</sup> Gerard W. Scully (1988), "The Institutional Framework and Economic Development," *Journal of Political Economy*, 652-62 shows empirically that politically open societies that subscribe to the rule of law and recognize private property grow at much faster rates than those where these freedoms are abridged.

for enforcing contracts and other rights, will strengthen the predictability and trustworthiness of the economic environment and in turn boost business confidence and activity.

After surveying 320 of the top corporations in the Philippines, law and economics professors from the University of the Philippines (including Professor Maria Lourdes Sereno who is now an Associate Justice of the Supreme Court) found that “Only weak market demand was cited as being more important than corruption, high crime levels, and lack of trust in government laws and policies as important obstacles to doing business.”<sup>17</sup> Specifically, “the operation of the judiciary is certainly one of the main factors affecting the overall atmosphere for doing business,” particularly with respect to enforcing contracts, resolving labor disputes, and settling tax liabilities.<sup>18</sup>

The most frequently cited effect [of an inefficient judiciary] is an increase in the spread of banks (81 percent), the decision not to implement investment projects (84 percent), and the acceptance of bad agreements. At bottom, these factors point to the effects of a generally low level of business trust that respondents feel will result from the absence of a rules-based system if the judiciary should fail in its task. The feared rise in bank spreads would result, for example, if the risk of contract breach and debt defaults was pervasive. Uncertainty and lack of trust are also the basis of a failure to invest and increased reticence to engage in subcontracting activities. In all this, the courts have a role to play in facilitating cooperation.<sup>19</sup>

Despite the reform efforts initiated in the past 10 years, the Philippines continues to lag behind in the governance indicators, including the rule of law. In the latest *Rule of Law Index of the World Justice Project*, the Philippines ranked last in the region (i.e. seventh out of seven Southeast Asian countries surveyed) in the areas of law and security (.57), fundamental rights (.50), and effective criminal justice (.53), and second to the last in the areas of limited government power (.57), absence of corruption (.45), clear, publicized and stable laws (.43), regulatory enforcement (.52), and access to civil justice (.48).<sup>20</sup> This was consistent with the results of the World Bank-supported study on governance indicators, wherein the Philippines also ranked consistently low in the Rule of Law indicator from 1996 to 2009.

The ROL program will work in concert with other USG agencies, most notably the Department of Justice, U.S. Trade Representative, and the U.S. Patent and Trademark Office to support efforts of the GPH to review laws and court rules and remove opportunities for delaying judicial proceedings in prosecuting corruption and intellectual property rights violations, and adjudicating business disputes. This includes decreasing the ability of defense lawyers to deliberately delay proceedings using interlocutory appeals (Rule 65). Particular attention will also be given to restudying and codifying rules on the prosecutorial process of determining probable cause for filing cases in courts (i.e. preliminary investigation) to discourage the filing of cases that are not backed by solid evidence. Prosecution offices will engage the Supreme Court in defining, observing and monitoring timelines in the disposition of cases, and in issuing a judiciary-wide directive on docket decongestion. The Supreme Court is committed to continue docket decongestion and integrity-building initiatives to hold judges accountable.

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<sup>17</sup> Ma. Lourdes A. Sereno, Emmanuel S. de Dios, and Joseph J. Capuno, “Justice and the Cost of Doing Business: The Philippines,” UPSE Discussion Paper No. 0711, Abstract (October 2007)

<sup>18</sup> *Id.* at 12-13.

<sup>19</sup> *Id.* at 14.

<sup>20</sup> Philippines ranks poorly in 2010 Rule of Law Index by Tetch Torres, *inquirer.net*, [www.inquirer.net](http://www.inquirer.net) (February 8, 2011).

## B. Goals and Objectives

The goal of PFG is to assist the Philippines achieve broad-based and inclusive economic growth by creating a competitive climate for trade and investment. This goal will be achieved through the following objectives of the ROL Program:

- Ensure the timely and predictable resolution of court cases, especially those that tackle economic and commercial disputes and violations, corruption, tax evasion, smuggling and intellectual property infringements;
- Strengthen the enforceability of contracts, specifically those that have substantial impact to trade and investments;
- Expand the use of alternative dispute mechanisms, particularly in resolving commercial cases; and
- Enhance judicial integrity.

Rule of law deals with legal frameworks that are fair and equally enforced. The ability to enforce contracts, uphold intellectual property rights, implement laws and rules, and provide legal remedies and sanctions for corruption or government abuse among others could have a significant impact on the governance agenda of the Aquino administration and the development of the Philippines as a whole. Ongoing USAID assistance to judicial reform has already yielded impressive results. USAID support for the institutionalization of court-referred mediation has helped reduce the backlog from almost 850,000 cases in 2001 to 550,000 at the end of 2010. The time required to resolve a large percentage<sup>21</sup> of all civil cases in the Philippines has been reduced from 4-6 years to an average of 4 months, from filing of the complaint to its final disposition. This has been done through a comprehensive and collaborative USAID-funded program with the Philippine judiciary to create small claims courts that are now firmly rooted in all 1,137 first level trial courts in the country. The Court of Appeals, Anti-Graft Court and Court of Tax Appeals, with USAID assistance, now use case management systems to manage and monitor their dockets, weeding out dormant cases and encouraging justices to promulgate decisions pending for years. USAID technical assistance also led to amendments to Rule 65 of the Court's Rules of Civil Procedure to discourage efforts to deliberately delay court proceedings.

However, this is still an area of significant need. Dysfunction in the administration of justice is one of the primary reasons for the weak rule-of-law regime in the country. In particular, the huge backlog of both civil and criminal cases means that formal justice takes many years to dispense and is often vulnerable to manipulation. Allegations of corruption and unethical conduct continue to undermine the credibility of the court system. The unenforceability of contracts and the lack of protection for intellectual property rights continue to discourage investment. Without the threat of detection and sanctions, resources meant for the provision of services to the Filipino people can be easily lost through corruption or ineptness.

All these argue very strongly for continuing USAID support to respond to new opportunities (e.g. Prioritization of docket decongestion to reduce the backlog to manageable levels, adoption of anti-

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<sup>21</sup> Before the introduction of the rule on small claims courts, the judiciary did not maintain statistics on the amounts in dispute in different cases. As a result, the actual percentage of pending civil cases involving disputes worth under P100,000 (approximately \$2,300) is difficult to assess. Judicial administrators however, reviewed available data and estimated that prior to small claims courts, approximately 60% of all non-family court, non-land dispute civil cases in the Philippines involved money disputes under P100,000.

corruption measures in response to the Court's integrity development review, and adoption of streamlined court procedures are among the priorities of the judiciary under the leadership of the current Chief Justice) and expand existing successful interventions until these become irreversibly woven into the judiciary's standard operating procedures (e.g. use of case management systems to increase efficiency, transparency and accountability; the practice of more effective courtroom management; the widespread implementation of speedy trial provisions; and nationwide implementation of small claims courts). USAID will look beyond the judiciary as well to support other potential partners in the justice sector, in particular the GPH Department of Justice, civil society, and private legal practitioners.

The ROL initiative will build on GPH commitments as articulated in the governance section of the PDP to promote effective and speedy resolution of cases in courts and quasi-judicial bodies and to increase the competence and integrity of justices, judges and court personnel and all other officers of the judicial and legal system. It will support efforts to ensure that contracts are consistent with international instruments, existing laws and public interests. It will support non-court efforts to quickly resolve contractual and business disputes through the promotion of alternative dispute resolution. Finally, it will build upon the current administration's commitments to enhance citizen's access to information and participation in governance by supporting civil society oversight, including media organizations and business groups, of judicial appointments and issuances.

## C. Program Components

USAID has supported the Philippine judiciary and other pillars of the justice system, notably the Department of Justice of the GPH, since the inception of the Supreme Court's Action Program for Judicial Reform in 2001. It is the largest grant donor for judicial and legal reform in the Philippines and is a major development partner of the Supreme Court. More recently, USAID was selected to be the co-convenor of the Philippine Development Forum Rule of Law Working Group. Under the PFG umbrella, USAID will harness its leadership in this area and build on the gains of existing programs to help improve the economic climate by implementing a ROL Program that encompasses several inter-related components: Judicial Efficiency, Contract Enforcement, Intellectual Property Enforcement, and Accountability and Confidence Building Measures through Institutional Reform and Public Oversight. USAID will collaborate and coordinate with other USG agencies, most notably the Department of Justice, the U.S. Trade Representative and the U.S. Patent and Trademark Office, to ensure that activities are mutually reinforcing and complementary.

### 1. Promote Judicial Efficiency

Among the various constraints faced by the courts, the twin problems of congestion of dockets and case delay are considered the most urgent that require immediate solution. As of December 2010, 550,000 cases were pending in the court system, not including those pending before administrative tribunals, a number that is equally high. A user perception survey commissioned by the SC-WB in 2006 identified judicial inefficiency as the most serious concern of the litigants.<sup>22</sup>

#### 1a. Reduce Docket Congestion

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<sup>22</sup> *National Survey on User's Experience and Perception on the Judiciary* (May 2006).

The backlog has accumulated for various reasons, the most common of which are: far too many cases filed in court as a result of population increase; socio-economic problems and complexity of business transactions; litigiousness of the Filipinos; courts being made the collection agent of traders (i.e. bouncing check law); a large percentage of cases that are dormant because of lack of interest of parties, which continue to clog the dockets of the courts; and judges who are not equipped to deal with huge case backlogs. In addition, although the *Barangay (Village) Justice System* does good work in filtering disputes that reach the courts, very few cases are settled during the pretrial stage (although court-annexed mediation and judicial-dispute resolution are gaining ground in increasing settlement rate). Furthermore, a high percentage of cases, even the most minor ones, are appealed to a higher court, reaching even the Supreme Court. Judgments take too long to become final and those that acquire finality are difficult to execute/implement.

The GPH, primarily under the leadership of the Supreme Court (SC), is committed to continue docket decongestion initiatives including the conduct of an exhaustive inventory of existing cases to identify dormant cases, and the review of laws and rules of procedure to increase both the disposition and clearance rates of judges.

USAID will support the Supreme Court's comprehensive docket cleansing efforts, which include but are not limited to addressing bottlenecks that delay trials, a thorough analysis of the case backlog of appellate courts and select trial courts with the highest volume of cases; and the implementation of case decongesting procedures, and tracking and management systems that will significantly reduce the current backlog of approximately 550,000 cases.

Illustrative activities:

- Provide technical assistance (TA) needed to review, revise and implement rules of procedure in the disposition of dormant cases
- Support enhanced case inventories of select courts with high caseloads
- Support the development and installation of case tracking and management systems
- Provide limited commodity support for the case tracking and management systems
- Provide TA for the establishment and monitoring of performance standards for trial and appellate courts
- Provide TA to review and propose revisions to laws (e.g. Bouncing Checks Law) that unnecessarily result in an overburdened judicial system
- Provide training on case and courtroom management to judges and court personnel
- Provide TA to review and implement the possible expansion of the jurisdiction of small claims courts
- Provide TA to streamline litigation procedures, incorporate this in the rules of court and implement
- Provide TA to support inter-agency coordination efforts in the streamlining and implementation of court procedures among others

Anticipated outcome: This will uphold the rule of law, primarily in ensuring the timely delivery of justice. Achieving court efficiency is essential not only in regaining public trust in the judicial system, but also in bolstering investor confidence, and in reducing transactions costs in resolving contractual disputes. An efficiently functioning judiciary is also critical in meeting the PFG goals of improving regulatory quality

and strengthening enforcement efforts against high financial crimes such as corruption, tax evasion, smuggling and piracy.

### **1b. Reduce Court Delay**

Docket congestion results in a host of other problems, including case delay. Because of the vast number of cases that need to be heard, it is not uncommon for the judges to schedule 20 or more cases in one morning, expecting that only 3 or 4 cases will be ready for hearing. With a similar frame of mind, private lawyers and public prosecutors come to court unprepared. Motions for postponement, extension and/or continuances are thus common in most courts, thereby resulting in delays. A study conducted by the World Bank in 2004 reported that it takes on the average 6.5 years to finish a case – from filing of case to issuance of decision by the trial court. This does not yet include the appeal process.

Among the causes of delay are: vacancy in the courts; inadequacies of presiding judges (i.e. inability to resolve motions and render decisions on time; perfunctory use of the pretrial procedure that misses opportunities to expedite or eliminate the need for trial; lack of clarity and accuracy in written orders and decisions, which increases the likelihood that cases will be appealed to higher courts; poor case-management capability, even allowing litigants to dictate the pace of trial; dilatory tactics employed by lawyers; piecemeal, instead of continuous trial system, where testimony is presented in short, hour-long sessions and then interrupted for weeks, thereby aggravating the delay problem); and very liberal rules for appealing decisions of the lower court.<sup>23</sup>

Court-related agencies contribute to delays in the dispensation of justice, which stem from poor coordination between the Judiciary and the other pillars of justice. This results in inability to produce the accused, protracted investigation, poor quality of evidence, inability to preserve evidence, poor quality of legal assistance provided to the accused or lack of lawyers for pauper litigants.<sup>24</sup>

The GPH, under the leadership of the Supreme Court and the other pillars of the justice system primarily the Department of Justice, GPH is committed to review laws and court rules and remove opportunities for delaying judicial proceedings, especially in prosecuting corruption. This includes decreasing the ability of defense lawyers to file interlocutory appeals (Rule 65) to delay or suspend proceedings. Particular attention will also be given to restudying and codifying rules on preliminary investigation (or the prosecutorial process of determining probable cause for filing cases in courts) to discourage the filing of cases that are not backed by solid evidence. Prosecution offices will engage the Supreme Court in defining, observing and monitoring timelines in the disposition of cases.

USAID will support efforts to analyze and address bottlenecks that delay trials. USAID will collaborate with the U.S. DOJ to catalyze coordination and collaboration among the courts, prosecution offices and law enforcement agencies to discuss and address gaps and weaknesses in laws and Rules of Court that allow interminable delay in the resolution of cases, including the rules governing preliminary investigation. USAID will assist the Supreme Court in monitoring judicial compliance to Rule 65 to ensure that judges only allow interlocutory appeals under exceptional circumstances and dissuade trial continuances.

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<sup>23</sup> See *Philippine Governance Assessment*, ADB (February 2005). Significantly, several factors identified by a 1993 study, many of which could have been addressed by the APJR, are still valid today

<sup>24</sup> Diagnostic Report (2003), *Strengthening Access to Justice by the Disadvantaged: Strengthening the Other Pillars of Justice through Reforms in the Department of Justice* (June ).

Illustrative Activities:

- Provide TA to analyze and address gaps and weaknesses in the laws and the Rules of Court that allow delay, including the rules on preliminary investigation
- Provide TA to support inter-agency coordination efforts
- Support the Supreme Court in monitoring compliance with the amendments to Rule 65 (interlocutory appeals)
- Provide training on case and courtroom management to judges and court personnel and on compliance with the provisions of the Speedy Criminal Trial Act
- Support the development of parallel modes of dispute resolution for commercial cases
- Provide support for the development and replication of initiatives to streamline litigation procedures
- Support the development of docket monitoring tools
- Provide TA to support the expansion of the jurisdiction of small claims courts

Anticipated outcome: Similar to docket congestion initiatives, reducing court delay will uphold the rule of law, primarily in ensuring the timely delivery of justice. Achieving court efficiency is essential not only in regaining public trust in the judicial system, but also in bolstering investor confidence, and in reducing transactions costs in resolving contractual disputes. An efficiently functioning judiciary is also critical in meeting the PFG goals of improving regulatory quality and strengthening enforcement efforts against high financial crimes such as corruption, tax evasion, smuggling and piracy.

## 2. Strengthen Contract Enforcement

Poor contract enforcement and inconsistencies in court decisions related to contract disputes is a key concern of the business community in the Philippines and potential investors. In the 2011 Doing Business ranking of the International Finance Corporation and World Bank, the Philippines ranked a lowly 118 out of 183 countries in enforcing contracts.

The GPH is committed to strengthening the rule of law, particularly in bolstering investor confidence, and in reducing transactions costs in resolving contractual disputes. To achieve this, the GPH seeks to ensure that government contracts are consistent with international instruments, existing laws, and public interest to avoid law suits. It seeks to ensure the independence of the Office of the Government Corporate Counsel of the DOJ in promulgating legal opinions on government contracts. It also seeks to promote the use of alternative dispute resolution to facilitate faster resolution of disputes.

USAID will provide capacity building to key selected courts in the handling of commercial cases and high financial crimes. It will provide technical advice to oversight and implementing agencies in drafting large-scale government contracts, including public-private partnerships for infrastructure to minimize opacity in contract provisions that could entail judicial resolution of issues. It will support GPH efforts to enhance commercial dispute resolution and promote the use of amicus curiae in business-related cases. Finally, USAID will support efforts to monitor court rulings to encourage both accountability and consistency.

Illustrative activities:

- Provide training to special commercial courts, court of appeals and others in the handling of commercial cases including the enforcement of arbitral awards
- Provide TA and training to the Office of the Government Corporate Counsel and other relevant agencies in drafting contracts
- Enhance the capacity of judges to decide complex issues that have an impact on the economy through training and the use of expert testimony
- Provide TA to gain better understanding of the relationship between the rule of law and economic development
- Provide TA to support inter-agency coordination efforts
- Support the development of parallel modes of dispute resolution for commercial cases
- Support oversight of court rulings by civil society groups, including media and business groups, to encourage accountability and consistency

Anticipated outcome: Transaction costs for businesses will be lowered, particularly in relation to contract dispute-related litigation. Government contracts will be consistent with international instruments, existing laws and public interest, and will be less prone to legal challenges. Both these outcomes will lessen risk and help achieve strengthened investor confidence in the Philippines.

### 3. Strengthen Intellectual Property Enforcement

The Intellectual Property Office (IPO) is the main administrative agency tasked with the administrative settlement of intellectual property rights (IPR) disputes. It coordinates very closely with other government agencies such as the Bureau of Customs, the National Bureau of Investigation, the Philippine National Police, the Department of Justice and the Department of Local Governments. Although the basic laws and organizational structures are in place for a stronger protection of intellectual property rights, the enforcement of these laws and the timeliness of administrative and judicial processes continue to be inadequate. The case of McDonald's Corporation vs. L.C. Big Mak Burger which was an action for trademark infringement and unfair competition, illustrates this point. It took the judicial system 15 years to finally decide the case in favor of McDonald's Corporation.

The GPH recognizes that a strong IPR regime will effectively increase trade with and direct investments from the United States and other countries. It is committed to pursue Amendments to the Intellectual Property Code to serve the needs of the copyright-based industries. It is also committed to strengthen the enforcement capability of the IPO.

USAID, in coordination with the U.S. Trade Representative and the U.S. Patent and Trademark Office, will provide support especially in the areas of combating piracy, enforcement of IPR laws and the speedy disposition of IPR cases.

Illustrative activities:

- Enhance the capacity of special commercial courts and the IPO to effectively resolve intellectual property rights cases and other business disputes
- Support the implementation of new Supreme Court rules that expedite the handling of IPR cases once they go into effect

- Provide TA to support inter-agency coordination efforts primarily between the IPO, law enforcement agencies and the courts.

Anticipated outcome: A strong IPR regime will help attract foreign investments and increase the volume of trade between the Philippines and its international trading partners, including the United States.

#### **4. Accountability and Confidence Building Measures through Institutional Reform and Public Oversight**

Allegations of corruption and doubts about the integrity of the court system in the Philippines have negatively affected public trust, including that of the business community, in the justice system. Although some judges and even justices have been disciplined for corrupt behavior, there is a general feeling that more action is needed on the part of the Supreme Court to fully address this problem, including the need to reform the system for disciplining judges and lawyers to ensure quick and decisive actions on complaints.

The GPH, led by the Supreme Court and the Philippine Department of Justice is committed to implementing integrity enhancing measures that will reduce opportunities for corruption as well as enhance the credibility of the judicial system. This will include establishing independent disciplinary units that will act on complaints against erring legal personnel. The GPH is also committed to an open and transparent search process in the selection of appointees in constitution commissions, regulatory bodies, and other independent bodies, public oversight of government processes, and the strict enforcement of anticorruption policies, including Codes of Conduct.

USAID will support both the demand and supply side for more transparent and accountable justice sector institutions. It will support integrity and confidence enhancing measures, including the expansion of citizen/media watchdog efforts in the selection and appointment of judges and monitoring of judicial issuances (e.g. temporary restraining orders & rulings on commercial disputes). It will strengthen accountability mechanisms of the judiciary (e.g. consistent, transparent & timely application of sanctions for judicial misconduct). USAID will support the implementation of integrity-building measures identified in the Supreme Court Integrity Development Review. It will also support the Philippine DOJ implement its Code of Conduct.

Illustrative activities:

- Support the expansion of citizen/media watchdog efforts in the selection and appointment of judges and monitoring of judicial issuances (e.g. temporary restraining orders & rulings on commercial disputes)
- Provide TA to strengthen accountability measures of the judiciary (e.g., consistent, transparent and timely application of sanctions for judicial misconduct)
- Provide TA to support the implementation of integrity-building measures identified in the Supreme Court Integrity Review
- Provide TA and training to Department of Justice to help establish an “internal affairs unit” that can effectively enforce a code of conduct and other professional standards and discipline prosecutors
- Support training of justice sector personnel in their respective codes of conduct

Anticipated outcome: This component will help uphold the rule of law, primarily by making the judicial system more accountable and less prone to corruption. This will boost public trust in the judicial system, as well as bolster investor confidence.

## D. Expected Results

Overall, the ROL Program activities expect to contribute to the following strategic objectives by 2016:

- World Governance Indicators (Regulatory Quality, Rule of Law, Control of Corruption): improving or on par with regional and emerging market peers;
- World Justice Project's Rule of Law Index (Accountable Government, Open Government and Regulatory Enforcement, Access to Justice): improving or on par with regional and emerging market peers;
- Judicial Efficiency enhanced through docket cleansing, case tracking and management, procedural reforms, and capacity building of various trial and appellate courts
  - Reduced backlog of 550,000 (2010 estimate) by 50%
  - Reduced trial duration of commercial cases by 54% from about 6.5 years (2010) to three years;
- Doing Business Ranking for Contract Enforcement: improving or on par with regional and emerging market peers; and
- More effective handling of civil and criminal intellectual property rights cases by the courts using streamlined procedures for the handling of such cases.
- Increased business sector confidence in the judicial system as measured through local polling data (e.g. Social Weather Station Surveys)

## E. Level of Resources Required

Subject to further refinement, total required USG funding for the ROL Program over the next five years is estimated at \$25.8 million.

| Partnership for Growth: Philippines 2011-2015 |                  |                  |                  |                  |                  |                   |                  |                   |
|---|------------------|------------------|------------------|------------------|------------------|-------------------|------------------|-------------------|
| Strengthening the Rule of Law (ROL) Program   |                  |                  |                  |                  |                  |                   |                  |                   |
|   | FY2011           | FY2012           | FY2013           | FY2014           | FY2015           | Total USG         | GPH In-kind      | Total Cost        |
| <b>ESTIMATED PRICE</b>                        | <b>2,786,831</b> | <b>5,253,000</b> | <b>5,942,000</b> | <b>5,942,000</b> | <b>5,942,000</b> | <b>25,865,831</b> | <b>8,700,000</b> | <b>34,565,831</b> |
| <b>1. Promote Judicial Efficiency</b>         | 1,500,000        | 3,000,000        | 3,242,000        | 3,242,000        | 3,242,000        | 14,226,000        | 7,000,000        | 21,226,000        |
| <i>a. Decongestion</i>                        | 1,000,000        | 2,000,000        | 2,242,000        | 2,242,000        | 2,242,000        | 9,726,000         | 5,000,000        | 14,726,000        |
| <i>b. Delay Reduction</i>                     | 500,000          | 1,000,000        | 1,000,000        | 1,000,000        | 1,000,000        | 4,500,000         | 1,200,000        | 5,700,000         |
| <b>2. Contract Enforcement</b>                | 500,000          | 1,000,000        | 1,000,000        | 1,000,000        | 1,000,000        | 4,500,000         | 1,000,000        | 5,500,000         |
| <b>3. IPR Enforcement</b>                     | 500,000          | 1,000,000        | 1,000,000        | 1,000,000        | 1,000,000        | 4,500,000         | 1,000,000        | 5,500,000         |
| <b>4. Institutional Reform and Oversight</b>  | 286,831          | 253,000          | 700,000          | 700,000          | 700,000          | 2,639,831         | 500,000          | 3,139,831         |

## F. Program Timeline by Component

Component timeline and project roll-out will be developed in more details with program design. All component activities can be implemented immediately, subject to available funding. The ROL Program encompass activities prioritized by the GPH, with continuing support from USAID, through activities aimed at judicial efficiency, court reform, and public oversight. Continued funding will prove crucial to maintain momentum in these ROL reform areas. For activities not yet started (under contract and IPR enforcement), immediate work will be essential to the overall success of the PFG.

| Component Timeline for Implementation, Strengthening the Rule of Law (ROL) |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
|--|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|
| ROL - Component Activities   | FY2012 |    |    |    | FY2013 |    |    |    | FY2014 |    |    |    | FY2015 |    |    |    | FY2016 |    |    |    |
|  | Q1     | Q2 | Q3 | Q4 |
| <b>1. Promote Judicial efficiency</b>                                      |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| a. Decongestion  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| b. Delay Reduction   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>2. Contract Enforcement</b>   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>3. IPR Enforcement</b>  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| <b>4. Institutional Reform and Oversight</b>                               |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |

### **III. Strengthening the Investment Climate through Anticorruption Measures (SICAM)**

#### ***Concept Note on Anti-Corruption***

##### **A. Overview**

The PFG constraints analysis affirms the conclusion of recent literature on growth that corruption is a major impediment to the Philippines economic performance. The high level of perceived corruption and the inability to address it in the Philippines have direct links to growth. In the 2010 Corruption Perception Index (CPI), the Philippines ranked 134th of 178 countries, lagging behind Malaysia, Thailand, Indonesia and Vietnam. The Philippines ranking on the Control of Corruption Index has steadily declined over the years, falling below Vietnam and Indonesia (as of 2005). By encouraging bribes and increasing the costs of doing business, corruption deters both foreign and domestic investment and weakening competition. Public corruption infects the judicial system, making it slow and unpredictable. Corruption and bureaucratic inefficiency account for almost half of the problematic factors cited in the 2010 Global Competitiveness report for the Philippines. Corruption manifests itself in regulatory capture. In the 2010 Rule of Law Index, the Philippines underperformed in all dimensions of public accountability in comparison to the East Asia and Pacific average. The country scored lowest in dimensions relating to the “exert of improper influence by government officials” and “impunity”. These findings suggest a serious inability by public sector institutions to reduce elite capture and promote competition.

Weak control of corruption, coupled with an inefficient court system, exacerbates governance failures, most glaringly in fiscal space. Despite having higher tax rates than regional peers, the Government of the Philippines (GPH) exhibits weaker revenue performance. This weak tax effort implies inefficiency in revenue performance and high tax leakage, attributable to a high incidence of tax evasion and/or bribery.

Addressing corruption remains challenging, an on-going struggle requiring predictable and timely enforcement of laws. The 2011 Index of Economic Freedom noted that previous attempts to curb corruption in the Philippines were inconsistent and unsuccessful in countering a long-standing culture of corruption, a departure from the well-known anticorruption reform strategy of other countries in the region. Hong Kong, Singapore, South Korea, and more recently Indonesia have significantly invested in building the capacity of anticorruption detection bodies, and effective enforcement has been the foundation of comprehensive anticorruption programs of these countries. Experiences of these countries show that anticorruption enforcement, if combined with targeted prevention efforts to reduce opportunities for corruption and engagement that harness the contributions of the private sector, can create substantial impact in attracting investments.

Fighting corruption is a key commitment under President Aquino’s Social Contract with the Filipino People. Through Partnerships for Growth (PFG), USG will carry out support activities directed at increasing the punitive risks of corruption and minimizing opportunities for corruption. Under the five-year PFG, USG, through USDOJ and USAID, will bolster GPH efforts in the speedy and visible application of laws against large-scale corruption, which are envisioned to contribute to creating a more secure destination and a level playing field for foreign and domestic investors.

USAID's contribution to PFG, specifically in enhancing anticorruption measures, will be carried out through the Strengthening the Investment Climate through Anticorruption Measures (SICAM) Program. SICAM will combine quick-response and medium-term technical assistance, which are envisioned to be flexible and demand-driven, cut across inter-related components but at the same time sharply focused on large-scale corruption. USAID will closely coordinate the design and implementation of activities closely with the U.S. Department of Justice.

## B. Goals and Objectives

The goal of PFG is to assist the Philippines achieve broad-based and inclusive economic growth by creating a competitive climate for trade and investment. This goal will be achieved through the following objectives of SICAM:

- Ensure consistent and timely prosecution of large-scale corruption cases;
- Improve legal tools for corruption detection;
- Intensify efforts to prevent corruption;
- Strengthen accountability of anticorruption offices including greater transparency in prosecution efforts; and
- Enhance corporate governance and greater business sector contributions to anticorruption efforts.

Strengthened anticorruption enforcement and enhanced efforts to reduce opportunities for corruption will lead to fair and open competition, reduced costs of doing business and ultimately to a more attractive climate for foreign and domestic investments. Reduced levels of corruption will contribute to higher revenues and reduced fraud and resource wastage. Anticorruption improvements will be measured by:

- Improvements in corruption perceptions ranking, including the Corruption Perception Index and Rule of Index (particularly in the public accountability dimension);
- Increase in the number of large-scale corruption cases decided in favor of the government, both in terms of the punitive risks of corruption and recovery of corruption proceeds;
- Increase in the compliance rate of investment- and trade-related agencies to the Anti-Red Tape Act and other efforts to reduce the cost of doing business; and
- Increase in the number of business associations that implement integrity-building measures among its member enterprises.

SICAM is intended to meet higher level objectives associated with a more stable investment climate:

- Improved enterprise perceptions on the costs of doing business and competitiveness; and
- Increase in the influx of foreign and domestic investments.

## C. Program Components

SICAM will implement three inter-related technical assistance components designed to meet the two-pronged goal of strengthening enforcement efforts targeting large-scale corruption and reducing opportunities for corruption in investment-related areas.

### **Component 1. Increasing the effectiveness of the Office of the Ombudsman and the Commission on Audit (COA) as the leading institutions in anticorruption enforcement**

The Ombudsman's Office and COA are independent institutions empowered by the 1987 Constitution to detect and pursue public sector corruption. The Ombudsman's Office has the authority to investigate allegations of corruption and to prosecute both criminal and civil cases against corrupt offenders. The Ombudsman's Office also has the authority to investigate and decide on administrative cases against public officials, a disciplinary authority shared with other oversight institutions (such as the Office of the President and the Civil Service Commission) and heads of implementing agencies. For criminal cases, Ombudsman lawyers conduct preliminary investigation, or the process of determining probable cause for filing cases in courts. The Ombudsman's Office of the Special Prosecutor prosecute cases against high-ranking officials before the Sandiganbayan (anticorruption court). Due to lack of prosecutors and field presence, the Ombudsman's Office passes on cases against lower-ranking officials to the Department of Justice for prosecution of cases in the Regional Trial Courts.

As the supreme external audit body, COA has the authority to examine all financial transactions to detect and deter fraud and wastage of public resources and assets. Among the various types of audits that COA conducts, fraud audit is the most relevant to anticorruption enforcement. Fraud audit is purposively (vs. regularly) undertaken to gather evidence to prove a fraudulent transaction that ultimately should lead to prosecution. Absent prosecutorial powers, COA works with the Ombudsman's Office to transform fraud audits into corruption cases. With USAID support, COA and the Ombudsman's Office entered into a memorandum of agreement in 2010 to establish the Joint Investigation Taskforce (JIT) responsible for evidence gathering/sharing and inter-agency coordination to effectively prosecute corruption cases entailing transactions over P50 million (approximately \$1.2 million) and with strong public interest/high media visibility. Both the newly appointed heads of the Ombudsman's Office and COA, Ombudsman Conchita Carpio-Morales and Chairperson Gracia Pulido-Tan, respectively, are committed to continue the JIT and strengthen the mechanism with their strong endorsement.

Performance of both supreme accountability institutions in detecting and prosecuting corruption have been criticized by Congress, media and the public to be poor, inconsistent, and evidently lacking the necessary focus on large-scale corruption. Underperformance is attributable to a number of inter-related factors.

#### ***Weak capacity to perform enforcement work***

In comparison to Hong Kong Independent Commission against Corruption (ICAC), the Ombudsman's Office and COA's Fraud Audit and Investigation Office seem to be significantly challenged in terms of its enforcement capacity. But a closer look at the Indonesia Corruption Eradication Commission (CEC) argues that the size of the anticorruption organization may not matter. Despite its limited resources and personnel in comparison to regional peers, CEC has convicted over 100 high ranking officials, with all appealed verdicts upheld by the Supreme Court. CEC has successfully recovered a substantial amount of corruption proceeds and has expanded its corruption prevention activities. CEC owes its success to (i) sufficient police powers including the ability to wiretap, examine bank accounts and tax records; (ii) efficient court system for corruption cases; institutionalized investigator-prosecutor cooperation; and (iv) strong accountability mechanisms (Bolongaita, 2010). Nonetheless, under-capacity in investigation and prosecution, if combined with weak legal tools for detection and prosecution, court delay, and weak accountability, may weaken enforcement effectiveness.

Table 1  
**Comparison of Hong Kong ICAC and GPH Ombudsman and COA, 2011**

|  | Investigator-civil servant ratio | Estimated annual budget (2011) | Percentage to total government budget (2011) |
|--|----------------------------------|--------------------------------|--|
| Hong Kong Independent Commission against Corruption (ICAC)             | 1:200                            | \$89 million                   | .38%   |
| Indonesia Corruption Eradication Commission                            | 1:28,817*                        | \$27.3 million**               |  |
| Philippines Office of the Ombudsman                                    | 1:8,500                          | \$23.8 million                 | .06%   |
| Philippines Commission on Audit - Fraud Audit and Investigation Office | 1:38,000                         | \$860 thousand                 | .0022%                                       |

Sources: Presentation of Tony Kwok, former operations head of HK ICAC to USAID/Philippines on 5 May 2011; Commission on Audit and Office of the Ombudsman, 2011.

Notes:

\* For the total number of Indonesia civil servants, ratio used 2009 data from Indonesia National Civil Service Agency, cited in "Career Path Planning for Indonesian Public Servant", Lecturers in Governmental Studies Department, Universitas Muhammadiyah Yogyakarta, no date. For the total number of "investigators" ratio used 2008 data from 2008 data from Indonesia Corruption Eradication Commission Annual Report, 2008

\*\* 2008 data from Indonesia Corruption Eradication Commission Annual Report, 2008.

Detecting and prosecuting corruption requires continuous capacity-building to ensure the development of specialization areas including financial forensics, trial advocacy, appellate advocacy, case management etc. The Ombudsman's Office only began investing in the training of investigators and prosecutors in 2003 through the support of USAID. COA's Fraud Audit and Investigation Office, the core unit at COA responsible for building corruption cases out of audit findings, began its training program only in 2010, at the inception of USAID's capacity building support. Building specialized skills/competence in technical aspects of enforcement work, such as forensic auditing, asset investigation, trial and appellate advocacy, etc., should be continued to support the plans of the new leadership at COA and Ombudsman to expand their investigation and prosecution arms. Among the immediate plans of the new Ombudsman is the hiring of 100 new lawyers as graft investigation and prosecution officers, indicating a substantial training requirement.

Both the Ombudsman's Office and COA are challenged by weak records management systems, which hamper the ability of these institutions to (i) safeguard the integrity of evidence and case documents, (ii) track the progress of cases, and (iii) gather information on the performance of their enforcement staff. Several studies funded by the MCC and managed by USAID under the Threshold Program pointed out serious issues in the records-keeping and evidence-handling policies, systems and practices of the Ombudsman Office. The survey of closed cases in the Sandiganbayan (2009) highlighted that less than 17% of Ombudsman cases studied had sufficient information available to be included in the study; and the rest of the cases were either not recorded in the central records repository or had substantial missing information or documents. A study that closely looked at the records management and evidence security practices of the Ombudsman's Office (2009) highlighted the lack of uniformity in documenting the progress and details of cases across the Ombudsman's investigation and prosecution offices, which compromises not only the accessibility of case information, but also the integrity of enforcement work. COA is confronted with the same records management issues. A study

commissioned by USAID for COA (2011), noted that COA's Fraud Audit and Investigation Office has a convoluted and unclear system for docketing cases, poor records storage facilities, and is lacking the capacity to monitor the transfer of records within COA and from COA to other offices (such as the Office of the Ombudsman).

### ***Weak legal tools to detect corruption***

Limitations in the legal environment impede the ability of the Office of the Ombudsman, COA and other anticorruption offices to effectively prosecute and recover proceeds of corruption. Corruption investigators in the Philippines do not have the authority to access information on bank accounts that are necessary in proving corrupt transactions. Although the Ombudsman is an independent anticorruption office, it does not have sufficient police powers, such as search and seizure for purposes of an investigation. The lack of a witness protection program discourages whistleblowing and hinders the Ombudsman's Office from collecting evidence needed to prosecute a case.

Moreover, some of the offenses outlined in the Anti-Graft and Corrupt Practices Act legislated in 1960 are not well-defined, thus are subject to diverse judicial interpretation. One of the findings of the Closed Case Study of Selected Cases before the Sandiganbayan for the Office of the Ombudsman conducted under the Philippines Threshold Program (2009)<sup>25</sup> is that majority of corruption cases surveyed are charged under this 1960 anticorruption law, particularly Section 3(e):

(e) Causing any undue injury to any party, including the Government, or giving any private party any unwarranted benefits, advantage or preference in the discharge of his official administrative or judicial functions through manifest partiality, evident bad faith or gross inexcusable negligence. This provision shall apply to officers and employees of offices or government corporations charged with the grant of licenses or permits or other concessions.

The Closed Case Study argues that the difficulty in proving rather opaque elements of corruption crimes such as the one cited above, can partly explain the low success of Ombudsman prosecutors in courts. For instance, proving that an alleged "injury" to Government of a questionable contract is "undue," or preference to a supplier was done with "evident" bad faith or "manifest" partiality, can be difficult to quantify or substantiate, thus subject to wide judicial interpretation.

Anticorruption institutions grapple with weak legal tools in recovering proceeds of corruption. The law on forfeiture of ill-gotten wealth is a civil action with characteristics of a criminal procedure. Republic Act 1379 on forfeiture of ill-gotten wealth requires the conduct of an inquiry similar to preliminary investigations in criminal cases to establish grounds that the government official acquired assets manifestly out of proportion to his salary and other lawful sources of income. Even if the burden of proof is on the accused public official, it is difficult for the Ombudsman's Office to pursue a case under this forfeiture law because of the inability to seize the assets while a case is pending resolution. By the time the forfeiture order is issued by the court, forfeitable assets have already been laundered. The Republic Act 1405 – Bank Secrecy Act and Republic Act 6426 – Foreign Currency Deposit Act uphold

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<sup>25</sup> The Philippines Threshold Program was funded by MCC and administered by USAID in 2007-2009. It assisted the GPH in reducing opportunities for corruption and improve revenue administration. For more information on the Threshold Program, please visit <http://philippines.usaid.gov/programs/democracy-governance/millennium-challenge-account-philippines-threshold>.

the inviolable confidentiality of bank deposits, making it extremely difficult to identify and preserve assets. Jurisprudence, such as the ruling on the Anti-Money Laundering Council (AMLC) v. Eugenio and Marquez v. Desierto, has limited the authority of the Ombudsman and the AMLC in conducting bank inquiries. COA's charter and rules of procedures are lacking the necessary provisions that should empower the office to execute audit decisions and recover disallowed transactions from private persons/entities.

### ***Weak accountability mechanisms***

Republic Act 6770 and Presidential Decree 1447 outline the functional and organizational structures of the Ombudsman's Office and COA, respectively. Their charters require both Ombudsman and COA to submit annual performance reports to the President and to Congress. Apart from impeachment proceedings against the heads of the independent accountability offices, public Congressional hearings on corruption cases in aid of legislation, and budget hearings in Congress, the annual reporting requirement may be the only other existing mechanism for the legislative and executive branches of government to check and balance the supreme powers of both the Ombudsman and COA. Investigative hearings in both houses of Congress on high-profile cases are not followed through by actual prosecution in courts.

### ***Court delay***

Interminable court delay reduces the success rate of the Ombudsman and COA in securing court decisions favorable to the state. When cases languish in courts, the momentum of trial is lost, witnesses lose interest and evidence-gathering necessary for trial becomes extremely difficult. A survey of Ombudsman cases brought before the Sandiganbayan (2009) shows that close to 60% of cases with sufficient information had an average case age of eight years, with actual trial running an average of three years.

Confluence of these factors thwarts the effectiveness of the Ombudsman and COA in detecting and deterring public sector corruption. In the 2009 survey of closed Ombudsman cases, close to half of the cases were dismissed after trial, and a measly four percent meted out convictions.

Fighting corruption is at the core of President Aquino's Social Contract with the Filipino People. The Aquino Administration recognizes that anticorruption reforms are crucial elements of good governance, social development and economic growth. GPH is committed to pursue corruption, particularly large-scale corruption, using all instrumentalities available to ensure that cases are supported by solid evidence. GPH is committed to review laws, court rules/procedures governing administrative, civil and criminal actions against corruption to ensure greater enforcement effectiveness and timely resolution of cases. GPH is also committed to improve the corruption detection through legislation, priority of which are the amendments to the Anti-Money Laundering Law, and passage of a whistleblower protection act. GPH is also committed to balance efforts to expand the authority of anticorruption offices with initiatives that strengthen accountability. GPH is committed to institutionalize a public reporting mechanism on adherence to anticorruption policies.

In collaboration with the US Department of Justice (USDOJ), USAID's SICAM Program will assist the Ombudsman's Office and COA to become the leading anticorruption enforcement institutions. USAID and USDOJ will jointly support the training of COA fraud auditors/investigators and Ombudsman investigators and prosecutors. Resources will be allocated for the training of 100 new lawyer-recruits

that the Ombudsman is currently hiring. Capacity building activities for the Ombudsman's Office and COA's anti-fraud unit will aim to provide basic, advance and specialized training in both substantive and procedural law as well as investigation and prosecution techniques, including such areas as criminal prosecution, asset forfeiture, asset management, chain of custody of evidence, administrative adjudication, appellate advocacy. SICAM will support the mobilization of international experts and local legal expertise, carry-out intensive training needs assessments, and cover the venue and other operational expenses of basic and advance training of Ombudsman and COA enforcement staff. Complementing this effort, it is envisioned that USDOJ will provide high-level resident experts/trainers and sponsor highly specialized training (e.g. training on cybercrime and use of electronic evidence). It is also expected that USDOJ will assist the Ombudsman and other anticorruption offices in maximizing the mutual legal assistance treaty between GPH and USG in evidence gathering and pursuit of actual corruption cases.

USAID will closely collaborate with USDOJ to assist the Ombudsman's Office in entering into effective partnership agreements with other law enforcement and non-law enforcement organizations. USAID will continue to strengthen the Joint Investigation Taskforce for large-scale corruption cases between the Ombudsman and COA by supporting dialogues on common policy and operational issues and joint training, and assist both agencies in setting up integrated systems for effective case tracking and records-keeping. USAID and potentially USDOJ will assist the GPH in reviving the Inter-agency Anti-Graft Coordinating Council (IAGCC) composed of the Ombudsman's Office, COA, Civil Service Commission, Department of Justice and other anticorruption units in the executive branch (such as the Presidential Anti-Graft Commission and the Anti-Money Laundering Council) to improve information sharing, and support a collective strategy for pursuing and monitoring corruption cases, including recovery of ill-gotten wealth and management of seized and forfeited assets. USAID will also support the Ombudsman, COA and other anticorruption offices in forging partnerships with non-law enforcement agencies, such as the Integrated Bar of the Philippines, the Philippine Bar Association and other volunteer legal groups to bolster the legal work in prosecuting cases. USAID will assist the Ombudsman's Office and other anticorruption offices in partnering with civil society organizations in monitoring the progress of corruption cases in the Sandiganbayan and other courts. USAID and prospectively USDOJ will support joint training among the collaborating anticorruption institutions to solidify cooperation at the working level and promote harmonized appreciation anticorruption laws.

USAID will closely collaborate with USDOJ in supporting efforts of the GPH in improving the legal framework for anticorruption enforcement. It is foreseen that USDOJ will bring in resident experts and support roundtable discussions among members of the IAGCC and other relevant actors (e.g. Sandiganbayan, Supreme Court, etc.) to tackle the gaps in the current set of anticorruption laws. USAID will carry out assessments and case studies to build evidence-based analysis in support of legislation. USAID will also engage the business community to discuss with Congress and anticorruption offices the negative effects of corruption on the investment climate.

USAID in close collaboration with USDOJ will support the GPH in enhancing efforts to recover proceeds of corruption, particularly in establishing an inter-agency task force that will coordinate asset recovery efforts in relation to corruption. USAID will continue to carry out case studies on the asset forfeiture and asset management experience of the Ombudsman and other GPH anticorruption offices to produce in-depth and evidence-based analyses on the gaps in laws and jurisprudence. It is envisioned that USDOJ will sponsor roundtable dialogues leading to the establishment of the task force.

USAID will also support GPH in strengthening accountability mechanisms to ensure consistency and timeliness of anticorruption enforcement. USAID will provide training to congressional committees to equip them with an in-depth understanding of anticorruption enforcement work. USAID will also support civil society-led monitoring activities on the performance of the Ombudsman, COA, the Sandiganbayan and other anticorruption institutions, including the length of corruption trials and predictability in the disposition of corruption cases. USAID will also support a study and forum series on the replicability oversight mechanisms in comparable jurisdictions (e.g. the Operations Review Committee governing the Hong Kong Independent Commission against Corruption).

Illustrative activities – USAID (through the implementing facility SICAM)

- Provide basic and advance training in forensic auditing, investigation and prosecution, engage international trainers outside USDOJ, engage local legal experts
- Provide technical assistance to support inter-agency coordination efforts
- Provide training, commodities, inter-connectivity to improve records management systems of anticorruption offices
- Support assessments and policy dialogues/fora on weaknesses of current legal environment and legislation requirements to improve anticorruption enforcement effectiveness, including enhancing asset forfeiture and asset management efforts
- Provide grants to civil society organizations and legal groups for court watch activities

As done in previous USAID rule of law programs, USAID will closely coordinate with USDOJ in implementing the illustrative activities.

*Anticipated outcomes:* More consistent, timely and fair application of anticorruption laws, punitive risks of corruption increased, recovered proceeds of corruption increased, perceptions on level of corruption in the Philippines improved

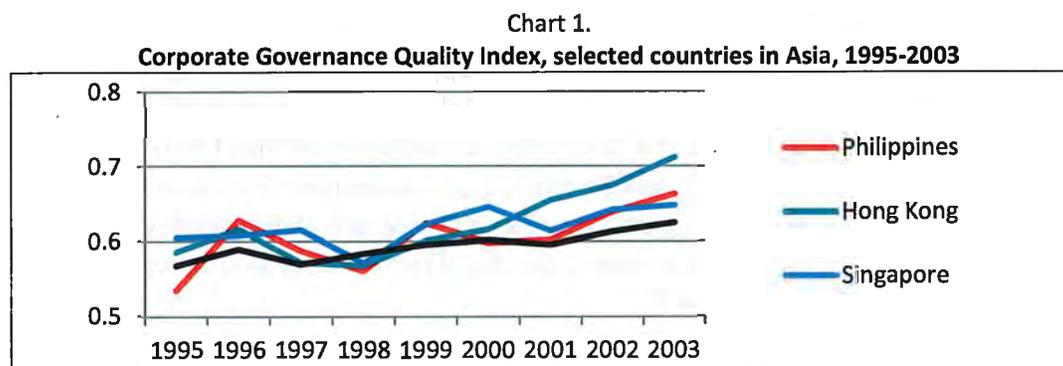
## **Component 2. Strengthening corporate governance initiatives**

Addressing corruption particularly as it relates to the investment climate requires substantial contribution from the business sector. The private sector has a crucial role in changing a business environment from one that tolerates corruption to that upholding transparent and fair competition with a level playing field. Chambers of commerce and business associations can effectively encourage transparent, honest and ethical business practices among its members and can explore self-regulatory mechanisms to ensure compliance to anticorruption and good governance standards. At the firm level, improved corporate governance can assist an enterprise in raising its corporate image and increasing investor confidence; at the economy level, strong corporate governance can demonstrate that the Philippines is a secure location for investments and trade.

Corporate governance is a key element of competitiveness, in fact, the Global Competitiveness Report of the World Economic Forum suggests that it is important for the private sector, as another key player in competitiveness (*vis-à-vis* public sector), to commit to good governance practices and transparency.

The perceptions on corporate governance initiatives in the Philippines seem to be more positive compared to perceptions on overall governance in the public sector. In the recent Global Competitiveness Report (2010), the Philippines ranked 56<sup>th</sup> of 136 countries surveyed in terms efficacy

of corporate boards<sup>26</sup>. In the 2006 study funded by IMF, the Philippines scores for corporate governance quality<sup>27</sup> is above the general average for 10 Asian countries surveyed, and comparable to the scores of Hong Kong and Singapore (see Chart 1). These perceptions signal the high probability of success in expanding corporate governance reforms in the Philippines.



Source: Corporate Governance Quality: Trends and Real Effects, International Monetary Fund, 2006.

GPH is committed to strengthen and expand private sector initiatives to police its own ranks and dissuade corrupt relations with government agencies, particularly in the payment of taxes and procurement.

Through SICAM, USAID will support business associations and chambers of commerce in establishing self-regulatory initiatives to encourage/promote anti-bribery practices and discourage other illegal and/or unethical business behavior that harms competition. USAID will also provide technical assistance to the Securities and Exchange Commission (SEC) in monitoring compliance to the Code of Corporate Governance. In 2009, the SEC issued a revised memo circular defining the minimum set of characteristics, roles and functions of governance boards and directors; and the general elements of sound internal controls and accountability reporting. More importantly, the circular highlights the SEC's oversight role, particularly in (i) monitoring code compliance by covered corporations, (ii) enforcement of administrative sanctions for code violations.

Illustrative activities – USAID (through the implementing facility SICAM)

- Provide technical assistance to business groups/chambers in developing integrity agreements/initiatives, which may include anti-bribery pacts, full disclosure and transparency commitments, adherence to corporate code of conduct
- Strengthen the SEC in overseeing corporate governance, improve compliance to the Revised Code of Corporate Governance
- Provide training and technical assistance to business groups/chambers to promote sound internal control

<sup>26</sup> Respondents were asked, "How would you characterize corporate governance by investors and boards of directors in your country? [1 = management has little accountability to investors and boards; 7 = investors and boards exert strong supervision of management decisions].

<sup>27</sup> The Corporate Governance Quality (CGQ) index is computed from a simple average of three indicators: (i) Accounting Standards; (ii) Earning Smoothing; and (iii) Stock Price Synchronicity. Data are constructed from accounting and market data for samples of non-financial companies listed in stock markets of the Worldscope and Datastream databases. For more information, see <http://www.imf.org/external/pubs/ft/wp/2006/wp06293.pdf>.

*Anticipated outcomes:* perceptions on corporate governance in the Philippines improved, increase in the number of business associations undertaking self-regulatory corporate governance increased, number of corporations sanctioned for misconduct increased

### Component 3. Reducing opportunities for corruption

Inefficient public sector systems and practices create opportunities for corruption. In a survey of expatriated business executives conducted by the Political and Economic Risk Consultancy (PERC) (2010), the Philippines landed the third worst economy in terms of bureaucratic inefficiency. Interestingly, Hong Kong and Singapore, countries perceived to be most effective in controlling corruption within the region as well as globally, are well-regarded in terms of government efficiency. The data can demonstrate the direct relationship between bureaucratic inefficiency and corruption (see Table 2).

In 2007, GPH passed the Republic Act 9485 or the Anti-Red Tape Act requiring all government agencies with frontline services to develop and publicly publish their respective Citizens' Charter that describes the step-by-step procedure in availing government services. Information on service delivery relevant to the public should be included in the charter (e.g. responsible office/government employees, processing time, documentary requirements, fees and charges, and procedures for filing complaints). The law also obliges the review and re-engineering of frontline services to cut red tape and ensure transparency and accountability in public service delivery. The GPH estimates that barely half of government entities have established their Citizens' Charters, and quality compliance may be more problematic. The Civil Service Commission, another constitutionally created accountability institution, in coordination with the Development Academy of the Philippines, a government-owned and –controlled corporation, is responsible for monitoring the implementation of the Citizen's Charter.

Table 2.  
Most Inefficient Bureaucracies in Asia, 2010  
Political and Economic Risk Consultancy (PERC)

| Rank | Country     | Score |
|------|-------------|-------|
| 1    | India       | 9.41  |
| 2    | Indonesia   | 8.59  |
| 3    | Philippines | 8.37  |
| 4    | Vietnam     | 8.13  |
| 5    | China       | 7.93  |
| 6    | Malaysia    | 6.97  |
| 7    | Taiwan      | 6.60  |
| 8    | Japan       | 6.57  |
| 9    | South Korea | 6.13  |
| 10   | Thailand    | 5.53  |
| 11   | Hong Kong   | 3.49  |
| 12   | Singapore   | 2.53  |

Source: PERC, cited in [www.abs-cbnnews.com/nation/](http://www.abs-cbnnews.com/nation/), June 2010

The GPH is committed to enhance transparency of transactions with businesses and with the public, particularly in enforcing full compliance with the Anti-Red Tape Act. The GPH also intends to strengthen integrity mechanisms, including the application of the Integrity Development Review<sup>28</sup> – a compendium of tools for assessing public sector systems to determine the level of vulnerability to corruption.

USAID through SICAM will provide support to the Civil Service Commission, the Development Academy of the Philippines and other oversight offices (such as the Department of Budget and Management) in monitoring and increasing compliance to the Anti-Red Tape Act. USAID will also support the application of the Integrity Development Reviews as well as develop and pilot other system diagnostic technologies in select government agencies. USAID will focus these corruption prevention efforts to national and local governments that are relevant to competitiveness and trade facilitation (e.g. local governments in growth sectors, regulatory offices, customs, and national offices with permitting and licensing services).

Illustrative activities – USAID (through the implementing facility SICAM)

- Provide technical assistance to the Civil Service Commission and other oversight offices to develop monitoring mechanisms and increase compliance to the Anti-Red Tape Act, particularly by investment- and trade-related agencies
- Develop and pilot-test tools that can assist government agencies reduce opportunities for corruption (e.g. Integrity Development Review), focus of technical assistance will be investment- and trade-related agencies including local governments in growth sectors

*Anticipated outcomes:* compliance to the Anti-Red Tape Act by investment- and trade-related government agencies increased, rankings on Philippines bureaucratic efficiency improved

## D. Expected Results

Overall, SICAM activities expect to contribute to the following strategic objectives:

- Improvements in corruption perceptions ranking, including the Corruption Perception Index, Rule of Index (public accountability dimension): increasing or comparable with leading regional or emerging market peers
- Improvements in the Global Competitiveness Index, Doing Business Ranking and Index of Economic Freedom (corruption dimension): increasing or comparable with leading regional or emerging market peers
- Increase in the number of large-scale corruption cases filed and decided in favor of the government, both in terms of the punitive risks of corruption and recovery of corruption proceeds: at least by 30% from designated base year
- Increase in the compliance rate of investment- and trade-related agencies to the Anti-Red Tape Act and other efforts to reduce the cost of doing business: at least by 50% from designated base year

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<sup>28</sup> The Integrity Development Review (IDR) was developed with USAID support in 2004.

Partnership for Growth: Philippines 2012-2016

- Increase in the number of business associations sanctioned for misconduct: at least by 30% from designated base year
- Enhanced Domestic Investment Climate (2016)
- Increase in share of regional foreign direct investment (FDI): from 1.7% in 2009 to over 4%

**E. Level of Resources Required**

Subject to further refinement, total required USG funding for the SICAM Program over the next five (5) years is estimated at \$37 million.

| Partnerships for Growth: Philippines 2011-2015   |                    |                    |                    |                    |                    |                     |                     |                     |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|---------------------|---------------------|---------------------|
| Strengthening the Investment Climate through Anticorruption Measures (SICAM) Program         |                    |                    |                    |                    |                    |                     |                     |                     |
|  | FY2011             | FY2012             | FY2013             | FY2014             | FY2015             | Total USAID         | GPH in kind         | Total Cost          |
| <b>Estimated Price</b>   | <b>\$3,882,804</b> | <b>\$8,333,000</b> | <b>\$8,333,000</b> | <b>\$8,333,000</b> | <b>\$8,333,000</b> | <b>\$37,214,804</b> | <b>\$12,392,530</b> | <b>\$49,607,334</b> |
| 1. Increasing effectiveness of Ombudsman's Office, COA and other anticorruption institutions | \$1,941,402        | \$4,166,500        | \$4,166,500        | \$4,166,500        | \$4,166,500        | \$18,607,402        | \$6,196,265         | \$24,803,667        |
| 2. Enhancing corporate governance initiatives  | \$776,561          | \$1,666,600        | \$1,666,600        | \$1,666,600        | \$1,666,600        | \$7,442,961         | \$2,478,506         | \$9,921,467         |
| 3. Reducing opportunities for corruption   | \$776,561          | \$1,666,600        | \$1,666,600        | \$1,666,600        | \$1,666,600        | \$7,442,961         | \$2,478,506         | \$9,921,467         |
| Evaluations  | \$388,280          | \$833,300          | \$833,300          | \$833,300          | \$833,300          | \$3,721,480         | \$1,239,253         | \$4,960,733         |

**F. Program Timeline by Component**

Subject to availability of funds, it is imperative that activities described above be implemented immediately and simultaneously to support the policy commitments and ongoing initiatives of GPH. Many of these activities, particularly Components 1 and 3, build on previous and ongoing technical assistance programs of USAID.

| Component Timeline, Strengthening the Investment Climate through Anticorruption Measures (SICAM) Program |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
|--|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|
| SICAM Component Activities   | FY2012 |    |    |    | FY2013 |    |    |    | FY2014 |    |    |    | FY2015 |    |    |    | FY2016 |    |    |    |
|  | Q1     | Q2 | Q3 | Q4 |
| Component 1. Increasing effectiveness of Ombudsman's Office, COA and other anticorruption institutions   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| Component 2. Enhancing corporate governance initiatives  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| Component 3. Reducing opportunities for corruption   |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| Evaluations  |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |

## IV. Facilitating Public Investments (FPI) *Concept Note on Fiscal Performance*

### A. Overview

Based on the results of a constraints analysis conducted by a joint USG-GPH technical team, poor governance and a reduced fiscal space were identified as the chief binding constraints to more competitive, inclusive growth in the Philippines. Within the fiscal space constraint, the **Facilitating Public Investments (FPI)** Program will directly address inefficient revenue generation (i.e., a low tax effort), weak tax evasion enforcement, and poor expenditure management, in which fiscal revenues are constrained by structural collection and enforcement inefficiencies, as well as weak public expenditure management. This initiative aligns with the GPH's goal to achieve a sound fiscal framework. As outlined in the Philippine Development Plan (PDP), the GPH considers its main task in fiscal policy "to expand the narrow fiscal space and to get on a sustainable revenue-and-spending path."<sup>29</sup>

In the Philippines, collecting enough taxes to finance essential public expenditures has been a perennial challenge. The tax effort peaked at 17 percent of GDP in 1997, but began a steady decline subsequent to the 1997 East Asian Financial Crisis. It currently stands at close to 12 percent of GDP. Meanwhile, regional peers of the Philippines sustain higher tax efforts: Malaysia (14.3 percent of GDP), Thailand (15.5) and Vietnam (24.3).<sup>30</sup> The weak tax collection effort poses a major problem for the Philippines' development prospects and its poverty reduction efforts. A low public revenue base leaves public finances very vulnerable to destabilizing exogenous (e.g. global recession) and endogenous (e.g. natural disasters) shocks. The resulting increase in fiscal risk raises public sector borrowing costs and renders the country less attractive for private investors. In order to limit the risk of a fiscal crisis the government is forced to cut back public expenditures, which hinders the provision of social and public infrastructure services, thereby contributing to a further deterioration of the investment climate, and the prospects for economic growth and poverty reduction.

The gaps in public spending due to limited fiscal resources compels a concomitant need to address inefficiencies in public expenditure management in order to maximize optimal development outcomes under a tight expenditure constraint. Doing so requires prioritizing public spending in the social and public infrastructure sectors --such as affordable housing, education, healthcare and transportation-- that would strongly complement private investment. According to recent assessments, overall public spending in these priority areas has to increase by close to 7 percent of GDP to close the public spending gap the Philippines faces relative to its regional peers.<sup>31</sup> By increasing public spending in priority areas that complement and, thereby, incite private investment, the current declining trend in total investment spending (i.e., public + private investment) in the Philippines could be reversed. Currently, the average annual rate of gross fixed capital formation of 15.6 percent of GDP in the Philippines for the period 2002-2008 pales relative to its regional peers: Indonesia (23.1), Malaysia (21.7), Thailand (26.7) and Vietnam (33.3)<sup>32</sup>.

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<sup>29</sup> See Government of the Philippines. *Philippine Development Plan 2011-2016, Strategic Framework, Fiscal Reforms*, p 46.

<sup>30</sup> ADB: *Key Indicators for Asia and the Pacific*, 2011.

<sup>31</sup> World Bank: *Philippines Discussion Note No. 4 on "Public Spending."*

<sup>32</sup> World Bank: *World Development Indicators*.

Additionally, the GPH needs to address the public sector's chronic under-execution of the national budget and the lack of budget transparency. Some of the most notorious Philippine corruption scandals in the last decade involved abuses of discretions in budget management. Consequently, there is a strong need in the public sector to enhance transparency, accountability and efficiency in expenditure and financial management.

Based on these considerations, the Philippines urgently needs to raise its tax revenue and increase the level and quality of its public expenditures. This requires the establishment of a sound tax policy framework, complemented by an efficient and well-governed tax administration system, and backed up by an efficient, transparent and accountable public financial management framework. Together, these form the optimal path to revenue sufficiency and the sustainable financing of essential public goods. These three elements are also core components of a sound investment climate that promotes domestic and foreign private investment, which in turn will strengthen broad-based economic growth.

As the name suggests, this Program will address the tax revenue inefficiencies, tax/duty evasion issues, and public spending limitations that greatly reduce the Philippines' fiscal space and strongly limit the provision of public goods and services necessary to complement and spur private investment. USAID and the FPI Program will support measures to increase the tax effort, mitigate tax/duty evasion, and promote greater transparency and accountability in public expenditures. Within the five year timeframe of PFG, FPI will support the implementation of priority efforts outlined in the PDP Strategic Framework for Fiscal Reforms.<sup>33</sup> By supporting tax administration and tax policy reforms needed to boost the tax effort, and public expenditure reforms to provide greater transparency in budget management, the Program will assist GPH efforts to increase public investments in priority social sectors, including affordable housing, education, healthcare and infrastructure.

The FPI Program will support GPH efforts to implement fiscal reforms, including improvements in tax policy and administration, and to enhance the provision of public goods and services to complement and attract private investment projects. This demand-driven Program covers both tax and non-tax components, as well as public expenditure activities, in response to GPH identified needs to improve the

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<sup>33</sup> The PDP overall strategy in the fiscal sector in the medium term is to increase the tax effort to 15.6 percent of GDP, through an annual incremental 0.3 percentage point rise in the collection effort of the Bureau of Internal Revenue (BIR) and a 0.1 percentage point rise in collections at the Bureau of Customs (BOC). This Agenda seeks the following tax administration reforms: (1) establishing a tax registry comprehending all taxpayers; (2) using comprehensive third data to determine the potential tax base; (3) maintaining a transparent and productive tax audit program; (4) fully staffing the BIR and BOC with competent and adequately trained personnel; (5) formulating transparent and consistent tax rulings; (6) revitalizing the Run After Tax Evaders (RATE), Run After The Smugglers (RATS) and Revenue Integrity Protection Service (RIPS) programs of government; (7) establishing appropriate performance standards and evaluations; and (8) instituting a more effective system of rewards and penalties under the Lateral Attrition Law backed up by performance standards. To complement the tax effort, the overall strategy will also pursue tax policy reforms such as the rationalization of the fiscal incentives system, the enactment of a fiscal responsibility law, adjustments in excise taxes, and a reversal of unnecessary tax exemptions. At the same time, non-tax revenue collection would be increasing to an average equivalent of 1.2 percent of GDP through governance reforms: fees and charges collected by government agencies will be reviewed for possible adjustments, since many of these have not been changed for over a decade, while Government-Owned and Controlled Corporations (GOCCs) will be made to contribute their fair share to the revenue effort by, among others, promptly remitting dividends. In terms of public expenditure reforms, the key challenge is how to substantially increase productive expenditures, such as those for infrastructure and social services. To address this challenge, the PDP envisions the implementation of several major public expenditure management reforms.

fiscal sector. Given the various USG agencies involved in administering foreign assistance and the unique policy initiatives in which the PFG Initiative is engaged, USAID will closely coordinate the implementation of the FPI Program with the Millennium Challenge Corporation (MCC), the US Treasury Department's Office of Technical Assistance, the US Department of Homeland Security, and other relevant USG agencies.

## **B. Goals and Objectives**

The goal of PFG is to assist the Philippines achieve broad-based and inclusive economic growth by creating a competitive climate for trade and investment. This goal will be achieved through the following objectives of FPI:

- improve tax administration,
- mitigate tax/duty evasion, and
- strengthen transparency and accountability measures in public expenditure management.

The FPI Program seeks to support the fiscal reform agenda of the new Philippine administration with appropriate mechanisms to facilitate increased public investment in social and public infrastructure.

## **C. Program Components**

Geared towards improving the fiscal space, the FPI Program encompasses three inter-related components: tax policy, tax administration, and public expenditure management.

### **1. FPI Tax Policy: Increase Fiscal Space through Expanded and Improved Tax Base**

This component seeks to address the low tax effort. Component activities will improve the Philippines' tax collection activities.

The Philippines has one of the lowest ratios of tax revenues to GDP in the region because of widespread tax evasion and special interest tax exemptions. Although the GPH has stressed the need to correct its fiscal imbalances, few of the administration's efforts to generate additional revenue have been legislated. There is a need to improve both revenue collection and the fairness of the tax system. The strategic objective laid out in the GPH's PDP is "to expand the narrow fiscal space and to get on a sustainable revenue and spending path." The PDP's medium-term objective is to increase the tax effort to 15.6 percent of GDP, through an annual incremental increase of 0.3 percent and a 0.1 percent in the collection effort of the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC), respectively.

The FPI Tax Policy Program envisions a highly targeted approach for its support of tax policy, focusing on areas where problems have been noted in the past and are likely to be in the future, where limited assistance may have strategic impact, and where assistance and reforms can be monitored by the public. The Program will assist in expanding the tax base by supporting a specialized fiscal unit within the Department of Finance (DOF) to set revenue targets more accurately against industry growth trends and set performance measures for BIR and BOC personnel, help generate revenue enhancement measures

through data sharing within and across pertinent GPH agencies to improve tax valuations and compliance, support efforts to lessen revenue-eroding measures, and assist in the review of additional tax revenue streams.

Illustrative activities:

- Assist in establishing a fiscal unit within the DOF to conduct economic and accounting analyses using comprehensive third-party data to help set realistic revenue targets
- Assist in formulating improvements in system linkages, data sharing and verification between the BIR and the BOC, and among the BIR, Land Registration Authority (LRA) and the Securities and Exchange Commission (SEC) to broaden the tax base, diagnose tax leakages and clean up tax registries
- Help establish the Electronic Certificate Authorizing Registration (eCAR) between BIR and LRA to enhance revenue collections from taxes derived from transfer of ownership of real properties
- Support the BIR use of geographical information systems (GIS) to access and interpret data gathered from sources such as zonal valuation, eSales and ITS Registration
- Support efforts to mitigate revenue-eroding measures through inflation indexation of excise taxes
- Assist in exploring new sources of tax revenue, such as changes in the personal and income tax regimes, and the elimination of unnecessary VAT exemptions

*Anticipated outcome:* Increased tax revenue; improved tax registry; better defined tax revenue targets

## **2. FPI Tax Administration - Increase Fiscal Space through Improved Tax and Duty Administration**

This component seeks to address tax and customs duty evasion. Component activities will improve the Philippines' tax administration.

The FPI Tax Administration Program will assist the BIR and the BOC in mitigating tax evasion and improving customs collections, respectively. The GPH plans to deal with protracted and unsuccessful prosecution of tax evasion cases and weak customs enforcement by revitalizing and improving the BIR's Run after Tax Evaders (RATE) campaign and the BOC's Run after the Smugglers (RATS) program. It will issue a directive that ensures tenure of RATE staff and increases funding for the RATS program, including recruitment of permanent staff. At the BIR the FPI Program will help monitor the progress of RATE, while at the BOC it will help prevent technical smuggling by supporting efforts to track the progress of RATS cases. As part of its support of the GPH's tax administration reform efforts, the Program will also assist in the review of existing fiscal incentives, as well as the GPH's efforts to enact the Fiscal Responsibility Law that seeks to strengthen fiscal discipline across government agencies.

Illustrative activities:

- Support measures to curb smuggling and tax evasion that specifically monitor the progress of Run After Tax Evaders (RATE) and Run After The Smugglers (RATS) cases
- Support mechanisms to track and coordinate the granting of fiscal incentives
- Assist efforts to strengthen fiscal discipline

- Assist with creating open access to the import entry database
- Assist in establishing better guidelines for the seizure process

*Anticipated outcome:* Smuggling and tax evasion reduced; tax and duty collections increased; rationalization of fiscal incentives

### **3. FPI Public Expenditure Management – Increase Fiscal Space through Improved Expenditure Management**

This component seeks to support improvements in the quality of public expenditure management policies and frameworks. Component activities will improve the Philippines' execution of the national budget.

The GPH budget reflects national priorities and affects tax administration, spending behavior, investment policies, and ultimately development and public welfare. Designing, allocating and executing national budgets, therefore, require a sound and robust check and balance system. The FPI Public Expenditure Management Program intends to strengthen the Department of Budget and Management (DBM) in overseeing critical aspects of the budget preparation, execution and accountability that will likely have substantial impact on fiscal space.

The GPH, primarily the DBM, is committed to implement immediate and long-term reforms in public expenditure management to increase productive expenditures and reduce waste and inefficiency through expenditure rationalization and increased budgetary transparency and accountability. Among its medium term commitments are the rationalization plan, passage of a fiscal responsibility bill and harmonization of accounting systems of GPH financial institutions. GPH has committed to completing the rationalization program within the executive branch by seeking to scale down or abolish redundant, overlapping and non-performing functions, as well as personnel and operations, among others. Government-owned and -controlled corporations (GOCCs) and government financial institutions (GFIs) will be prioritized in the rationalization effort. GPH has also committed to passing a Fiscal Responsibility Law to strengthen controls on the budget and ensure that, when applicable, new legislation has a corresponding funding source. GPH also plans to establish the Government Integrated Financial Management System (GIFMIS) to harmonize the charter of accounts of the DBM, the Bureau of Treasury and the Commission on Audit to improve budgeting, financial management and accountability.

GPH has also committed to implementing short-term reforms that are feasible despite the structural and operational limitations in public financial management, and which can create visible results. For the first two national budgets passed under the Aquino Administration, the DBM carried out purposive evaluations of key programs/budget items, especially budget-intensive ones, to assess their alignment with priorities and determine their effectiveness and efficiency. Program evaluation enabled the DBM to terminate programs that no longer deliver intended outcomes (e.g. Food-for-School Program of the Department of Education, Kalayaan Barangay Program, etc.). Through program evaluation the DBM was also able to reduce problematic subsidies (e.g. the National Food Authority's subsidy for rice procurement) and lump sum accounts (by about 30%). After close scrutiny of personnel salaries, the DBM transferred the budgets for unfilled positions to a miscellaneous personnel benefits fund to allow the DBM to monitor the filling of the vacancies, release the funds only when necessary, and ensure that

salaries are transformed into bonuses or allowances. An estimated P23 billion from vacancies were reverted back to the DBM fund pool.

To increase transparency and accountability the GPH required departments and agencies, including those enjoying fiscal autonomy, to make their approved budgets and the status of their programs/projects publicly available. The GPH will further engage civil society in budget formulation and execution, and institutionalize the monitoring of lump sum accounts. The GPH also plans to expand the pool of third party observers in procurement activities, especially as the government intends to scale up public-private partnerships in constructing critical infrastructure projects.

Illustrative activities:

- The FPI Public Expenditure Management Program will provide technical assistance to DBM in enhancing and institutionalizing its capacity for program evaluation. The Program will assist DBM in utilizing program evaluation tools/techniques in the exercise of the department's oversight functions. A crucial component of the Program's technical assistance is assisting DBM in effectively communicating/presenting evaluation results to spending agencies.
- FPI will provide capacity building and technical assistance to associations of enterprises and professionals to enable them to become potential third party observers of public-private partnerships for infrastructure. There are now five priority projects underway: the Manila international airport expansion, the expressways in North and South Luzon, and the privatization of the operations and maintenance of the two Metro Manila rail transit systems. The lack of transparency in past infrastructure projects created many opportunities for corruption.
- USAID provided technical assistance to the DBM in developing a database for tracking select lump sum fund releases, including funds for school building programs, allocations for the Department of Public Works and Highways, pork barrel, and internal revenue allotments to local governments. Under PFG, FPI will assist the DBM in developing the second component of the database, which tracks the utilization of lump sums covered in the existing fund release database.

*Anticipated outcome:* Lump sum allocations reduced; greater transparency in priority lump sum utilization; inefficient programs reduced

## D. Expected Results

Overall, FPI Program activities expect to contribute to the following strategic objectives:

- Increase tax effort to close to 16 percent of GDP (by 2016)
- Increase Gross Fixed Capital Formation to around 22 percent of GDP
- Increase Total Government Expenditures to approximately 23 percent of GDP
- Increase net FDI gains to close to 3 percent of GDP

The Program's contribution to increased private investment include:

- Number of institutional actions taken by USG-assisted organizations to improve GPH tax effort, tax administration, and public expenditure management that will generate enhanced provision of social and public infrastructure to complement and incite additional private direct investment flows to the Philippines

### E. Level of Resources Required

Subject to further refinement, total required USG funding for the FPI Program over the next four (4) years is estimated at \$28 million.

| Partnerships for Growth: Philippines 2012-2015 |             |             |             |             |              |             |              |
|--|-------------|-------------|-------------|-------------|--------------|-------------|--------------|
| Facilitating Public Investments (FPI) Program  |             |             |             |             |              |             |              |
|  | FY2012      | FY2013      | FY2014      | FY2015      | Total USAID  | GPH in kind | Total Cost   |
| Estimated price                                | \$6,351,147 | \$7,234,830 | \$7,234,830 | \$7,234,830 | \$28,055,637 | \$9,342,527 | \$37,398,164 |
| FPI - Tax Policy                               | \$2,117,049 | \$2,411,610 | \$2,411,610 | \$2,411,610 | \$9,351,879  | \$3,114,176 | \$12,466,055 |
| FPI - Tax Administration                       | \$2,117,049 | \$2,411,610 | \$2,411,610 | \$2,411,610 | \$9,351,879  | \$3,114,176 | \$12,466,055 |
| FPI - Public Expenditure Management            | \$2,117,049 | \$2,411,610 | \$2,411,610 | \$2,411,610 | \$9,351,879  | \$3,114,176 | \$12,466,055 |

### F. Program Timeline by Component

Subject to availability of funds, it is imperative that activities described above be implemented immediately and simultaneously to support the policy commitments and ongoing initiatives of GPH. Many of these activities, particularly Components 1 and 3, build on previous and ongoing technical assistance programs of USAID.

| Component Timeline, Facilitating Public Investments (FPI) |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
|---|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|--------|----|----|----|
| FPI Component Activities                                  | FY2012 |    |    |    | FY2013 |    |    |    | FY2014 |    |    |    | FY2015 |    |    |    | FY2016 |    |    |    |
|   | Q1     | Q2 | Q3 | Q4 |
| 1. FPI – Tax Policy                                       |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| 2. FPI – Tax Administration                               |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |
| 3. FPI – Public Expenditure Management                    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |        |    |    |    |

