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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

PHILIPPINES

PRIVATE SECTOR STRATEGY

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EXECUTIVE SUMMARY

Newly-industrialized countries in Asia and elsewhere are increasingly moving toward more open and competitive markets in order to mobilize the energy and resources of the private sector to achieve sustainable economic growth. Government interventionism in business is no longer a credible policy option and privatization of government assets is increasingly widespread.

The economy of the Philippines has been slow to remove excessive government controls, many of which date from the import substitution regime adopted in the 1950s. Protectionist policies have resulted in the propagation of inward-looking, entrenched and inefficient industries. This segment of the Philippine private sector has created loose political associations, inter-locking directorships and interest groups whose main purpose is to ensure the maintenance of a protected system.

Yet, in spite of the existing protectionist environment, a relatively small export-oriented and outward-looking segment that competes efficiently in competitive markets has been able to establish itself and co-exist with the inward-looking elements.

A third segment of the private sector is comprised of small-scale entreprises that operate outside of the system of laws and regulations intended to administer (and tax) business activity.

USAID seeks to promote greater economic efficiency in all three segments to enable them to compete more effectively in open markets. Near term objectives of the strategy are: 1) to reduce or eliminate economic policy constraints; 2) to encourage rapid growth of outward looking private exporters through a process of deepening and widening their exports; 3) to improve the efficiency and competitiveness of inward-looking producers by contributing to the progressive elimination of protectionist policies; 4) to assist struggling informal sector enterprises to improve productivity and to become an integral part of the economy; and 5) to help meet the requirements of private sector enterprises for improved transportation and communication services.

To achieve these objectives, USAID implements a number of projects and programs and conducts policy dialogue with the GOP, aimed at specifically addressing constraints to and the needs of the private sector. A private sector advocacy theme is inherent in all of the Mission's sectoral strategies, including those for health, agriculture and infrastructure.

This policy-oriented approach, on both macro and sector-specific levels, is balanced by focused transactional projects that use innovative mechanisms to channel USAID's bilateral development resources directly to the for-profit business communities, both Filipino and American.

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USAID/Philippines

Private Sector Strategy - June, 1991

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PRIVATE SECTOR STRATEGY

I. Economic Rationale for Private Sector Led Growth

The post World War II economic development of various countries clearly demonstrates that those which have achieved sustained, long-term economic growth have one common characteristic: their economies are dominated by private sector entrepreneurs who are free to pursue for-profit business activities in a competitive economic environment.

A freely-functioning, open-market economy results in efficient utilization of resources, rising worker productivity and standards of living, and a society characterized by social mobility and political freedom. This view draws support from the historical experience of market economies in the industrialized West, Japan, and the newly industrialized countries of South Korea, Taiwan, Singapore and Hong Kong. Conversely, the more recent experience of Eastern Europe illustrates the extent of economic weakness in government-controlled economies and interventionist states.

The key to accelerating economic development is allowing the private sector to undertake economic activity largely unfettered by government restriction. Expansion of government beyond its minimal function (e.g., public goods such as defense and public order) impairs efficient resource use. In an open-market system, government is expected to put in place an environment in which private enterprise can operate in a manner most responsive to the needs of domestic and international markets.

Private enterprises perform better than parastatals mainly because:

1. profit motivation (rather than political interests), in the face of competition, drives enterprises to produce goods and services efficiently and cost effectively;

2. Unlike their counterparts in the public sector, private entrepreneurs bear the financial consequences of inefficiency and hence have greater incentive to ensure that business ventures succeed;

3. private enterprises have greater capacity to shed surplus labor, to expand a labor force in response to market signals, or to restructure factors of production, as necessary to optimize economic efficiency.

The concept of private-sector led growth is a tenet of A.I.D. strategic policy embodied in the Partnership for Business and Development Initiative (December 1990). A.I.D.'s "systemic commitment to private enterprise as the key vehicle to help emerging countries improve their economic performance" is made explicit in that policy initiative.

II. Conditions for Private Sector-Led Economic Growth

For private entrepreneurs to be able to apply their ingenuity toward efficient production and distribution, a competitive and largely unrestricted business environment has to be allowed to exist. Many studies stress the need for the establishment of basic economic conditions in order for the private sector to participate fully in the development process. These conditions are:

1. Competitive Environment: The government must help create an overall business environment in which for-profit private entrepreneurs compete with each other to produce and market goods and services in the most efficient manner. The government must formulate development strategy and enact laws and regulations that are designed to enhance competition among business entities. In addition, government ideally plays the role of fair and impartial arbitrator in resolving disputes between businesses.

2. Appropriate Economic Policy: A competitive business environment must coincide with economic policy that is designed to promote the efficiency of factor mobilization. Development experience shows that the best means of achieving the ideal set of economic policies is to let market forces determine price levels. Thus, market forces in the product market should decide prices of products; market forces in the financial market should set the price of money (interest rates); similarly market forces in the foreign exchange market should determine the exchange rate; and so on.

3. Infrastructure Investment: In order for the private sector to be the engine of growth, the government must also provide basic infrastructure that cannot be efficiently provided by the private sector, i.e., investment in roads and highways, air and sea ports, telecommunication facilities, reliable power supply, national defense. In addition, human infrastructure investment must be carried out to improve labor productivity and job opportunities.

Although analysts differ in their views as to which infrastructure investments should be provided by the government and which should be borne by the private sector, there is no disagreement about the need for adequate infrastructure development if the private sector is to become the prime mover of the economy.

4. Political Stability: Finally, political stability is a pre-requisite for private entrepreneurs to invest in a given country or to expand existing economic activities there. This is especially true of long-term private investment. Without political stability, private investors will opt for short term profits at the expense of long term returns. Under such circumstances, no sustained growth is likely to take place.

In the real world, no developing country has been successful in providing all the ideal business conditions. Only Hong Kong and possibly Taiwan have come close to creating the ideal conditions. Some economies were deficient in creating a competitive environment, whereas others failed to establish prices that were good approximations for market prices. Still others were beset with political instability, resulting, at best, in the continuation of an economic status quo, with few prospects for sustained growth.

The economic rationale for private sector-led growth is based on a conviction that the most efficient growth path is achieved by creating an ideal business environment through the establishment of competition, appropriate policy setting, functioning infrastructure, and stability.

Developing economies that have succeeded in approximating the ideal business environment have been rewarded with sustained growth over a long period of time and eventual graduation from the ranks of underdeveloped countries.

III. A Brief Background on the Philippine Private Sector

The modern Philippine economy was developed on the basis of agricultural commodities. The Philippines was competitive in the world market in the production of coconuts, sugar, tobacco, pineapple, and other agricultural commodities, earning sufficient foreign exchange for imports of manufactured products. Since these products were mostly produced for the world market, the scale of operation became important to stay competitive. As the scale of operation became larger, a wealthy landowning class emerged to form a politically powerful group. The landowners were also the most highly educated intellectual elite of the society.

After World War II and subsequent independence, Philippine leaders realized the importance of industrialization. The government decided to develop industry based on an import substitution strategy, a model of development strategy adopted by practically all developing countries in the 1950s. High tariff walls were erected to shield fledgling domestic industries from foreign competition. To encourage domestic investment, interest rates were kept low, foreign exchange was undervalued to encourage capital goods imports, and entry of foreign investors was made difficult or outright prohibited to safeguard domestic investors. In the initial stage, the development strategy worked quite well. Investment increased rapidly, previously imported consumer goods were replaced by domestically produced goods, high-paying industrial jobs were created, managerial and white collar middle income classes emerged to project an image of industrial development, and the national income increased at a satisfactory pace, albeit with fluctuations.

However, Philippine industrialization during the Marcos years was highly centralized and controlled. Government became a dominant presence in many businesses in the economy - from the provision of public services to the establishment of parastatal agricultural monopolies and large government owned and controlled corporations.

The result of Government interventionism, over time, was inefficiency in the use of resources; wasteful use of foreign exchange; heavy resource burdens on government coffers; depletion of renewable natural resources; creation of economic rents for a privileged few; and, more importantly, general constraints imposed on the expansion of private sector initiative and productivity.

One illustration of the cost of government involvement in business was the drain imposed on budgetary resources. The annual budgetary support to public enterprises consisting of budgetary transfers, equity contributions and net lending from government traced an increasing pattern from 5 percent of national government budgetary expenditures in 1975 to a peak of 30.7 percent in 1984. With the proliferation of public enterprises, the government was forced to nearly empty its coffers to subsidize them. The average fiscal burden from 1975-1986 was 1.2 times the budget deficit. The national government would have posted budget surpluses during those periods if there were no budgetary support requirements for government enterprises.

Weaknesses of the import substitution strategy in the Philippines were also readily apparent. The limited size of the domestic economy led to the disappearance of investment opportunities. The protected industry became capital intensive, due to low interest rates relative to wage levels; and industrial products were generally high priced and low quality. Thus, the protected industry was not competitive in the world market. As a consequence, the industrial sector became a foreign exchange user rather than a foreign exchange earner and industry became dependent on agriculture for its foreign exchange needs.

Agriculture was not able to supply all the foreign exchange needed by industry, because under-valued foreign exchange and low agricultural prices did not provide sufficient incentives to increase investment and production for exports. In addition, because of wide price fluctuations in the world market for agricultural commodities, agricultural export earnings were highly cyclical, with periods of feast literally followed by periods of famine.

Foreign exchange availability was exacerbated by a generally downward trend in world demand for many of the Philippines' agricultural products and by the oil shocks of the 1970s. When foreign exchange shortages occurred, the Philippines resorted mainly to short term solutions, i.e., external borrowing which led to subsequent debt payment crises. When the government tried to improve the efficiency of the industrial sector and to encourage domestic competition, powerful vested interest groups lobbied effectively to thwart the government's initiatives.

An important outcome of the inefficient economic structure is that the economy was unable to create a sufficient number of productive jobs in industry, while population increased unabated. The conjuncture of these two factors resulted in a large unemployed population that, paradoxically, was adequately educated and trainable. To make matters worse, many rural dwellers migrated to cities in search of jobs and because of the lure of city living, creating social problems as well as overburdening existing infrastructure.

Yet in spite of these endemic problems, persisting through the 1970's and early 1980's, the Philippines also harbored a small segment of the private industrial sector that was vibrant and highly efficient, although often not fully integrated into the local economy. These entrepreneurs produce labor intensive manufactured goods and services utilizing factors of production in which the Philippines has comparative advantage, i.e., an inexpensive but well educated labor force. Following the change in government in 1986 and policy adjustments that began to reverse the anti-business bias of the Marcos years, certain dynamic entrepreneurs began to respond to market incentives and produce world-class products for export.

In areas such as electronics, niche production and private sector initiatives have been rewarded by a nearly three-fold increase in exports from 1985-1989 ($600 million to $1.6 billion). During the same period, exports of finished clothing have jumped from $1 billion to $1.7 billion (World Bank, 1990).

This segment of the private sector which may be called "outward-looking", as opposed to the "inward-looking" protected segment, represents an increasingly significant force for constructive social and economic policy change.

IV. A Description of the Private Sector

Very little cross-sectoral data exist on the composition and scope of private sector activity in the Philippines. Taken in its broadest sense, the private sector can be defined as all economic contributors that are not part of the formal public sector.

Using that definition, it is increasingly apparent that, since 1986, the private sector has come to dominate the production of goods and services in the Philippines. In 1987, government services accounted for 5.5% of GDP, and government expenditures were around 19%. By 1990, those figure were reduced to 2.5% and 12% respectively, indicating a strong shift away from government participation in the economy.

Parastatals, i.e. government-owned or controlled corporations (GOCC) numbered about 299 in 1990 of which only 70 are planned to be retained. The remainder will be either abolished, consolidated or privatized. Although in some sectors, such as finance, aviation and oil, the GOCCs remain quite important, in aggregate, they account for only about 2% of GDP.

The government also owns or controls the assets of government financial institutions, some of which were acquired through loan default on the part of private owners or represent the sequestered assets of Marcos-era cronies. Privatization of these assets, especially the acquired or sequestered assets, is proceeding rapidly. Of 399 acquired assets in 1986, 76 have been fully privatized.

An analysis of the private sector shows a wide disparity between the development of large firms and small enterprises, with a largely insignificant category of medium-sized enterprises. Large firms consist of only two percent of the total number of registered industrial firms, but account for more than half of total employment in the formal sector. The predominant small and micro businesses in the country mostly consist of off-farm private enterprises.

The slow growth and inability of small scale enterprises to graduate into the medium size category can be traced to the long-standing policy and regulatory constraints which favored the development of large, capital-intensive firms while creating serious biases against labor-intensive small and medium enterprises.

Large private enterprises are mostly engaged in manufacturing activities. They are predominantly capital-intensive firms with import substituting production. Most of them have low capital and labor productivities, with their overall economic inefficiencies preventing them from absorbing a large proportion of surplus labor from the agricultural sector.

This pool of surplus labor has contributed, particularly in urban areas, to an explosive growth of "informal sector" enterprises. Such enterprises are usually unregistered, unregulated, and out of reach of government extension and promotional services. Many of these enterprises operate on a subsistence basis and provide only marginal employment. Estimates of the contribution of the informal sector to GDP range from 40 to 60 percent.

Awareness of the large role that informal businesses play in the economy is moving government to adopt legislation such as the Kalakalan 20 and the Magna Carta for Small Businesses. Both aim to remove barriers to growth for informal businesses and to provide better access to services available through formal channels.

The strong partnership of both local and foreign investors is another distinguishing mark of the Philippine private sector. Private foreign investments have supplemented limited domestic savings in increasing the economy's capital stock and adding to national output and income.

During 1989, domestic private investments registered with the Board of Investments were valued at $1 billion. At the same time private foreign capital inflow was estimated at $0.8 billion. In terms of total investments in the Philippines, Americans and Japanese investors have the largest stakes in the economy. In terms of sectoral distribution, the prepondereance of private investments is in the manufacturing sector.

For conceptual purposes, the private sector in the Philippines can thus be divided into three distinct categories*:

1. Inward-looking enterprises, founded during a prolonged period of protectionism. Ownership of this segment is highly-concentrated, politically powerful, and opposed to policy initiatives that would serve to open domestic markets to competitive forces.

2. Outward-looking enterprises, that use a relatively more efficient mix of factors of production to maintain competitiveness in niche markets. These enterprises have managed to co-exist with their politically powerful compatriots by working at the margins of production possibilities in areas where they are not directly threatening to entrenched interests.

3. Informal sector enterprises, that extend the concept of niche marketing to its socio-economic and geographic extreme, by providing marginally-profitable goods and services to the poorest segments of the urban and rural population. These enterprises manage to co-exist with their politically powerful compatriots by avoiding detection where possible and paying bribes when necessary.

A. Constraints to Private Sector Growth

The capacity of the Philippine private sector to expand and prosper, particularly in international markets, is being hampered by a host of economic and political factors. Some of these constraints are policy related, and contribute to a prevailing economic environment that is not conducive to private sector initiatives (Section II, conditions 1, 2, and 4). Others relate to infrastructure investment (condition 3).

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* As with any economic model, this description of the Philippines private sector oversimplifies the breadth and diversity of economic actors, some of which combine characteristics of more than one segment. Others do not fit neatly into any of the three segments described above. It is presented here for analytical purposes and to provide a conceptual framework for the discussions which follow.

1. Political Uncertainty

Chief among constraints to private sector initiatives and investments is the political uncertainty created by attempts of various factions, including Marcos loyalists, communists and right wing military rebels, to overthrow the government. The instability resulting from these external threats to the political regime is compounded by in-fighting between the Philippine Congress and the executive branch and within the executive branch itself, over virtually any proposal for substantive policy change.

The lack of an internal consensus has cast doubts on the overall ability of the government to encourage and protect investments and initiatives from the private sector, as well as to uphold commitments to deliver basic social services supporting the private sector. The net result of political uncertainty is higher perceived risk, and a general impression that the Philippines presents a less attractive environment for foreign investment than alternative sites in Asia and elsewhere.

2. Anti-Business Trade and Investment Policies

Despite the repeated vows of the Aquino government to shift trade and investment policies away from those favoring regulatory, rent-seeking and government-led approaches, much remains to be accomplished to help foster economically rational private sector activity.

Certain existing policies are highly counterproductive to economic development through private sector initiatives. The overvalued exchange rate penalizes exports and depresses domestic prices of agricultural output. Heavy and uneven tariffs allow for the perpetuation of inefficient and capital-intensive industry. Heavy domestic borrowing by government to finance a chronic budget deficit leads to excessively high interest rates and crowds out financing for productive private sector (and employment generating) investment.

3. Cronyism

The inordinate influence of an entrenched group of politically powerful industrialists inhibits domestic competition. Insufficient regulation and inadequate enforcement of existing monopoly laws have contributed to the growth of protected special interests with little incentive to maximize efficiency. Worse, rampant cronyism has led to a pervasive view that the system is rigged - that legal, regulatory and financial systems operate to protect the interests of the landed elite who have the right "connections". This perception effectively stifles entrepreneurial initiatives of those who are not so well-connected. Moreover, lobbyists for protected industries have successfully obstructed progressive trade and investment policy reforms that would serve to open the Philippine economy to market forces and enhanced competition.

4. Inadequate Supporting Institutions

Heavy centralization of government functions and decision making processes has prevented the expedient delivery of infrastructure and basic social services required to support private sector activities.

Inefficiencies in the provision of government services lead to increased costs in terms of bureaucratic delays and create opportunities for graft and corruption.

Centralized agricultural marketing boards have over-regulated and inconsistently intervened in agricultural markets. This, when combined with poor transportation and communication systems, has resulted in exceptionally high marketing costs and opportunities for price fixing by unscrupulous middlemen. An inefficient Board of Investment with an unclear mandate has resulted in uncertain discretionary interpretation and implementation of investment policy, making the investment climate more unpredictable and risky than it would otherwise be. Incomplete liberalization of financial markets permits continued bias in the credit allocation for industry, weak market institutions and inadequate credit resources available for private investment.

5. Inadequate Infrastructure

A lack of well maintained roads and inadequate services at ports seriously impede both essential import and export activities. Inadequate telecommunication facilities discourage private foreign investments, particularly in remote areas of the country. Power outages and noncompetitive rates also inhibit foreign investment inflows and cause high operating costs for existing businesses.

Private investment in infrastructure has been limited by the delay in the issuance of implementing rules governing private sector participation; by inadequate incentives for private investors; and by stringent rules constraining foreign participation in infrastructure development.

B. Impact of Constraints on Private Sector Segments

Prevailing policy and infrastructure constraints on private sector activity have had markedly different impacts on the three segments of the private sector identified earlier.

1. The In-Ward Looking Segment

The inward-looking segment of the Philippine private sector has benefitted from protectionist policy to accumulate enormous wealth without taking commensurate risk. This segment has created loose political associations, inter-locking directorships and interest groups whose main purpose is to ensure the maintenance of the protected system. Inward-looking industrialists can be expected to oppose and obstruct political change that would serve to enfranchise a broader cross-section of the private sector and open the Filipino economy to increased levels of competition (e.g. reducing tariffs and/or quantitative restrictions on imports, liberalizing foreign investment).

This segment would benefit from improved economic infrastructure and service delivery, but to a lesser extent than other segments of the private sector insofar as they are currently able to exploit their privileged status to circumvent onerous bureaucracy and attain a disproportionate share of scarce resources.

2. The Out-Ward Looking Segment

The outward looking segment engages in niche production and marketing to produce goods and services that are potentially competitive in the world market. They are obliged to be extremely responsive to changing market signals and to maximize efficiency in the use of factors of production.

This segment can be expected to support constructive policy change that would serve to unfetter and deregulate the markets. The nature of their production in areas such as textiles, garments, electronic assembly, wood products, toys, ceramics, fishery products, etc., is highly flexible and labor intensive. The prospects for open market competition would thus be far less threatening to this segment than to the inward-looking industrialists who produce capital-intensive manufactured goods inefficiently (read non-competitively).

Improved access to credit, to streamlined delivery of services, and to improved infrastructure would enable this segment of the private sector to capitalize on their existing efficiency and profit orientation to expand production into areas from which they are presently excluded, for cost or regulatory reasons. Selectively channeling resources to outward-looking entrepreneurs who have historically been constrained by distortions in the allocation of public goods, would ostensibly elicit a very strong response in terms of production and employment growth.

3. The Informal Segment

The informal sector, defined as economic activity conducted outside and in defiance of state laws intended to regulate it, exists because the formal system of governance is deemed to be onerous. Informal sector entrepreneurs react to restrictive national policy by eluding, circumventing or ignoring it. Changes in the policy environment that would reduce the exposure of informal sector entrepreneurs to the vagaries of inappropriate regulation would permit greater economic efficiency. Resources expended to avoid detection or pay economic rents could then be more productively applied to expanding production and generating increased marginal employment.

Informal sector enterprises are typically small. They produce and sell their goods or services within a relatively limited geographic radius. Infrastructure constraints that impede the production and marketing of the other segments of the private sector are less problematic for informals. In fact, much informal activity (e.g. urban transportation) is a creative market response to inadequate infrastructure. However, any negative repercussions of improvements in infrastructure that might impinge upon informal sector activity would be offset, to a degree, by jobs created in the formal sector. Experience has shown that as formal sector job creation accelerates, informal sector employment diminishes proportionately.

V. USAID Private Sector Strategy

A. Orientation

The USAID private sector strategy seeks to make all segments of the private sector efficient and competitive in an open world market. Near-term objectives of the strategy are: 1) to reduce or eliminate economic policy constraints; 2) to encourage rapid growth of outward-looking private exporters through a process of deepening and widening their exports; 3) to improve the efficiency and competitiveness of inward-looking producers by contributing to the progressive elimination of protectionist policies; 4) to assist struggling informal sector enterprises to improve productivity and to become an integral part of the economy; and 5) to help meet the requirements of private sector enterprises for improved transportation and communication services.

To carry out these objectives, the Mission implements a number of programs and projects and conducts policy reform dialogue with the GOP, aimed at specifically addressing constraints to and the needs of the private sector. USAID's strategy for the private sector cuts across all of the Mission's technical offices and is coordinated through the Private Enterprise Support Office (PESO) to ensure that each intervention addresses the needs of the private sector to the maximum extent possible, and fits within the global Mission strategy to encourage private sector driven economic growth.

There are two themes in the application of the Mission's private sector strategy. The first theme is to encourage and promote the outward-looking segment of the Philippine private sector to grow faster than the inward-looking segment, and eventually to dominate the Philippine economy.

Second, is an emphasis on getting government out of the business of running businesses.

B. Implementation

USAID will implement its private sector strategy in two ways: by helping to shape a policy environment that is conducive to economic efficiency; and by channeling resources directly to private sector firms and associations that have the potential to increase production, generate economic growth and create higher levels of employment.

1. Contributing to a Pro-Business Policy Environment

At the forefront of USAID efforts to improve the business climate are various policy-based assistance programs. USAID continuously lobbies for a supportive macro-economic framework necessary for market-oriented, private sector-led growth. The Mission has successfully influenced reforms in support of:

-a market-oriented foreign exchange policy;

-maintenance of sufficient levels of international reserves;

-restraint on national government deficit and public sector borrowing;

-monetary responsibility consistent with growth; and

-price and external stability through limits set on growth of money supply and domestic liquidity.

USAID also encourages a more open and competitive economy conducive to private investments and expanded trade opportunities. Since 1987, USAID has been encouraging the GOP to expedite its liberalization of import restrictions on many commodities and to lower its high tariff walls. Similarly, USAID has supported administrative reforms and the simplification of investment rules.

The Mission continues to pursue with the GOP a reduction of government regulations over private businesses, as in the granting of fiscal incentives, inter-island shipping rate controls and route franchising, and foreign investment administration.

Among other economic policy initiatives that USAID has supported through policy dialogue and project assistance is the privatization of Government owned and controlled corporations (GOCC's). Privatization increases the quality of goods and services available in the market while at the same time making them more responsive to consumer needs and demands. Privatization also facilitates the adoption of competitive markets, relieves the resource burden on government by ending costly subsidies necessary to keep inefficient parastatals afloat, and frees up limited government resources for more productive undertakings such as effective delivery of basic services and infrastructure.

Policy dialogue and program leverage are crucial to the implementation of the Private Sector Strategy, not only because they serve as a means of influencing appropriate policies but also because they enhance the economic efficacy of other forms of USAID assistance to the Philippines. Without policy reforms, the physical as well as the socio-economic impact of USAID projects would be undermined and the prospects for sound long-term growth would be diminished.

a. Sector-Specific Policy Initiatives

Agricultural policy reform efforts focus on commodities deregulation, rural financial sector reform, and basic grains price stabilization. These policy initiatives are aimed at improving agricultural productivity and increasing agricultural incomes through the provision of correct (market-based) price signals.

The USAID agriculture and natural resource strategy calls for accelerating private sector-led investment in agriculture and improving national food security through increased reliance on open market mechanisms and agribusiness development.

In a similar vein, the Mission strategy for population, health and nutrition fosters private sector participation in the sector by working with government to help shift preventative health care services from public to private sector delivery mechanisms. USAID also encourages efficiency in the provision of family planning and nutrition services by de-emphasizing the role of government wherever practicable.

Health sector strategy supports the inclusion of the private for-profit and non-profit sectors in area health planning and utilization of the private sector to promote appropriate health behavior. In family planning, social marketing and other private sector mechanisms, such as workplace and NGO-provided services are being emphasized to expand services delivery.

Infrastructure support projects are designed to serve the needs of expanded private sector activity and future growth. Adequate infrastructure, such as secondary and tertiary roads, air and waterway linkages and telecommunications are necessary to facilitate the development of open markets. Sector strategy focuses both on relieving infrastructure constraints on private sector development and on getting the private sector to play a greater role in the creation of supporting infrastructure. Mixed credit financing of private sector investment and the promotion of build-operate-transfer mechanisms are two means by which the Mission will help mobilize private sector investment to supplement and displace government as the primary source of financing for capital projects.

2. Channeling Resources to and through Private Sector Entities

The Partnership for Business and Development Initiative encourages A.I.D. missions to involve a broad base of private sector participants (particularly the local American business community) in the elaboration and implementation of private sector support activities. USAID will continue to foster an active, consultative, and mutually-supportive relationship with business organizations in the Philippines and will engage such organizations, where practicable, in the implementation of specific project activities.

USAID views the private sector as both a beneficiary of development efforts and as an agent of change. To achieve sustainable growth, an open economy and an open society, the private sector plays the critical productive role; in turn, progress toward these ends means increased business opportunities for the private sector.

USAID will continue to provide direct assistance to the private sector through project activities designed, inter alia, to:

-accelerate private investments and trade;

-encourage private sector credit programs;

-improve the private sector skills base through technical and managerial training.

USAID will continue to directly support the development of private sector business groups and NGOs to strengthen the voice of the private sector. Through co-financing, USAID will support community development work of private companies. USAID will also provide technical assistance and financial support for private institutions which support private enterprise activities, i.e., chambers of commerce, foundations, private research organizations and trade associations.

C. Segmentation

As previous sections indicate, the private sector can be divided into three broadly distinct segments. The Mission uses a mix of projects, programs and policy dialogue mechanisms to help improve the competitiveness and efficiency of each. However, these mechanisms have different purposes depending upon the specific characteristics of the private sector actors and are intended to impact differently on each segment.

1. Outward-looking Firms

The Mission's strategy for improving the efficiency of "outward-looking" firms is to take an active and direct supporting role.

For small and medium outward-oriented firms, USAID will provide project and program assistance to promote trade and investment, improve product quality, improve access to financing, help eliminate superfluous regulation and improve the marketing of Filipino products overseas.

Policy dialogue will focus on enhancing the export competitiveness of this segment through foreign exchange liberalization, improved financial mediation and access to trade credits and tariff restructuring and rationalization for imported inputs.

While the policy reforms described above will benefit large and small firms alike, the principal beneficiaries of the Mission's efforts will be the majority of outward-looking firms that are in the category of small and medium sized enterprises. Such firms will benefit, particularly, from the improved access to trade information and brokerage services made available through project assistance mechanisms and from a reduction in regulatory and administrative burdens to be leveraged through a combination of project-funded research, continuing policy dialogue and program assistance, as appropriate.

Financial market reform, to be supported through both project and program assistance modalities, will contribute to the achievement of the overarching objective of attracting new investment and putting existing investments to better use.

Small and medium scale enterprises will have improved access to credit through the intermediary of USAID projects that specifically target these beneficiary groups.

2. Inward-looking Firms

Conversely, the private sector strategy vis-a-vis inward-looking firms concentrates on the identification and progressive elimination of policies that shelter such firms from the rigours of the marketplace and perpetuate protectionism.

A central approach to strategy implementation involves engaging the government in policy dialogue to encourage the removal of policies constraining competition. To improve prospects for leveraging substantive policy changes, the Mission coordinates its policy dialogue efforts with those of other donors and seeks to identify specific areas where the Mission can make a difference.

At the macro-economic level, the Mission encourages the creation of a competitive business environment through: 1) reducing effective rates of protection; and 2) liberalizing foreign investment. The Mission will also encourage exchange rate reform to improve the export competitiveness of all Philippine exporters.

At the microeconomic level, the Mission will encourage competition and transparency by leveraging adjustments in the pricing structure and administration of controlled services and commodities - where such prices are not yet determined by market forces. Inter-island transportation rates, for example, may require more rapid and efficient adjustments in response to changing external circumstances. Similarly, the basic grain prices should be allowed to more closely approximate equilibrium market levels. Minimizing the administration of prices will reduce opportunities for windfall profits and rent seeking behavior, ultimately opening the market to a greater diversity of suppliers or producers and improving their collective efficiency.

Changes in protectionist policies, however, will not come easily. The GOP, while acknowledging the need for reform, faces strong opposition from those who have benefitted from the protectionist regime. Performance-based cash disbursements to the GOP, through programs designed to help offset political resistance, are a critical element of the private sector strategy that seeks to counterbalance the disproportionate influence of entrenched inward-looking enterprises.

3. Informals

In a perfect economy, informals would not exist. However, in a real world environment, USAID's immediate objectives are to improve the productivity of the informal sector by identifying and removing constraints to the efficient use of resources within informal sector enterprises.

This strategy is implemented in two ways:

On a transactional level, community development projects implemented through NGOs assist in improving the economic viability of some informal businesses. USAID lends funds, through existing private voluntary organizations, to improve the welfare of microenterprises. The ultimate objective of these transactional activities is to generate increased employment and improve competitiveness, to the point where informal enterprises can bear the perceived costs of entry into the outward-looking segment and reap the advantages of formality.

On a policy level, USAID will promote research and advocacy efforts, complemented by policy dialogue and program assistance, to help ensure that burdensome governmental regulations are changed to reduce constraints to economic efficiency. USAID will further seek to improve the capacity of indigenous research and advocacy groups to identify and influence appropriate policy or regulatory reforms on a continuing basis.

VI. Conclusion

Private enterprises do not constitute a sector in themselves, but rather a development channel available to all sectors. Private sector health, agriculture and infrastructure support activities, among others, offer A.I.D. and the Philippines a vehicle for leveraging accelerated sustainable economic growth.

In the private sector strategy, USAID seeks to influence the government on the policy level to remove the remnants of state capitalism. In its place, the Mission seeks to guide the adoption of market-oriented policies. The bulk of program assistance funds made available to the GOP across all sectors are released against performance on policy reform matrices that favor open markets and private sector-led growth through accelerated trade and investment.

This policy-oriented approach, on both macro and sector-specific levels, is balanced by focused transactional projects that use innovative mechanisms to channel USAID's bilateral development resources (DA, ESF, MAI) directly to the for-profit business communities, both Filipino and American.

In partnership with business, USAID is able to leverage its impact by having the private sector cost share activities. USAID can also provide assistance to businesses, individually or collectively, to accelerate their response to policy reforms enacted by the GOP.

Within the context of an open markets policy approach, USAID is evenhanded in its relationship with the private sector. Project activities are designed for the most part to be inclusive; that is, to accommodate business opportunities for enterprises that are small or large, urban or rural.

Using the American business community in collaboration with their Philippine counterparts, USAID is mobilizing the market place for development in the mutual interest of both the Philippines and the United States.