Philippines
Economic Performance Assessment

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DISCLAIMER

Sponsored by the Economic Growth office of USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT), under Contract No. PCE-I-00-00-00013-00, Task Order 004, the Country Analytical Support (CAS) Project, 2004–2006, Nathan Associates Inc. developed a standard methodology for producing analytical reports to provide a clear and concise evaluation of economic growth performance in designated countries receiving USAID assistance. The reports are tailored to meet the needs of USAID missions and regional bureaus for country-specific analysis. Each report contains:

— A synthesis of key data indicators drawn from numerous sources, including the World Bank, the International Monetary Fund, the Millennium Challenge Corporation, the United Nations, other international data sets, and host-country documents and data sources;

— International benchmarking to assess country performance in comparison to similar countries, groups of countries, and predicted values based on international data;

— An easy-to-read analytic narrative that highlights areas in which a country's performance is particularly strong or weak, to assist in the identification of future programming priorities.

— A convenient summary of the main findings, in the form of a Highlights Table and a Performance Scorecard (in lieu of an Executive Summary)

Under Contract No. GEG-I-00-04-00002-00, Task Order 004, 2006-2008, Nathan Associates continues to provide support to the EGAT Bureau by producing analytical reports evaluating economic growth performance in designated host countries. Through the same task order, Nathan is also developing a special template for countries emerging from crisis, assessing data issues in countries with large gaps in their data; conducting in-depth sector reviews based on the diagnostic analysis in the country reports; and providing other analytical support to the EGAT Bureau.

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Subject to EGAT consent, electronic copies of reports and materials relating to the CAS project are available at www.nathaninc.com. For further information or hard copies of CAS publications, please contact:

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HIGHLIGHTS OF THE PHILIPPINE'S PERFORMANCE

Economic Growth	Real GDP has grown by 5.2 percent per year over the past five years, despite a low investment rate. Investment productivity, however, has been very good.
Poverty	The incidence of poverty is high compared to those of other lower-middle income countries, but the most serious problem is severe inequality.
Economic Structure	The service sector accounts for 53.7 percent of GDP, with industry and agriculture generating 32.1 percent and 14.2 percent, respectively. But more than one-third of the labor force still depends on agriculture—at very low levels of productivity.
Demography and Environment	The population is growing at a relatively rapid rate of 2.0 percent per year. The country is highly urbanized and has a high concentration of people in coastal areas. Major environmental problems include poor urban air quality and depletion of fishery stocks.
Gender	The Philippines has achieved gender equality in the basic economic indicators, with the notable exception of a very low labor force participation rate for females.
Fiscal and Monetary Policy	The fiscal reform program shows strong signs of progress, through a combination of expenditure restraint and revenue enhancement. But the revenue yield is still low, which constrains the government's ability to deliver critical services and public investments.
Conflict Status	The sporadic conflict in the south clearly impedes development of that region and therefore dampens national growth. Major sources of conflict risk include regional grievance, economic disparity, weakness in government legitimacy, and factionalized elites.
Business Environment	On most business environment indicators, the Philippines is about average compared to the benchmarks. By global standards, however, the private sector faces major impediments to doing business. The foremost problem is corruption.
Financial Sector	Financial sector indicators are mixed. There are notable weaknesses in the banking sector, including very low levels of credit to the private sector. But stock market capitalization is strong, signaling investor confidence.
External Sector	The economy is open; export growth is solid, if unspectacular; and remittances are high. The current account is in surplus, and there is pressure for strengthening of the peso.
Economic Infrastructure	Infrastructure quality is generally poor, constituting a serious constraint for investors and a drag on competitiveness. Roads and ports, in particular, need attention.
Science and Technology	The Philippines benefits from technology transfer from FDI, but weak intellectual property protection and a limited supply of science and technology professionals suggest that more emphasis is needed to foster homegrown technology capacity.
Health	Although life expectancy is now more than 70 years, there are serious problems with maternal health care, child nutrition, and child inoculation. These problems reflect low public expenditure on health as well as poverty and income inequality.
Education	Enrollment rates and youth literacy are high. But indicators such as the pupil–teacher ratio and expenditure per pupil suggest that the quality of education may be inadequate to meet the challenges of doing business in a competitive global economy.
Employment and Workforce	Unemployment is high but declining, while underemployment is high, and nearly eight million Filipinos have left the country for better job opportunities. Job creation is therefore a critical need. Yet labor market rigidities appear to hinder investment.
Agriculture	Labor productivity in agriculture is rising, but greater efforts are needed to increase rural incomes through land and pricing policies and infrastructure investment.

Note: The methodology used for diagnostic benchmarking is explained in the Appendix.

PHILIPPINES: NOTABLE STRENGTHS AND WEAKNESSES—SELECTED INDICATORS

Selected Indicators, by Topic	Notable Strengths	Notable Weaknesses
Growth Performance		
Real GDP growth	✔	
Investment productivity—incremental capital-output ratio (ICOR)	✔	
Gross fixed capital formation, percentage of GDP		✔
Poverty and Inequality		
Human poverty index	✔	
Income share of the bottom 20% of households		✔
Demography and Environment		
Population growth rate		✔
Youth dependency rate		✔
Urbanization Rate	✔	
Gender		
Girls' primary completion rate	✔	
Female life expectancy at birth	✔	
Labor force participation rates, female		✔
Conflict Status		
Uneven development		✔
Delegitimization of the state		✔
Fiscal and Monetary Policy		
Government budget balance	✔	
Government revenue, percentage of GDP		✔
Inflation rate	✔	
Business Environment		
Ease of doing business ranking		✔
Corruption perception index		✔
Time to enforce a contract		✔
Total tax payable by business		✔
Financial Sector		
Domestic credit to the private sector		✔
Interest rate spread	✔	
Stock market capitalization rate, percentage of GDP	✔	
External Sector		
Trade in goods and services, percentage of GDP	✔	
Remittance receipts, percentage of exports	✔	

Selected Indicators, by Topic	Notable Strengths	Notable Weaknesses
Current account balance	✔	
Inward FDI potential	✔	
Present value of debt, percentage of GNI		✔
Economic Infrastructure		
Roads, paved as percentage of total		✔
Quality of infrastructure—ports		✔
Internet users per 1,000 people		✔
Telephone density, fixed line and mobile	✔	
Science and Technology		
FDI technology transfer index	✔	
IPR protection index		✔
Health		
Life expectancy at birth	✔	
Maternal mortality rate		✔
Prevalence of child malnutrition, weight for age		✔
Public expenditure on health, percentage of GDP	✔	
Education		
Net primary enrollment rate (%)	✔	
Gross tertiary enrollment rate (%)	✔	
Persistence to grade 5, total		✔
Expenditure per pupil, secondary and tertiary	✔	
Employment and Workforce		
Rigidity of employment index		✔

Note: The chart identifies selective indicators for which the Philippines' performance is particularly strong or weak relative to benchmark standards, as explained in the Appendix. Details are discussed in the text. The separate Data Supplement presents a full tabulation of the data and international benchmarks examined for this report, along with technical notes on the data sources and definitions. The supplement is available at
http://www.nathaninc.com/projects/projectdetails.asp?pid=138&pfid=0&rpid=4&rid=9

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1. Introduction

This report is one of a series of economic performance assessments prepared for the EGAT Bureau to provide USAID missions and regional bureaus with a concise evaluation of key indicators covering a broad range of issues relating to economic growth performance in designated host countries. The report draws on a variety of international data sources[1] and uses international benchmarking against reference group averages, comparator countries, and statistical norms to identify major constraints, trends, and opportunities for strengthening growth and reducing poverty. This study uses two other large, lower-middle income countries in the same region, Indonesia and Thailand, as comparators. Indonesia provides a good baseline for direct comparison, whereas Thailand represents an aspiration. In addition, the Philippines' performance is compared to median values of other lower-middle-income (LMI) countries.

METHODOLOGY

The methodology used here is analogous to examining an automobile dashboard to see which gauges are signaling problems. Sometimes a blinking light has obvious implications—such as the need to fill the fuel tank. In other cases, it may be necessary to have a mechanic probe more deeply to assess the source of the trouble and determine the best course of action.[2] Similarly, the Economic Performance Assessment is based on an examination of key economic and social indicators, to see which ones are signaling problems. Some "blinking" indicators have clear implications, while others may require further study to investigate the problems more fully and identify appropriate courses for programmatic action.

The analysis is organized around two mutually supportive goals: transformational growth and poverty reduction.[3] Broad-based growth is the most powerful instrument for poverty reduction. At the same time, programs to reduce poverty and lessen inequality can help to underpin rapid and sustainable growth. These interactions can create a virtuous cycle of economic transformation and human development.

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[1] Sources include the World Bank, the International Monetary Fund, the Millennium Challenge Corporation, the United Nations (including the Millennium Development Goals database), the World Economic Forum, and host-country documents and data sources. This report reflects data available as of early February 2007.

[2] Sometimes, too, the problem is faulty wiring to the indicator—analogous here to faulty data.

[3] In USAID's white paper *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century* (January 2004), transformational growth is a central strategic objective, both for its innate importance as a development goal and because growth is the most powerful engine for poverty reduction.

Transformational growth requires a high level of investment and rising productivity. This is achieved by establishing a strong ***enabling environment for private sector development,*** involving multiple elements: macroeconomic stability; a sound legal and regulatory system, including secure contract and property rights; effective control of corruption; a sound and efficient financial system; openness to trade and investment; sustainable debt management; investment in education, health, and workforce skills; infrastructure development; and sustainable use of natural resources.

In turn, the impact of growth on poverty depends on policies and programs that create opportunities and build capabilities for the poor. We call this the ***pro-poor growth environment.*** Here, too, many elements are involved, including effective education and health systems, policies facilitating job creation, agricultural development (in countries where the poor depend predominantly on farming), dismantling barriers to micro and small enterprise development, and progress toward gender equity.

In countries such as the Philippines, which have experienced ongoing conflict, there is also an interaction between security conditions and economic performance. Overt conflict, or even the risk of serious conflict, can adversely affect growth; conversely, an end to conflict can deliver a peace dividend. In addition to conflict affecting the economy, economic conditions may either exacerbate or help to ameliorate security problems. Thus, it is useful to view economic performance in the Philippines through a conflict lens. Accordingly, this report includes a section on conflict risk.

The present evaluation must be interpreted with care. A concise analysis of selected indicators cannot provide a definitive diagnosis of economic performance problems, nor simple answers to questions about programmatic priorities. Instead, the aim of the analysis is to spot signs of serious problems affecting economic growth, subject to limits of data availability and quality. The results should provide insight about potential paths for USAID intervention, to complement on-the-ground knowledge and further in-depth studies.

The remainder of the report presents the most important results of the diagnostic analysis, in four sections: Overview of the Economy; Conflict Risk; Private Sector Enabling Environment; and Pro-Poor Growth Environment. Table 1-1 summarizes the topical coverage. The appendix provides a brief explanation of the criteria used for selecting indicators, the benchmarking methodology, and a table showing the full set of indicators examined for this report.

Table 1-1

Topic Coverage

Overview of the Economy	Conflict Status	Private Sector Enabling Environment	Pro-Poor Growth Environment
• Growth Performance • Poverty and Inequality • Economic Structure • Demographic and Environmental Conditions • Gender	• Social Indicators • Economic Indicators • Political and Military Indicators • Indicators of Capacities of the State	• Fiscal and Monetary Policy • Business Environment • Financial Sector • External Sector • Economic Infrastructure • Science and Technology	• Health • Education • Employment and Workforce • Agriculture

DATA QUALITY AND FORMAT

The breadth and quality of economic data collected for the Philippines is very good. The World Bank gave the Philippines an overall score of 83 percent in its 2006 Statistical Capacity Indicator Index, including a perfect score in data collection. Some issues remain, however, with the national accounts and balance of payments statistics. The IMF is particularly concerned with discrepancies between the expenditure and production figures that result in conflicting GDP growth figures. Also, the government is making progress to narrow the gap between the national data on trade and corresponding figures reported by the country's trading partners. These problems do not significantly affect the analysis in the present report.

2. Overview of the Economy

This section reviews basic information on the Philippines' macroeconomic performance, poverty and inequality, economic structure, demographic and environmental conditions, and indicators of gender equity. Some of the indicators cited here are descriptive rather than analytical and are included to provide context for the performance analysis.

GROWTH PERFORMANCE

The Philippines narrowly qualifies as a lower middle-income country according to the World Bank's classification. Per capita income for 2006 is $1,345 in current U.S. dollars[4], whereas the median per capita income for LMI countries worldwide is $2,397. Using the exchange rate to convert dollars to local currency, per capita income in the Philippines falls below both those of Indonesia ($1,581) and Thailand ($2,959). When the purchasing power parity (PPP) method is used, however, a different picture emerges: the Philippines (PPP$5,314) edges out Indonesia (PPP$4,753), but both still fall short of Thailand's PPP$8,877 per capita income. In addition, per capita income in the Philippines, by this measure is nearly equal to the median for LMI countries (PPP$5439). When these two approaches diverge, the PPP method is generally a better basis for comparing living standards (even though the World Bank uses an exchange rate method to place countries into income categories).

The Philippines has maintained a relatively stable pattern of growth since 2002. Between 2002 and 2006, GDP growth averaged 5.2 percent per year (Figure 2-1) and registered an estimated 5.4 percent in 2006. This is on par with the regression benchmark for a country with the Philippines' characteristics (5.6 percent). GDP growth in the Philippines has been outpacing GDP growth in Indonesia and Thailand (5.2 percent and 4.5 percent for 2005 and 2006, respectively), as well as the median for LMI countries globally (4.9 percent). If the Philippines continues with its reform program, the IMF predicts that GDP growth will accelerate to 5.8 percent in 2007,[5] putting the Philippines on track to achieve the Millennium Development Goal of eradicating extreme poverty and hunger by 2015.[6]
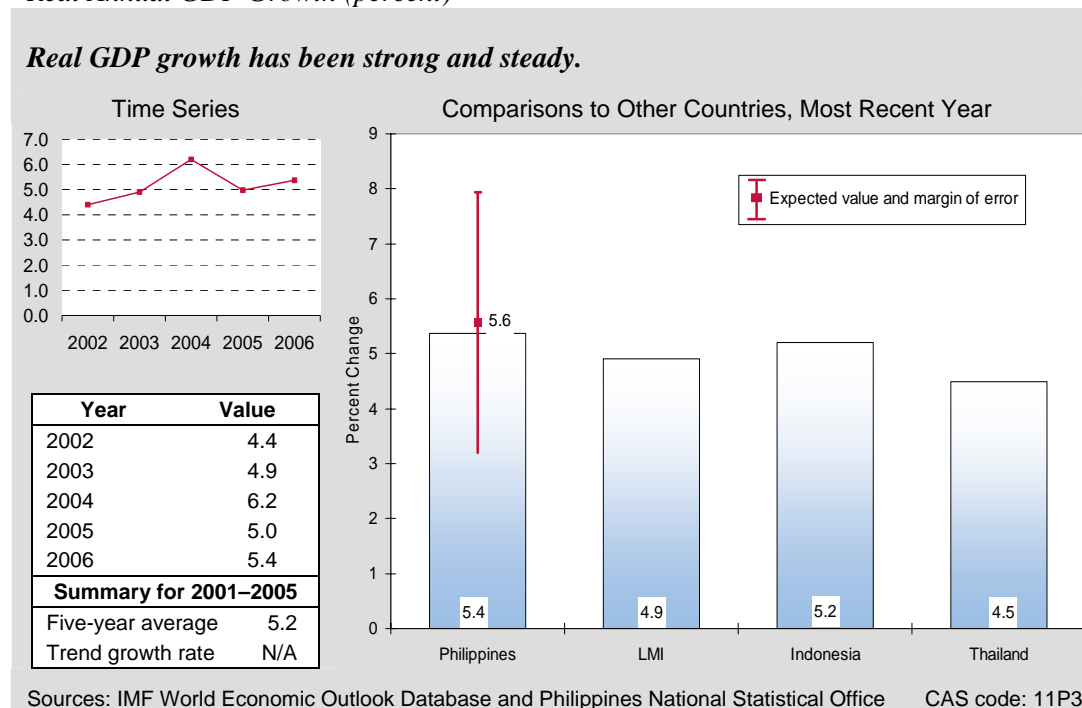
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[4] The 2006 per capita income in current US dollars for the Philippines is an IMF estimate.

[5] IMF, *Article IV Consultation—Staff Report*, February, 2007, 27.

[6] UNESCAP, *Financial and Other Key Resource Mobilization Issues in Implementing the Millennium Development Goal Target for Income Poverty,*1 September 2003, 8.

Figure 2-1
Real Annual GDP Growth (percent)

Real GDP growth has been strong and steady.

Time Series	Comparisons to Other Countries, Most Recent Year

Year	Value
2002	4.4
2003	4.9
2004	6.2
2005	5.0
2006	5.4
Summary for 2001–2005	
Five-year average	5.2
Trend growth rate	N/A

Comparison bars: Philippines 5.4 (expected value 5.6), LMI 4.9, Indonesia 5.2, Thailand 4.5. Legend: Expected value and margin of error.

Sources: IMF World Economic Outlook Database and Philippines National Statistical Office   CAS code: 11P3

The Philippines has achieved strong growth despite poor investment performance (Figure 2-2). Gross domestic investment fell from an already weak 17.6 percent of GDP in 2002 to 14.2 percent in 2006. This is considerably lower than the investment rates for LMI countries (22.4 percent of GDP), Indonesia (20.7 percent), and Thailand (29.0 percent). In the same period, the share of gross fixed private investment in GDP fell from 14.5 percent to an extremely low 11.8 percent.

The combination of solid growth with low investment indicates that the investment has been very efficient. This can be seen in the incremental capital-output ratio (ICOR), which averaged 3.9 over the five years to 2005, meaning that $3.90 of capital investment has been required to achieve an extra dollar of output. (A lower value for the ICOR indicates higher investment productivity.) By this gauge, investment efficiency in the Philippines is enviable compared to the benchmarks of Indonesia (4.2), Thailand (5.0), and LMI countries globally (4.9). In addition, the ICOR for the Philippines has improved (fallen) substantially compared to the 6.6 during the five years to 2002. This favorable trend signals that the economic reform program is delivering important growth benefits.

The improved investment efficiency isolates the rate of investment as the central hurdle to even stronger economic growth. By the same token, there is ample scope for achieving even more rapid growth if further reforms can be pursued to strengthen the business environment and boost investment. The analysis below shows that two of the most important problems dissuading potential investors are widespread corruption and poor infrastructure.

Figure 2-2

Gross Fixed Investment (percentage of GDP)

Weak investment is a central constraint on achieving even faster growth.

Time Series				
2002	2003	2004	2005	2006

Year	Value
2002	17.6
2003	16.8
2004	16.1
2005	14.9
2006	14.2
Summary for 2001–2005	
Five-year average	15.9
Trend growth rate	-5.3

Comparisons to Other Countries, Most Recent Year

Philippines	LMI	Indonesia	Thailand
14.2	22.4	20.7	29.0

Global Standing

Highest-five average: 35.1
PHI
11.1
Lowest-five average

Source: World Development Indicators 2006 and IMF Article IV   CAS code: 11S3

POVERTY AND INEQUALITY

During the 1990s, the Philippines made remarkable progress in fighting poverty.[7] The result is evident in the country's performance on the UNDP's Human Poverty Index (HPI), which measures the prevalence of deprivation in terms of life expectancy, literacy, access to safe water, and child nutrition. For 2006, the Philippines achieved an HPI score of 15.3. Since higher values indicate more serious poverty, this score compares favorably to the LMI average (17.1), and the score for Indonesia (18.5), though it is well short of Thailand's excellent score (9.3).

Nonetheless, the country's performance on poverty reduction in the early 2000s has shown mixed signs. On the one hand, the incidence of poverty, using the national poverty line, fell from 33 percent of the population in 2000 to 30.4 percent in 2003.[8] The percentage of the population lacking minimum dietary energy consumption also declined from 22 percent in 2001 to 18 percent in 2003,[9] reflecting a steady rise in the crop production index from 2000 to 2004 (see Agriculture, p. 36). On the other hand, the estimated population living on less than PPP$1 per

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[7] According to the *Family Income and Expenditure Survey* of 1997, poverty incidence fell from 49.3% of total population in 1985 to 40.6% in 1994 and 36.8% in 1997. The poverty line for the year 2000 was set at P13,823, or about US$470 at the exchange rate at that time.

[8] Data reported in the UNDP Human Development Report for 2006 show a different figure of 39.4 percent for the proportion of population below the national poverty line in 2000. No explanation could be found for the data disparity.
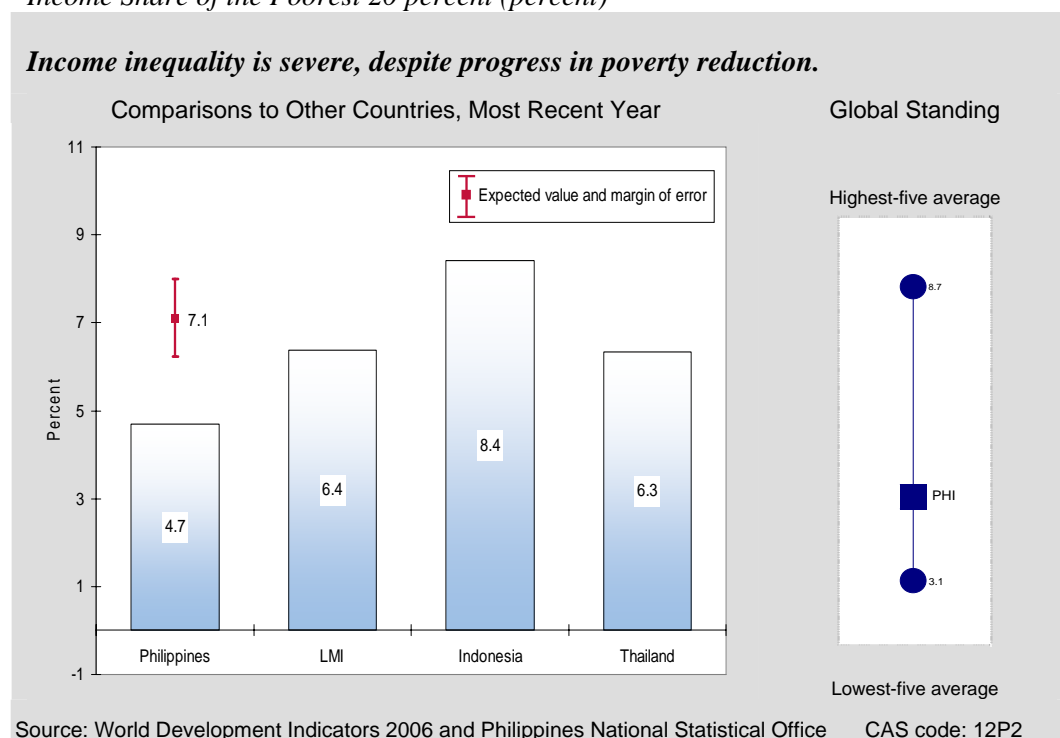
[9] This is the FAO's preliminary estimate for the percentage of population below the minimum dietary energy consumption for 2002-2004.

day, the international threshold for absolute poverty, has not shown any sign of reduction, with 15.5 percent falling below that threshold in 2000 and 15.6 percent in 2003.

Despite the evidence of declining poverty and the favorable HPI score, the highly inequitable distribution of income in the Philippines is a major cause for concern (Figure 2-3). In 2003, only 4.7 percent of income trickled down to the poorest 20 percent of the population. This is far below the regression benchmark of 7.1 percent for an economy with the Philippines' characteristics; it is also lower than the global average for LMI countries and the corresponding figures for Indonesia and Thailand (6.4 percent, 8.4 percent, and 6.3 percent, respectively, for 2002). Furthermore, the small income share accruing to the poorest 20 percent of the population appears to have fallen from 5.4 percent in 2000 to 4.7 percent in 2003.

Figure 2-3
Income Share of the Poorest 20 percent (percent)

Income inequality is severe, despite progress in poverty reduction.

Source: World Development Indicators 2006 and Philippines National Statistical Office   CAS code: 12P2

Regional poverty differentials are also important. For example, the 2003 Family Income and Expenditure Survey, a nationwide triennial household survey, found that the National Capital Region accrued the largest share of total income, 26.6 percent, while Caraga and the Autonomous Region of Muslim Minadanao (ARMM) posted the least with only 1.6 percent each.[10]

This high degree of income inequality poses a threat to sustainable growth. Equally important, inequality and rural poverty help to fuel the flames of conflict in outlying regions of the country

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[10] Data for regional poverty and income are obtained from the National Statistical Coordination Board, Philippines. The indicators and data are not included in the Appendix.

(see Chapter 3, Conflict Risk). These problems therefore merit serious attention by the government and its international partners.

ECONOMIC STRUCTURE

The economy is exhibiting a slow but steady structural transformation, broadly in line with international development experience. The service sector—which includes transport and communications, finance, private services, business process outsourcing, other information technology, and commerce—has been a leader; its share of GDP rose from 53.1 percent to 53.7 percent in the past five years (to 2006). Over the same period, industry's share of GDP rose marginally, from 31.8 to 32.1 percent. Agriculture has been the lagging sector, with a GDP share that declined by nearly a full percentage point, from 15.1 to 14.2 percent.

The economic structure in 2006 is very similar to the median for LMI countries globally. For that benchmark group, the corresponding figures are a 53.7 percent share of GDP for services; 31.7 percent for industry, and 12.0 percent for agriculture. In contrast, the regional comparators have followed a notably different structural path, with more rapid industrial development and a smaller share of output in the service sector. Specifically, industry accounts for 40.7 percent of GDP in Indonesia and 46.9 percent in Thailand—compared to 32.1 percent in the Philippines. But the service sector accounts for a much larger share of GDP in the Philippines (53.7 percent) than in Indonesia (45.3 percent) or Thailand (43.5 percent). As for agriculture, the GDP share in the Philippines is virtually the same as in Indonesia (14.0 percent), but considerably higher than in Thailand (9.6 percent).

These differences in economic structure are important because labor productivity is particularly high in manufacturing and very low in agriculture. This can be seen by comparing output shares to employment shares (Figure 2-4). In 2006, only 14.8 percent of the labor force was engaged in industry yet produced close to one-third of the economy's output. In comparison, 36.7 percent of the labor force is engaged in agriculture yet produces just 14.2 percent of GDP. This means that each job in industry produces nearly six times as much as each job in agriculture. In the service sector, average productivity is nearly three times higher than in agriculture, but barely half the level attained in industry.

These figures reveal that structural transformation in the Philippines is leaving in its wake gross inefficiencies in labor allocation. While programs to boost productivity in agriculture will be helpful, the central implication is that programs are needed to stimulate greater investment and more rapid job creation in the industrial and services sectors, as a powerful lever for increasing aggregate labor productivity and overall economic growth.

Figure 2-4

Comparison of Output Structure and Labor Force Structure, Most Recent Year

Huge differences in labor productivity by sector indicate inefficient labor allocation.
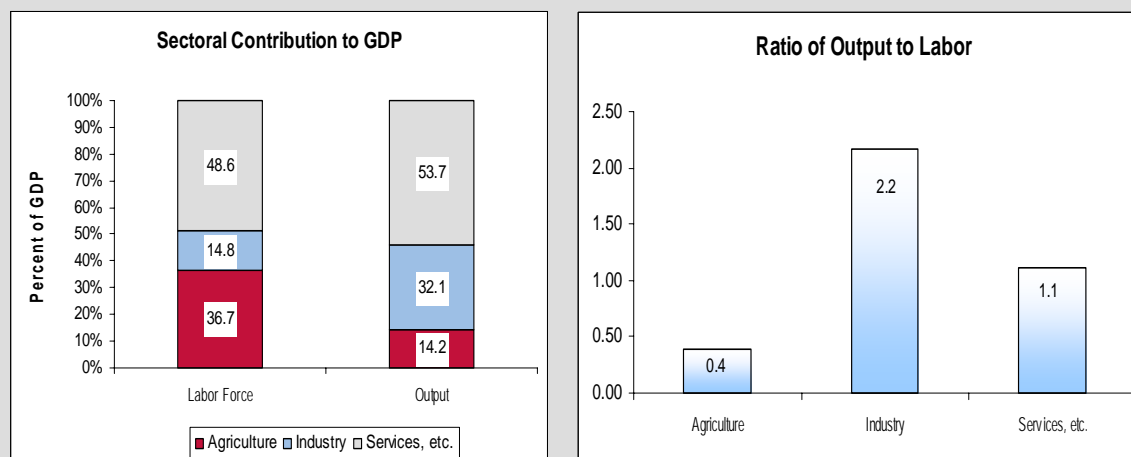
Source: World Development Indicators 2006   CAS Codes: 13P1, 13P2

DEMOGRAPHY AND ENVIRONMENT

The population growth rate for the Philippines remains high, at 2.0 percent per year (Figure 2-5). This is more than twice the population growth rate in Thailand (0.8 percent) and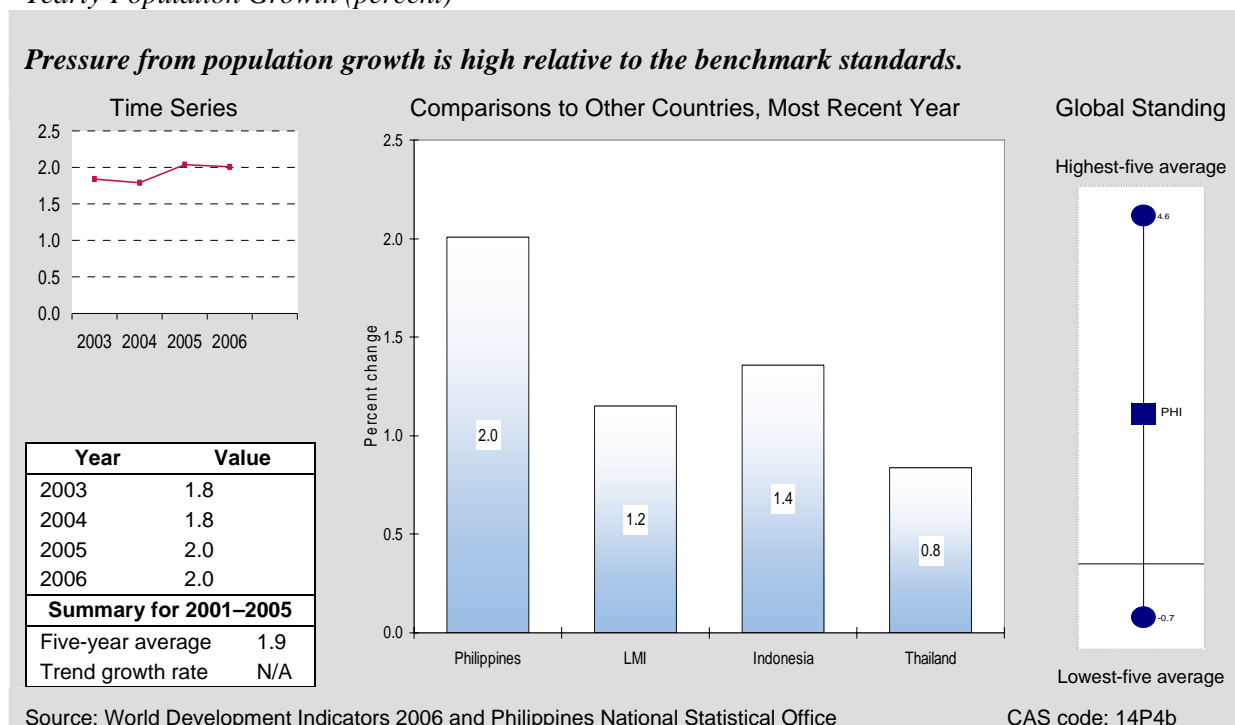 well above the rate in Indonesia (1.4 percent), as well as the median for LMI countries globally (1.2 percent). A direct result of this demographic pressure is that the youth dependency ratio is high, with 0.59 dependents per person of working age, compared with an average of 0.43 in Indonesia and 0.35 in Thailand. A high dependency ratio puts a strain on the educational system and accentuates the need for rapid job creation.

The Philippines is also highly urbanized; 62.7 percent of the people live in urban centers, with Metro Manila the dominant demographic hub. This level of urbanization stands out relative to the global average for LMI countries (56.0 percent) and even more so in comparison to the regional comparators, with Indonesia at 48.1 percent urbanization, and Thailand at 32.3 percent. In addition, rural-to-urban migration is continuing apace, with the urbanization rate increasing by more than 3 percentage points in just the past five years. This migration is a natural response to the low productivity and income in agriculture. In the long term, this is a healthy feature of structural transformation. But the rapid pace of urbanization intensifies pressure on urban infrastructure and services and underscores the need for investment that will create more jobs in industry and services.

Rapid population growth can also put a strain on natural resources. According to a new international environmental performance index (EPI) that evaluates environmental stress and ecosystem vitality in each country, the Philippines scores 69.4 out of 100. This is above the normal range predicted by the regression benchmark for a country with the Philippines' characteristics and better than the EPI scores for Indonesia (60.7) and Thailand (66.8). Nonetheless, looking at components of the EPI, one finds the Philippines faces serious

environmental challenges in urban air quality, overfishing, and dependence on nonrenewable energy.

Figure 2-5
Yearly Population Growth (percent)

Pressure from population growth is high relative to the benchmark standards.

Year	Value
2003	1.8
2004	1.8
2005	2.0
2006	2.0
Summary for 2001–2005	
Five-year average	1.9
Trend growth rate	N/A

Source: World Development Indicators 2006 and Philippines National Statistical Office   CAS code: 14P4b

These demographic and environmental issues are particularly worrisome in conjunction with the poverty and inequality indicators discussed above. Without a concerted effort to pursue pro-poor growth strategies, the pressure from rapid population growth, rural-to-urban migration, and environmental degradation will retard progress in improving living standards for the poor, especially in urban areas and fishing communities.

GENDER

Gender equity enables faster economic growth by ensuring that the productive capacities of all citizens can be developed and used to full extent. The Philippines performs well on every basic indicator of gender equity with the notable exception of female labor force participation—which is surprising given the country's history of women in leadership positions.

Life expectancy at birth is a fundamental indicator of health conditions. For the Philippines, the average life expectancy in 2004 was 72.9 years for women, compared to 68.7 years for men. This 4.2-year differential in favor of women conforms to the international norm. In countries with an advanced level of human development, women live longer than men by five years or more, on average. In Indonesia, the life expectancy for women is 69.3 years, and the gender differential is 4.0 years. For Thailand, the life expectancy for women in 74.2 years, and a gender gap is even wider, 7.5 years.

There is also a differential in favor of females in the gross enrollment ratio at all levels of schooling (primary through tertiary). In 2004, this rate was 84.0 percent for girls and women and just 79.0 percent for boys and men. Presumably, this reflects a pattern of men leaving school to join the labor force, even at an early age. This thesis is corroborated by a lower persistence rate to grade 5 for males than for females—71.5 percent for males and 79.6 percent for females, in 2003 (see Education, p. 33).

Unfortunately, the favorable indicators of gender equity in education are not matched by equity in the labor force. On the contrary, the labor force participation rate is 78.8 percent for males and just 50.8 percent for females. This high degree of gender inequality in the labor market seriously undermines the country's productive potential. As women continue to match or exceed their male counterparts in educational achievement, policymakers must focus commensurate attention on creating equitable opportunities for women in the workplace, so that all Filipinos can fulfill their productive potential and contribute to national development.

3. Conflict Risk

According to a recent review of the literature on conflict and growth, conflict can dampen growth by drawing resources into nonproductive military activities, impeding investment in physical capital and human resources, impairing fiscal capacity for other essential government expenditures, and imposing a debt burden that will encumber future budgets.[11] One influential study found that civil wars reduce GDP per capita at an annual rate of 2.2 percent relative to estimates of what would occur in the absence of conflict.[12] The impact on per capita income is especially pronounced in regions directly affected by conflict.[13]

Although most of the country is relatively stable, the Philippines has experienced sporadic violent conflict in the south, which unquestionably has limited the development in that region, and very likely diminished overall growth for the nation.

To assess the risk to regional security, we use the Conflict Assessment System Tool (CAST) developed by the Fund for Peace. CAST gauges the extent to which states are vulnerable to violent internal conflict and societal dysfunction by rating 12 factors in three categories: social, economic, and political or military. Each indicator is scored on a scale of 1 to 10 (with 10 being the worst). The scores are based on a computerized content analysis that processes thousands of news articles and documents from approximately 12,000 sources around the world. These results are combined with statistical data. Higher scores represent greater risk, with 120 being the maximum, representing "state collapse." A score of 90 or higher means that a country falls into the "critical" category.[14]

For 2007, the CAST score for the Philippines is 79.2, which is an improvement from the score for 2006 of 83.0. Although the Philippines experienced chronic instability in some areas, no specific events caused the indicator to move significantly. Table 3-1 shows the 2007 score for the Philippines broken down into the 12 component indicators. Indonesia and Thailand receive scores

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[11] Daniel Mejia, "Conflict and Economic Growth: A Survey of the Theoretical Links," Webpondo, September 2004. http://www.webpondo.org/filesoctdic2004/conflict_growth.pdf, accessed April 13, 2007.

[12] Paul Collier, "On the Economic Consequences of Civil War," Oxford Economic Papers 51 (1999), 168–83. http://www.worldbank.org/research/conflict/papers/cw-consq.pdf, accessed April 13, 2007.

[13] Alberto Abadie and Javier Gardeazabal, "The Economic Costs of Conflict: A Case Study of the Basque Country," July 2002. http://ksghome.harvard.edu/~aabadie/ecc.pdf, accessed April 13, 2007.

[14] The CAST Methodology is described in greater detail on the Fund for Peace's website: http://www.fundforpeace.org/web/index.php?option=com_content&task=view&id=107&Itemid=145.

for 2007 of 89.2 and 80.4, respectively. The coup in Thailand caused several indicators to worsen, but the country appears to be recovering well.

Table 3-1

Component Ratings of the Philippines 2007 CAST Scores

Category	CAST Score
SOCIAL	
Demographic pressures	7.0
Refugees and displaced persons	5.5
Group grievance	7.2
Human flight	5.7
ECONOMIC	
Uneven development	7.5
Economic decline	5.3
POLITICAL AND MILITARY	
Delegitimization of the state	7.8
Public Services	6.0
Human rights	6.1
Security apparatus	7.0
Factionalized elites	7.2
External influence	6.9

Source: Fund for Peace

For half the indicators the score is 7 or higher, which is the "alert" category. The analysis identifies the main sources of conflict risk in the Philippines as regional grievances, economic disparity, weakness in government legitimacy, and factionalized elites.

SOCIAL INDICATORS

Muslims make up about 5 percent of the population in the Philippines and live mostly in the south. Violent challenges to the state are driven largely by a sense of economic exclusion. Unequal development is used to muster Muslim separatist sentiments, particularly in Mindanao, the second-largest island in the country. Along with the Sulu Archipelago, Mindanao includes almost a quarter of the population. The decades-long insurgency on Mindanao has impaired economic development, despite the islands' abundant natural resource wealth, creating a vicious cycle that intensifies the economic disparities and further legitimizes the insurgency.

A peace agreement with the Philippine government signed in 1996 established the Autonomous Region in Muslim Mindanao (ARMM), giving the majority-Muslim areas in the south some degree of autonomy, including the right to implement sharia law, set up schools, and manage their

own administrative system. The agreement also declared that a percentage of revenue from mines and mineral resources would be allocated to the autonomous region.[15]

The score of 7.0 for demographic pressure is on the cusp of the alert category. Demographic pressures can accentuate conflict risk through soil degradation and depletion of natural resources, including fishing stocks and deforestation (see Demography and Environment, p. 10). Although the Philippines has strong environmental regulations, enforcement is a problem.[16]

Several administrations have sought to ease demographic pressure by sponsoring the resettlement of Filipinos from the north to the south. Muslims have viewed this as an encroachment on their land and a tactic to marginalize them politically as they lose voting clout to new arrivals. Muslims now constitute only 20 percent of the population of the southern Philippines. Tensions such as these between the government and Islamic groups also resulted in a score of 7.2 for group grievance. Furthermore, approximately 150,000 people have been displaced because of fighting between government troops and the Moro Islamic Liberation Front (MILF) and Abu Sayyaf rebel groups. Although the CAST score for refugees is only 5.5, refugees remain a significant source of potential conflict.

ECONOMIC INDICATORS

The CAST score of 7.5 for uneven development highlights the role of economic inequality. The distribution of income is highly unequal throughout the country. The ARMM, in particular, has the lowest per capita income, 75.8 percent below the national average, and only about half the income of the next-poorest region. Poverty incidence in the ARMM is almost twice the national average.

POLITICAL AND MILITARY INDICATORS

Continued fighting between the government and militant Islamic groups on Mindanao, together with calls for President Arroyo's resignation over allegations of vote rigging in 2005, contributed to the high-risk score of 7.8 for state legitimacy. The score for public services is outside the alarm range, at 6.0, but per capita spending in the ARMM for public services such as education and infrastructure are among the lowest in the Philippines.[17] Although human rights are generally respected, there are reported instances of abuses committed by the police and by members of the various insurgent groups, which contributed to a score of 6.1 for this indicator. The presence of

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[15] *The Tripoli Agreement*, Dec. 23, 1976, Peace Agreements Digital Collection: Philippines, United States Institute of Peace, accessed at http://www.usip.org/library/pa/philippines/tripoli_12231976.html; *Final Implementation of the Tripoli Agreement*, July 18, 1996, Peace Agreements Digital Collection: Philippines, United States Institute of Peace, accessed at http://www.usip.org/library/pa/philippines/peace_agree_07181996.html

[16] Source: World Bank, Environment in East Asia and the Pacific, Philippines Environment, 2007. http://go.worldbank.org/82O4OVSJO0

[17]National Statistical Coordination Board - 2005 Gross Regional Domestic Product-Per Capita. http://www.nscb.gov.ph/grdp/2005/2005concap.asp

insurgent groups also factored heavily into the CAST indicators for the security apparatus and factionalized elites, which received scores of 7.0 and 7.2, respectively. U.S. military support in fighting the insurgent groups resulted in a score of 6.9 for external intervention.

CAPACITIES OF THE STATE

A country's ability to cope with the conflict risks described above depends on the strength of its institutions. The CAST methodology provides ratings for the capacity of five core state institutions in terms of legitimacy, representativeness, and professional competency. The ratings are on a scale of 0 to 5, with 5 being the best. The most striking institutional factor is the score of 2 for the judicial system, reflecting widespread reports of corruption and inefficiencies in the legal and judicial structure. Although the law provides for an independent judiciary, claims that wealthy or influential offenders enjoy impunity are not uncommon. The CAST rating system also produces relatively weak scores of 3 for leadership and the quality of the civil service.

Overall, the Philippines has ample state capacity to cope with the limited state of conflict. Yet weaknesses in key state institutions need to be addressed, not only because of their role in conflict management, but also because of their importance for the business environment.

4. Private Sector Enabling Environment

This section reviews key indicators of the enabling environment for encouraging rapid and efficient growth of the private sector. Sound fiscal and monetary policies are essential for macroeconomic stability, which is a necessary (though not sufficient) condition for sustained growth. A dynamic market economy also depends on basic institutional foundations, including secure property rights, an effective system for enforcing contracts, and an efficient regulatory environment that does not impose undue barriers on business activities. Financial institutions play a major role in mobilizing and allocating saving, facilitating transactions, and creating instruments for risk management. Access to the global economy is another pillar of a good enabling environment because the external sector is a central source of potential markets, modern inputs, technology, and finance, as well as competitive pressure for improving efficiency and productivity. Equally important is development of the physical infrastructure to support production and trade. Finally, developing countries need to adapt and apply science and technology to attract efficient investment, improve competitiveness, and stimulate productivity.

FISCAL AND MONETARY POLICY

The government of the Philippines has embarked on an ambitious fiscal reform program. The clearest sign of progress is a marked improvement in the budget balance, from a deficit of 5.6 percent of GDP in 2002 to a deficit of 1.9 percent in 2006. The result for 2006 is in line with the regression benchmark for the Philippines and better than the deficit in Thailand but less favorable than the global average for LMI countries or the budget position in Indonesia (Figure 4-1).

The improvement in fiscal health has been achieved through a combination of expenditure restraint and revenue enhancement. Between 2002 and 2006, central government expenditure fell as a share of GDP, from 20.3 percent to 17.9 percent. The latter figure is 11 percentage points under the regression benchmark, but in line with central government expenditure estimate in Thailand (17.7 percent of GDP) and Indonesia (17.0 percent).

Figure 4-1

Overall Budget Balance (percentage of GDP)

The fiscal balance has improved greatly.

Time Series		
Year	Value
2002	-5.6
2003	-4.9
2004	-4.2
2005	-3.0
2006	-1.9
Summary for 2001–2005	
Five-year average	-3.1
Trend growth rate	30.4

Source: World Development Indicators 2006; IMF Article IV; Philippines National Statistical Office   CAS code: 21P5
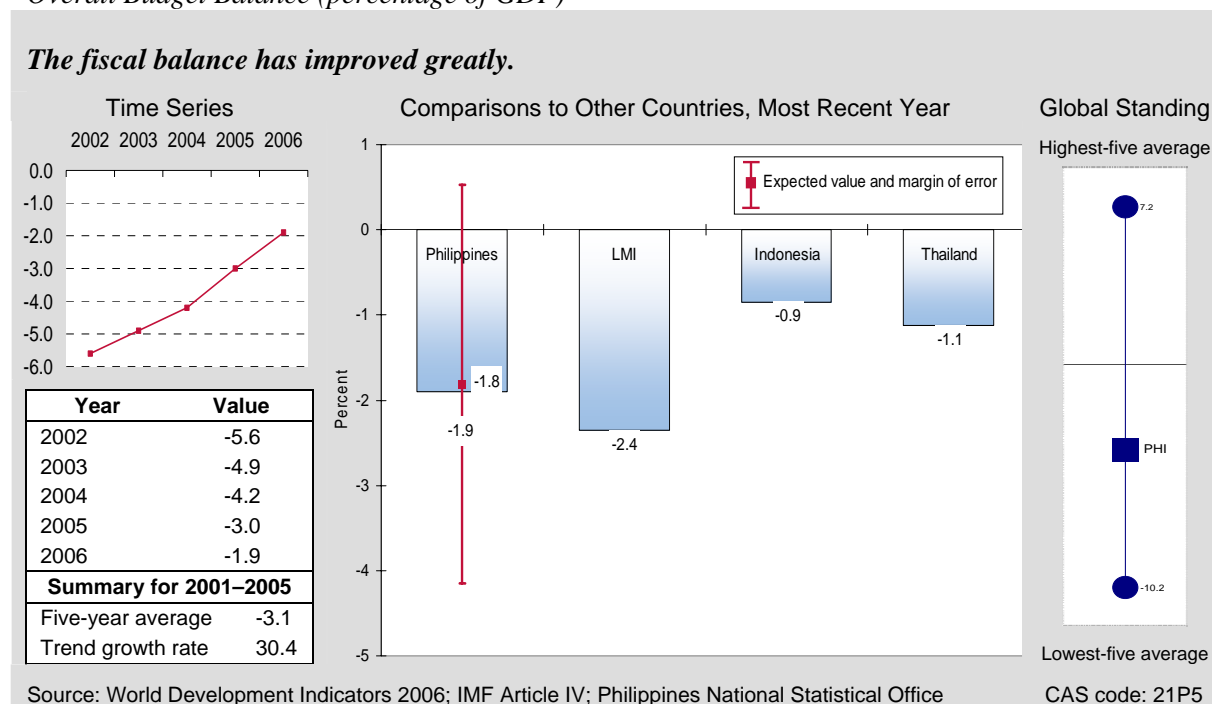
On the revenue side, successful implementation of the new value-added tax (VAT) boosted the yield from taxing goods and services from 19.2 percent of total revenue in 2005 to 26.9 percent in 2006. At the same time, dependence on distortionary international trade taxes dropped from 16.6 percent to 13.8 of total revenue. In addition, improvements in tax administration have broadened the tax base and generated additional major gains in revenue.[18] Overall, government revenue increased from 14.4 percent of GDP in 2002 to an estimated 16.0 percent in 2006 (Figure 4-2). Even the latest figure, however, is far below the regression benchmark of 20.3 percent, as well as the revenue yields in Indonesia and Thailand, at 18.6 and 19.6 percent of GDP, respectively (for 2004). Despite the important gains, revenue mobilization is still very weak for a lower-middle-income country.

One major benefit of tighter fiscal policy is that it has reduced the government's appetite for inflationary financing. Whereas credit to the public sector absorbed 68.2 percent of the increase in the broad money supply in 2003, this was down to 11.5 percent by 2006. Even so, the expansion of credit to the private sector still accounted for just 21.1 percent of the money supply growth in 2006. By far the largest component of money growth was an accumulation of foreign exchange reserves, as the government built up reserves to stave off pressure for an appreciation of the peso due to a balance-of-payments surplus (see External Sector, p. 23). The strategy was moderately successful but came at the expense of crowding out credit growth to the private sector.

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[18] IMF, *Article IV Consultation – Staff Report*, February, 2007, 7.

Figure 4-2

Government Revenue (percentage of GDP)

Government revenue has increased sharply, but remains low compared to the benchmarks.

Time Series		
Year	**Value**	
2002	14.4	
2003	14.7	
2004	14.6	
2005	15.1	
2006	16.0	
Summary for 2001–2005		
Five-year average	14.9	
Trend growth rate	2.4	

Comparisons to Other Countries, Most Recent Year

Expected value and margin of error

20.3

Philippines 16.0 · LMI 27.3 · Indonesia 18.6 · Thailand 19.6

Global Standing

Highest-five average — 68.4

PHI 12.8

Lowest-five average

Source: World Development Indicators 2006 and IMF Article IV   CAS code: 21P2

Another effect of the accumulation of foreign exchange reserves has been a steep increase in the overall monetary growth rate. In 2006, the broad money supply expanded by 19.6 percent, triple the average of the previous three years (6.6 percent). Even with rapid expansion of the money supply in 2006, as well as pressure from high oil prices and food prices (due to natural disasters), inflation remains moderate. The consumer price index rose by just 6.2 percent, down from 7.6 percent in 2005. According to the IMF, the core inflation rate (excluding volatile fuel and food prices) is closer to 4 percent. But if monetary policy were to remain highly expansionary, inflation would probably accelerate, with adverse effects of inflation on both the investment climate and living standards for the poor. Maintaining a strong and credible commitment to macroeconomic stability should continue to be a high priority for the government.

BUSINESS ENVIRONMENT

Institutional barriers to doing business, including corruption in government, are critical determinants of private sector development and prospects for sustainable growth. The World Bank's composite Doing Business index places the Philippines at an unsatisfactory 126th rank out of 175 countries. This ranking is far worse than the regression estimate of 83 for a country with the Philippine's characteristics. Indeed, it is even far outside the normal band from the benchmark regression. Looking at the comparator countries, Indonesia's performance is even worse, ranking 135th, whereas Thailand is among the world leaders, ranking 18th—which shows what can be done with a strong program of market-supporting reforms.

Most of the business environment indicators examined for this report are in line with the international benchmarks. These include the number of procedures required to register property and start a business and the ratings for government effectiveness, regulatory quality, and rule of

law. But there are glaring exceptions. The most striking deficiency is the time required to enforce an illustrative contract—600 days. The score for Indonesia is nearly as bad, at 570 days; even so, the enforcement time in the Philippines is 22 percent more than the LMI median and 41 percent more than in Thailand (Figure 4-3). This differential arises even though enforcing a contract in the Philippines requires fewer procedures (25) than in either Indonesia (34) or Thailand (26). Thus, the main problem lies in the process itself. The good news is that the estimated time to enforce a contract in the Philippines has improved considerably, from 740 days in 2003. But this is still a serious constraint on business activity and financial market development.

Figure 4-3
Time to Enforce a Contract (days)

Contract enforcement is a glaring weakness in the business environment.

Source: World Bank, Doing Business; Enforcing Contracts category   CAS code: 22S5
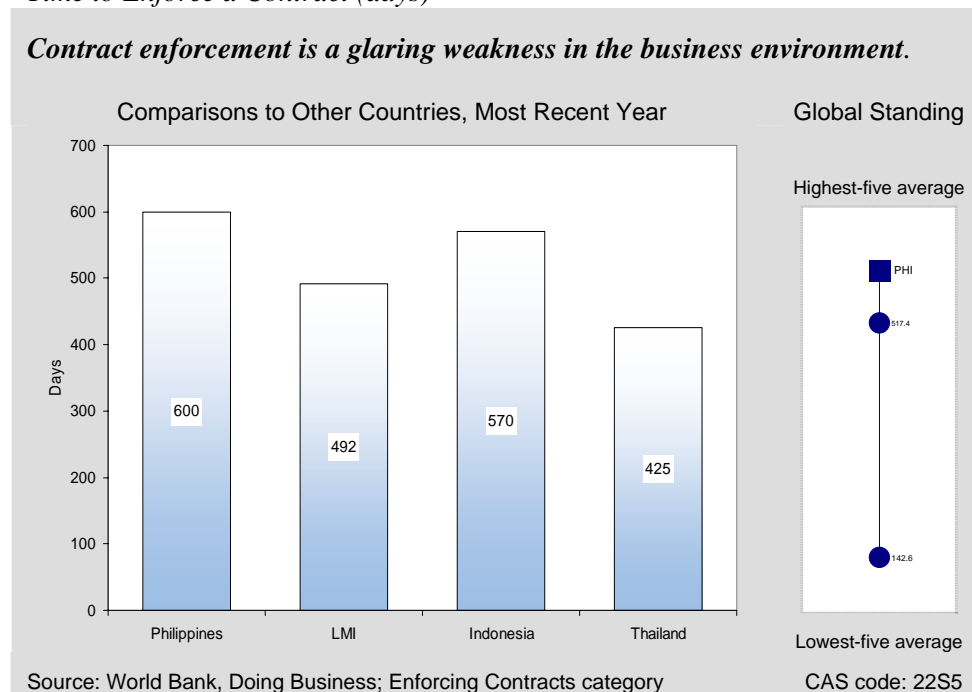
Businesses in the Philippines also appear to face a high tax burden, at least in terms of statutory requirements (as distinct from actual payments). The Doing Business report for 2006 estimates that the total taxes payable by a standardized business amount to 53.0 percent of operating profit in the Philippines, compared to 37.2 percent in Indonesia and 40.2 percent in Thailand.

Senior managers' time spent dealing with government regulation constitutes another burden on the private sector in the Philippines. Filipino executives spend an average of 9.5 percent of their time each week navigating bureaucracy, compared to the LMI average of 8.8 percent and 5.4 percent in Indonesia. (No comparable figure is available for Thailand.)

Corruption is also a serious and persistent problem. Transparency International's Corruption Perception Index has consistently given the Philippines a score of 2.5 or 2.6, on a scale of 0 to 10, with higher numbers indicating less corruption. This score is just outside the lower bound of the regression benchmark and also below the global median of 2.8 for LMI countries. To put these scores into perspective, a score below 3.0 is considered an indication of rampant corruption.

These indicators go a long way toward explaining why investment has been so low despite many major reforms. Clearly the Philippines has a long way to go in establishing a truly friendly business environment as an instrument to stimulate investment, increase productivity, and foster more rapid growth. Both the government and the donor community should consider reform of economic governance and reduction of corruption as very high priorities.

FINANCIAL SECTOR

A sound and efficient financial sector is a key to mobilizing saving, fostering productive investment, and improving risk management. In the Philippines, the indicators for financial sector performance paint a mixed picture. Some key indicators look reasonably good. For example, the ratio of broad money to GDP is a basic gauge of the development of the banking system. For the Philippines, the broad money supply equals 62.9 percent of GDP. This is better than the regression benchmark (57.4 percent) and far better than the global median for LMI countries (39.2 percent), as well as the ratio in Indonesia (41.0 percent). Not surprisingly, this indicator shows that financial development in Thailand is far more advanced, with a ratio of 90.5 percent.
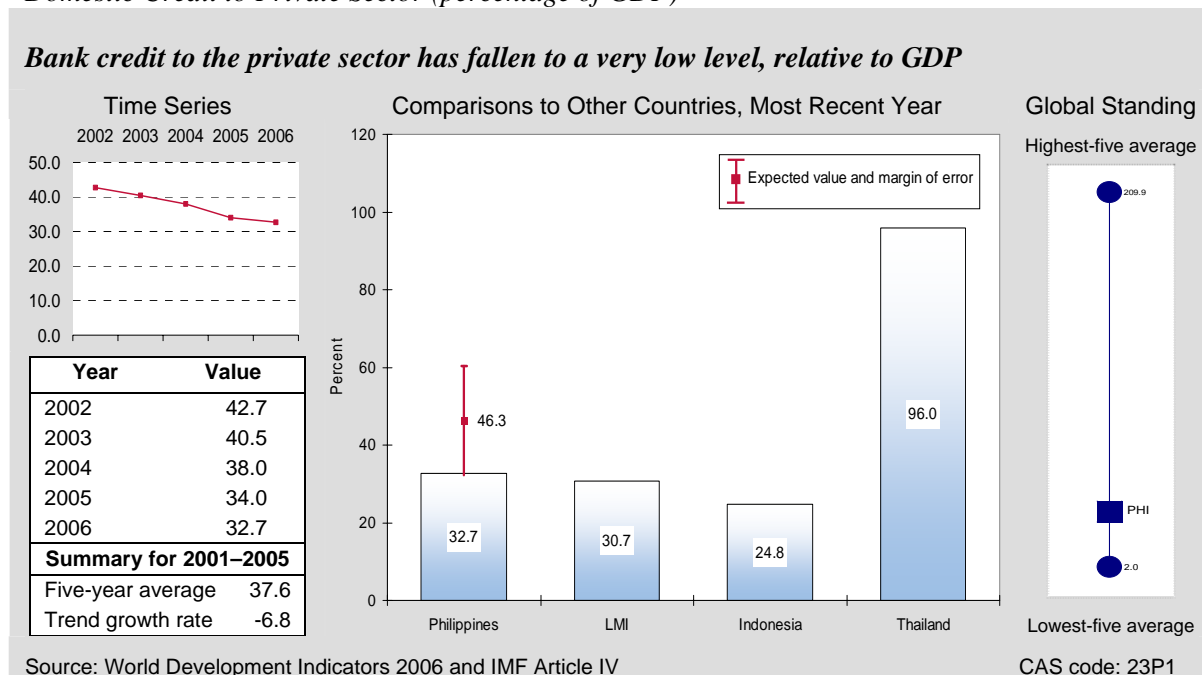
Another favorable sign is the spread between lending and deposit rates, which can be viewed as a gauge of efficiency in financial intermediation. For 2005, the World Bank estimates the spread in the Philippines at 4.6 percent. This compares to a regression benchmark of 7.8 percent, and a median of 7.6 percent for LMI countries. Here, too, the performance of the financial system in the Philippines is better than in Indonesia (at 6.0 percent), but less efficient than in Thailand (at 3.9 percent). One problem is that the spread has increased slightly over the past four years, which puts upward pressure on the interest rates for bank loans.

The most disturbing trend, however, is the large decline in domestic credit to the private sector, which fell from 42.7 percent of GDP in 2002 to 32.7 percent in 2006 (Figure 4.4). This places the Philippines below the regression benchmark of 46.3 percent. While the Philippines is ahead of Indonesia, at 24.8 percent of GDP, it is not even close to the exemplary performance of the financial system in Thailand, where credit to the private sector amounts to 96.0 percent of GDP. One reason for the poor performance in extending credit is that the banking sector is making slow progress in shedding a legacy of nonperforming loans. The lack of progress in resolving this problem is hindering investment growth. To stimulate lending, the central bank imposed a tiering scheme in November 2006, which involves paying lower interest rates to the banks on larger deposits of reserves.[19] It will be important to watch this indicator closely to see if the incentive succeeds in expanding bank credit to the private sector.

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[19] Ibid., 16.

Figure 4-4

Domestic Credit to Private Sector (percentage of GDP)

Bank credit to the private sector has fallen to a very low level, relative to GDP

Time Series		Comparisons to Other Countries, Most Recent Year	Global Standing

Year	Value
2002	42.7
2003	40.5
2004	38.0
2005	34.0
2006	32.7
Summary for 2001–2005	
Five-year average	37.6
Trend growth rate	-6.8

Comparisons to Other Countries, Most Recent Year

Expected value and margin of error

- Philippines: 32.7 (46.3 expected value)
- LMI: 30.7
- Indonesia: 24.8
- Thailand: 96.0

Global Standing — Highest-five average: 209.9; PHI; 2.0; Lowest-five average

Source: World Development Indicators 2006 and IMF Article IV   CAS code: 23P1

Turning to the institutional foundations for financial sector development, the Philippines receives a score of 3.0 on the World Bank's index of Legal Rights of Borrowers and Lenders for 2006, on a scale of 0 (poor) to 10 (excellent). This is markedly below the score of 5 for Indonesia and Thailand; indeed, 5 is the global median for LMI countries (Figure 4-5). This indicator alone shows starkly the need for further legal and regulatory reform to facilitate the expansion of bank credit to the private sector.

Figure 4-5

Legal Rights of Borrowers and Lenders Index

The weak legal system impedes financial market development.

Comparisons to Other Countries, Most Recent Year

0 (Very Poor) - 10 (Excellent)

- Philippines: 3.0
- LMI: 5.0
- Indonesia: 5.0
- Thailand: 5.0

Global Standing — Highest-five average: 4.8; PHI; 0.8; Lowest-five average

Source: World Bank, Doing Business; Getting credit category   CAS code: 23S1
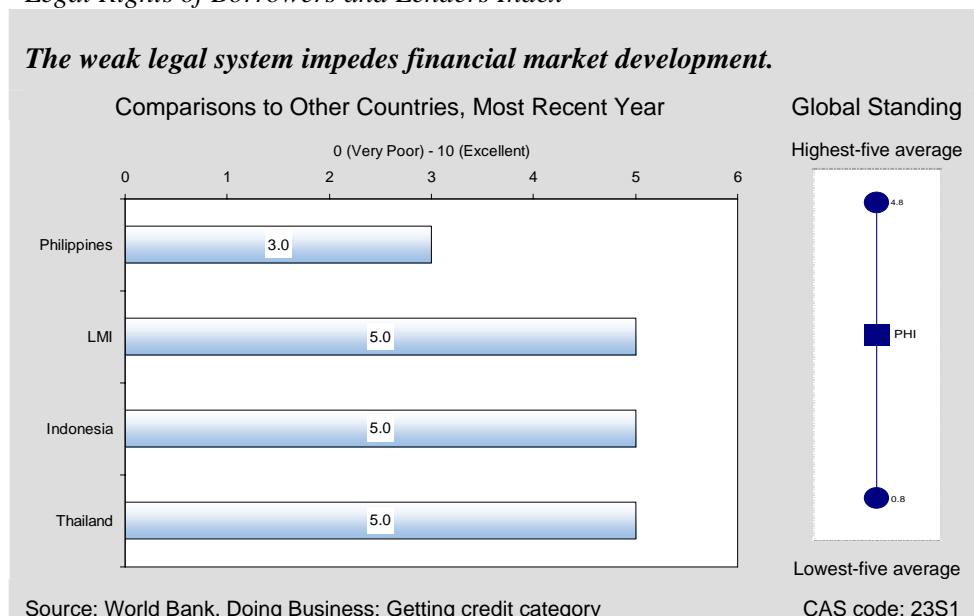
Beyond the banking system, stock market capitalization is a primary indicator of financial sector development for emerging economies. The ratio of stock market capitalization to GDP surged from 27.8 percent in 2001 to 40.9 percent 2005, coinciding with the emergence of strong growth and serious fiscal reforms, which bolstered investor confidence. Although the capitalization ratio remains below the regression benchmark of 43.7 percent, it is now above the median of 39.2 percent for all LMI countries, and the trend is very positive.

Despite signs of progress in banking sector reform and financial sector development, credit growth continues to be major constraint on business investment. Donors may wish to consider programs that will deepen the reforms and accelerate the growth of a sound and efficient banking system, along with further development of the capital markets.

EXTERNAL SECTOR

Fundamental changes in international commerce and finance, including reduced transport costs, advances in telecommunications technology, and lower policy barriers, have fueled a rapid increase in global integration in the past 25 years. The international flow of goods and services, capital, technology, ideas, and people offers great opportunities for the Philippines to boost growth and reduce poverty by stimulating productivity and efficiency, providing access to new markets and ideas, and expanding the range of consumer choice. At the same time, globalization creates new challenges, including the need for reforms to take full advantage of international markets, and cost-effective approaches to cope with the resulting adjustment costs and regional imbalances.

International Trade and Current Account Balance

The Philippines is a very open economy, with solid export performance and large remittance inflows. Total trade (exports plus imports of goods and services) in 2006 amounted to 94.4 percent of GDP. This ratio is well within the normal range from the benchmark regression and better than the global average of 83.9 percent for LMI countries. By comparison, total trade in Indonesia amounts to just 70.3 percent of GDP, while Thailand is far more globalized, with exports plus imports totaling nearly 150 percent of GDP.
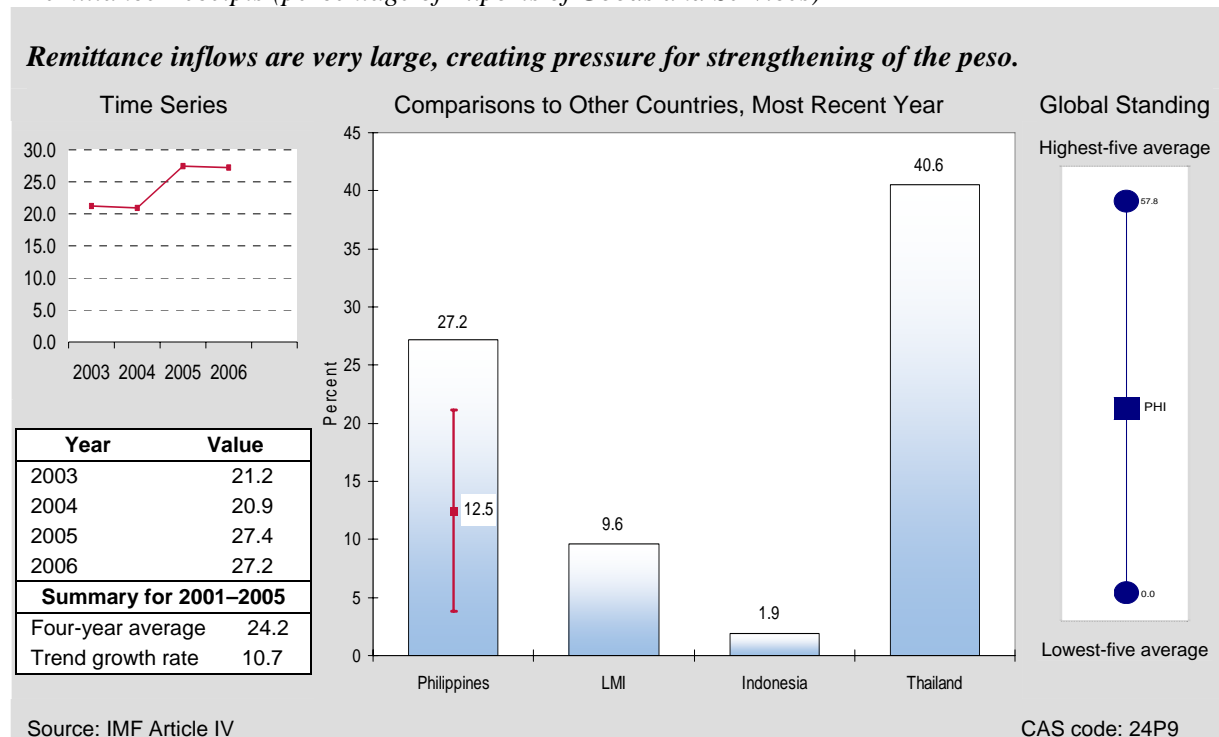
Over the past five years, exports have grown by an average of 8 percent per year, including an impressive 15.1 percent growth rate in 2006. Manufactured goods account for over 90 percent of merchandise exports, with electronic products being especially prominent. A favorable policy environment clearly contributes to the strong trade performance. This can be seen in the Trade Policy Index compiled by the Heritage Foundation, which gauges the degree of freedom from barriers to trade, including tariffs, customs regulations, import licensing requirements, sanitary and phytosanitary restrictions, widespread corruption, and intellectual property rights protection, among other factors. For 2006, the Trade Policy Index score for the Philippines was 74.8 (on a scale of 0 to 100). This compares favorably to the LMI average (62.8) as well as to the scores for Indonesia (69.6) and even Thailand (63.4).

Another very positive component of the current account in the balance of payments is the inflow of workers' remittances. Between 2003 and 2006, remittances played an increasingly important role, rising from 21.2 percent of export earnings to 27.2 percent (Figure 4-6). Income from

remittances now amounts to 11 percent of GDP.[20] This large and growing source of foreign exchange and national income is indicative of widespread opportunities for Filipinos to work outside the country, but at the same time, it reflects a lack of attractive job opportunities in the country. Thus far remittances have served primarily to increase consumption and generate local demand for consumer goods. The growth effects could be enhanced if programs were introduced to channel a larger portion of remittance income into savings and investment.

Figure 4-6

Remittance Receipts (percentage of Exports of Goods and Services)

Remittance inflows are very large, creating pressure for strengthening of the peso.

| Time Series | Comparisons to Other Countries, Most Recent Year | Global Standing |

Year	Value
2003	21.2
2004	20.9
2005	27.4
2006	27.2
Summary for 2001–2005	
Four-year average	24.2
Trend growth rate	10.7

Source: IMF Article IV   CAS code: 24P9

The current account balance has been consistently positive, though varying in magnitude from year to year. In the period from 2002 to 2006, the current account balance averaged 3.2 percent of GDP and reached 4.3 percent in 2006 because of strong growth in exports and remittances. One side effect of the strong current account balance has been upward pressure on the value of the peso, which tends to erode the competitiveness of both exports and domestic products that compete against imports. Despite the central bank's efforts to resist appreciation by accumulating foreign exchange reserves, the peso still strengthened in real terms by nearly 10 percent in 2006. In this light, the recent export boom is even more impressive. The real exchange rate, however, was depreciating between 2002 and 2004. Hence, the peso is now only slightly stronger than it was five years ago. Nevertheless, the recent trend is of serious concern, because a major appreciation could weaken the prospects for further rapid growth of exports and the concomitant stimulus to job creation.

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[20] Asian Development Bank, *Asian Development Outlook 2007*, 2007, 226.

Foreign Investment, External Assistance, and International Reserves

Foreign direct investment (FDI) can catalyze productivity gains and growth by transferring technology, developing human capital, and enhancing competition. The flow of FDI into the Philippines totaled 1.9 of GDP in 2005 and 2.0 percent in 2006, recovering from anemic levels of about 0.5 percent of GDP the previous two years. The 2006 ratio is in line with the regression benchmark of 1.8 percent but still falls short of the global average for LMI countries of 2.9 percent.

Even so, the climate for attracting FDI appears to be reasonably good compared to the benchmarks. This can be seen in the index of Inward FDI Potential, as compiled by UNCTAD. On a scale of 0 (poorest) to 1 (best), the Philippines' score of 0.21 for 2002–2004 (latest year available) was on par with Thailand's score (0.22) and better than Indonesia's score (0.15) as well as the LMI average (0.16). These comparisons, however, cannot mask the fact that the Philippines has a long way to go to achieve a truly attractive investment climate. According to an ADB Investment Climate Report in 2005, the major hindrances to investment include weak macroeconomic fundamentals, poor infrastructure, a perception of widespread corruption, and complex business procedures.[21] The present analysis suggests that macroeconomic conditions have improved but serious impediments to investment remain.

One continuing macroeconomic concern is the level of external debt. The present value of debt obligations amounts to 73.1 percent of the gross national income (GNI). By comparison, the regression benchmark is 63.0 percent, and the global average for LMI countries is just 44 percent. Indonesia and Thailand also bear a lower overhang of debt, at 60.9 percent and 35.2 percent of GNI, respectively. The cost of debt service is not a major problem but is still high. In particular, the ratio of debt service to export earnings was 19.6 percent in 2006. A ratio of 20 percent is often considered the "sustainable maximum." In addition, the debt service burden is more than double the regression benchmark of 9.2 percent and nearly double the LMI average of 10.5 percent. These debt indicators suggest that the level of external debt is not alarming, though it is high enough to make the country more vulnerable to external shocks.

The bottom line in the balance-of-payments accounts is the net accumulation of foreign exchange reserves. In 2006, the central bank accumulated reserves as a way to alleviate the market pressure causing an appreciation of the peso. As a result, gross reserves increased from 3.6 months of import requirements in 2004 to 4.4 months by the end of 2006. Normally, at least 4 months of import cover is considered a prudent minimum to hedge against trade shocks. Reserves are also needed to hedge against shocks resulting from short-term capital flows. According to the IMF, gross reserves covered 160 percent of short-term foreign liabilities at the end of 2006. Hence, the monetary authorities now hold an adequate but not abundant level of reserves.

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[21] Asian Development Bank, *The Philippines: Moving towards a Better Investment Climate 2005,* 52.

ECONOMIC INFRASTRUCTURE

Reliable physical infrastructure—for transportation, communications, power, and information technology—is the backbone for improving competitiveness and expanding productive capacity. For the Philippines, the quality of infrastructure has been improving but is still a serious deterrent to investment. The World Economic Forum (WEF) compiles an annual index of overall infrastructure quality based on a survey of executive opinion in each country. For 2006, the Philippines received a rating of 2.7 on a scale of 1(for poor) to 7 (for excellent). This is a low score in absolute terms and also relative to cohort comparisons. Indeed, 2.7 is the lower bound of the normal range estimated by the benchmark regression. It is also below the LMI average, of 3.1, as well as the excellent rating of 5.0 for Thailand. The fact that the score for Indonesia is slightly worse, at 2.5, does not change the fact that inadequate infrastructure is a major problem for attracting investment, creating jobs, and reducing poverty in the Philippines. It is not surprising that a World Bank survey of 715 private sector firms identified poor infrastructure as a major concern for investors.[22]

It is difficult to find a good indicator for benchmarking road quality across countries, but one widely used proxy is the percentage of roads that are paved. According to standardized World Bank data, 21.6 percent of roads in the Philippines were paved in 2003. This is extremely low compared to the figures of 98.5 percent for Thailand in 2000, 58.0 percent for Indonesia in 2002, and the global LMI average of 47.7 percent. An obvious conclusion is difficult because of wide data discrepancies. In particular, the 2005 World Bank report on infrastructure noted above has a detailed table of government data showing that 70 percent of roads are paved in the Philippines. Even so, the World Bank report leaves no doubt that the overall road infrastructure is poor.

For a country so dependent on maritime transport, port facilities are another critical infrastructure element. Yet the Philippines gets a very disappointing rating of 2.7 (on a scale of 1 to 7) in 2006 on the WEF index of port quality. By comparison, Indonesia registers 2.4, while Thailand's rating of 4.7 provides a mark to which the Philippines can aspire (Figure 4-7).

According to the WEF ratings, the quality of the air transport infrastructure is much better than the quality of ports, though still not particularly strong. On this indicator, the Philippines receives a score of 4.0 for 2006, which is on par with Indonesia's score (4.1) and the LMI cohort average (3.9). Again, Thailand sets a much higher standard, with a score of 5.5.

The WEF ratings for electricity infrastructure reveal mediocre performance for the Philippines. The country's score of 4.0 for 2006 is in line with the LMI average of 4.1 and notably better than Indonesia's 3.5, but far below Thailand's standout score of 5.5.

Because of the rapid growth of the mobile phone industry, the Philippines is performing very well in telecommunications infrastructure. Telephone density, measured as the number of fixed lines and mobile subscribers per 1,000 people, nearly quadrupled between 2000 and 2004, from 125.6 to 445.7. The latter figure is more than double the regression benchmark of 213.0 and far higher

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[22] World Bank, *Meeting Infrastructure Challenges*, 2005, p.

than the LMI average of 337.3. By comparison, Thailand has achieved a telephone density of 536.6 per 1,000 people, whereas Indonesia lags far behind at 183.8.

Figure 4-7
Quality of Ports Index

Inadequate port infrastructure is one of several serious infrastructure problems.

Comparisons to Other Countries, Most Recent Year   Global Standing
1 (Very Poor) - 7 (Excellent)

Philippines	2.7	
LMI	3.4	
Indonesia	2.4	
Thailand	4.7	

Global Standing

Highest-five average
6.6
PHI
1.3
Lowest-five average

Source: Global Competitiveness Report 2006-2007, World Economic Forum   CAS code: 25S1b

Although its telecommunications indicators are strong, the Philippines is at risk of being left behind in the race to keep up with the information age. The number of Internet users increased by 17.7 percent per year from 2001 through 2005, but even at this pace the Philippines has not kept pace with its neighbors. In 2005, the Philippines had 53.2 internet users per 1,000 people, whereas Indonesia registered 72 users and Thailand had 110. Globally, the average for LMI countries that year was 58 users per 1000 people—and growing rapidly.

The quality of infrastructure in the Philippines is therefore a serious impediment to investment and a drag on competitiveness. The government of the Philippines has rightly identified infrastructure development as a priority in the 2004–2010 Medium-Term Development Program. There is no doubt that donors should strongly support the government in this endeavor, particularly in roads, ports, and ICT development.

SCIENCE AND TECHNOLOGY

Science and technology are vital to a dynamic business environment and a driving force behind increased productivity and competitiveness. Even for lower-middle-income countries such as the Philippines, transformational development depends on acquiring and adapting technology from the global economy. Lack of capacity to access and use technology prevents an economy from

leveraging the benefits of globalization. Unfortunately, very few international indicators can be used to judge performance in this area for low- and lower-middle-income countries.

From the limited information that is available, it appears that science and technology capability in the Philippines is average to below average for its level of development. UNESCO compiles international data on research and development (R&D) spending. The latest data point for the Philippines is from 2002; at that time R&D spending amounted to just 0.1 percent of GDP. This is equal to the figure for Indonesia, but below those for the other benchmarks: for both the LMI average and the benchmark regression estimate, the corresponding figure is 0.4 percent of GDP. A similar picture emerges from the World Bank's tabulation of science and technology journal articles per million population; the value for the Philippines in 2001 (latest data) of 158 falls short of the performance in both Indonesia (207) and, not surprisingly, Thailand (727).
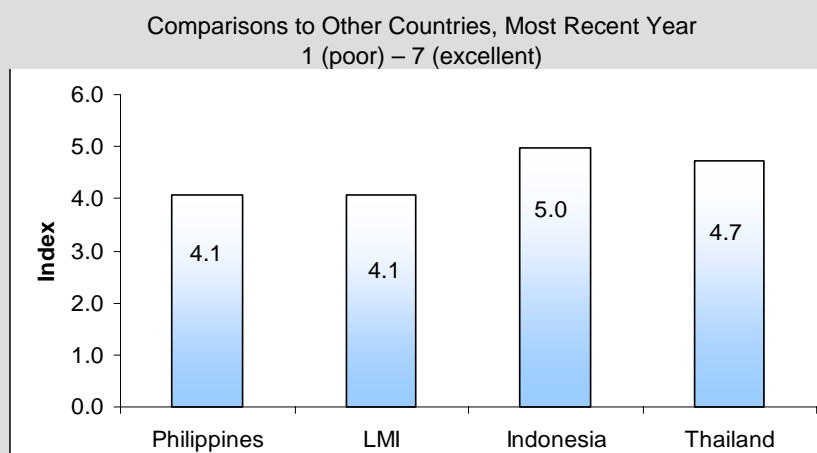
One science and technology area in which the Philippines performs in line with expectations is the WEF's index of FDI Technology Transfer, which is a gauge of executive perceptions of the quality of FDI entering the country as a source of new technology. The Philippines score is 5.1, on an ascending scale of 1 to 7. This is on par with the regression benchmark (5.0) and the scores for both Indonesia (5.0) and Thailand (5.3), and above the LMI average (4.5). For perspective, the average of the top five performers globally is 5.9.

Homegrown technology, however, is less accessible than FDI technology. On the WEF index of the availability of scientists and engineers, the Philippines receives a score of 4.1 in 2006, on a scale of 1 to 7, putting the country 84th out of 125 countries rated (Figure 4-8). This rating is a compilation of executive perceptions, not an objective measurement, however; so while the Philippines ranks directly below Nigeria, it ranks just above Mexico. In all three countries, the best economic opportunities for scientists and engineers lie beyond the borders, so the low scores may be a reflection of brain drain (see Employment and Workforce, p. 35).

Figure 4-8
Availability of Scientists and Engineers Index

Compared to the benchmarks, the Philippines is not strong on the availability of scientists and engineers.

Comparisons to Other Countries, Most Recent Year
1 (poor) – 7 (excellent)

Source: Global Competitiveness Report 2006-2007, World Economic Forum   CAS code: 26P3

Another concern is the apparent weakness in intellectual property rights protection. The Philippines received a rating of 3.0 on the WEF executive survey in 2006, which is well below the scores for Indonesia (3.6) and Thailand (4.2). It is likely that this ranking will increase, however, because of improvements in the coordination among agencies enforcing intellectual property rights; on this basis, the U.S Trade Representative in 2006 removed the Philippines from its Special 301 Watch List, which is an annual review of intellectual property rights protection.[23]

Despite the country's excellent education statistics (see Education, p. 33), these indicators suggest that the Philippines is a laggard among LMI countries in science and technology performance. Part of the problem may be a lack of attractive domestic opportunities for skilled scientists and engineers because of weaknesses in the investment climate. But the indicators also suggest a possible need to strengthen science and technology education.

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[23] USTR, "US Government Praises Philippines for Improved IPR Enforcement," press release, February 15, 2006. See:
http://www.ustr.gov/Document_Library/Press_Releases/2006/February/US_Government_Praises_Philippines_for_Improved_IPR_Enforcement.html.

5. Pro-Poor Growth Environment

Rapid growth is the most powerful and dependable instrument for poverty reduction, but the link from growth to poverty reduction is not mechanical. In some circumstances, income growth for poor households exceeds the overall rise in per capita income, while in other cases the poor are left far behind. A pro-poor growth environment stems from policies and institutions that improve opportunities and capabilities for the poor while reducing their vulnerabilities. Pro-poor growth is associated with investment in primary health and education, the creation of jobs and income opportunities (particularly for Filipino women to bridge the labor force participation gap between the sexes), the development of skills, microfinance, agricultural development, and gender equality. This section focuses on four of these issues: health, education, employment and the workforce, and agricultural development.

HEALTH

The provision of basic health service is a major form of human capital investment and a significant determinant of growth and poverty reduction. Although health programs do not fall under the EGAT bureau, an understanding of health conditions can influence the design of economic growth interventions.
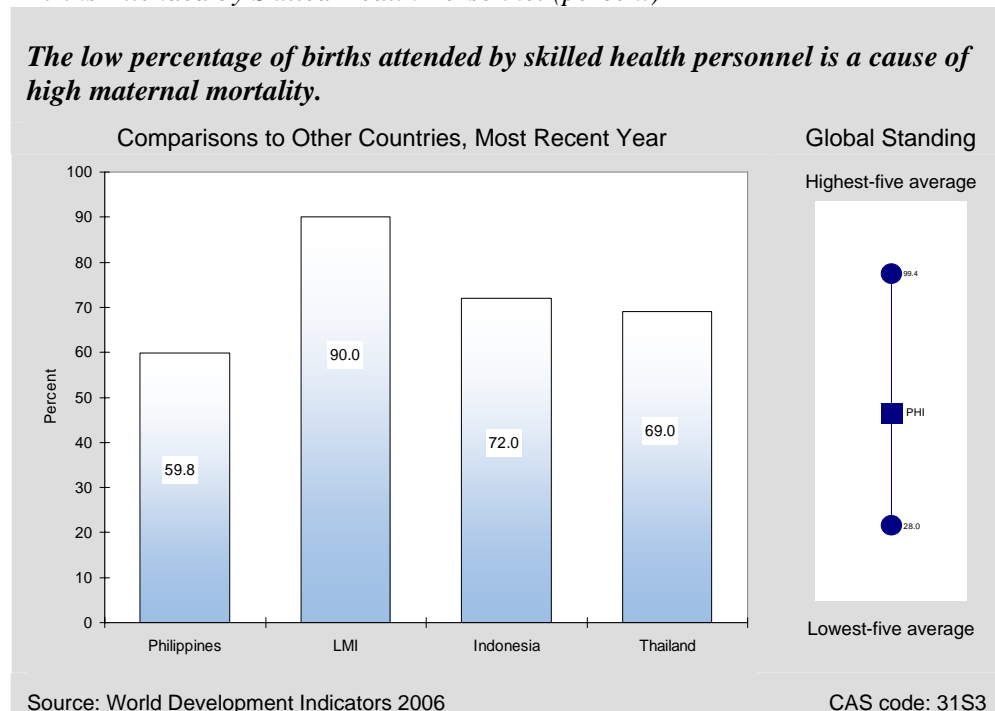
Life expectancy at birth is commonly regarded as the best overall indicator of health status of a population. By this measure the Philippines is performing well. The estimated life expectancy reached 70.8 years in 2004, up from 69.5 years at the turn of the century. Life expectancy is on par with the LMI average of 70.4 years, and even the achievement of Thailand, at 70.5 years.

The country is also performing well on providing access to improved water and sanitation. In 2004, 85 percent of the Filipino population had access to clean water, and 72 percent had access to improved sanitation. These figures are in line with the average for LMI countries globally, at 87 percent for water and 74 percent for sanitation. Indeed, on access to clean water, the Philippines matches Thailand (85 percent) and outperforms Indonesia (77 percent). For sanitation, however, Thailand sets a global standard, at 99 percent coverage, with Indonesia far behind, at 55 percent.

In several vital areas, however, significant deficiencies demand attention. The maternal mortality rate is estimated at 162 maternal deaths per 100,000 live births in 2006. Although this is better than the regression benchmark (200) and the mortality rate in Indonesia (230), it is far above the LMI average of 130 and the outstanding performance of Thailand (44). Most important, the

maternal mortality rate in the Philippines is unconscionably high. One reason for the high maternal mortality rate is that only about 60 percent of births are attended by skilled health personnel, according to the latest data (2003) (Figure 5-1). This is a big improvement from 46 percent in 1999, but it falls far below cohort standards, with Indonesia at 72 percent, Thailand at 99 percent, and the global LMI average of 90 percent.

Figure 5-1
Births Attended by Skilled Health Personnel (percent)

The low percentage of births attended by skilled health personnel is a cause of high maternal mortality.

Comparisons to Other Countries, Most Recent Year — Global Standing

Philippines 59.8, LMI 90.0, Indonesia 72.0, Thailand 69.0

Global Standing: Highest-five average 99.4, PHI, Lowest-five average 28.0

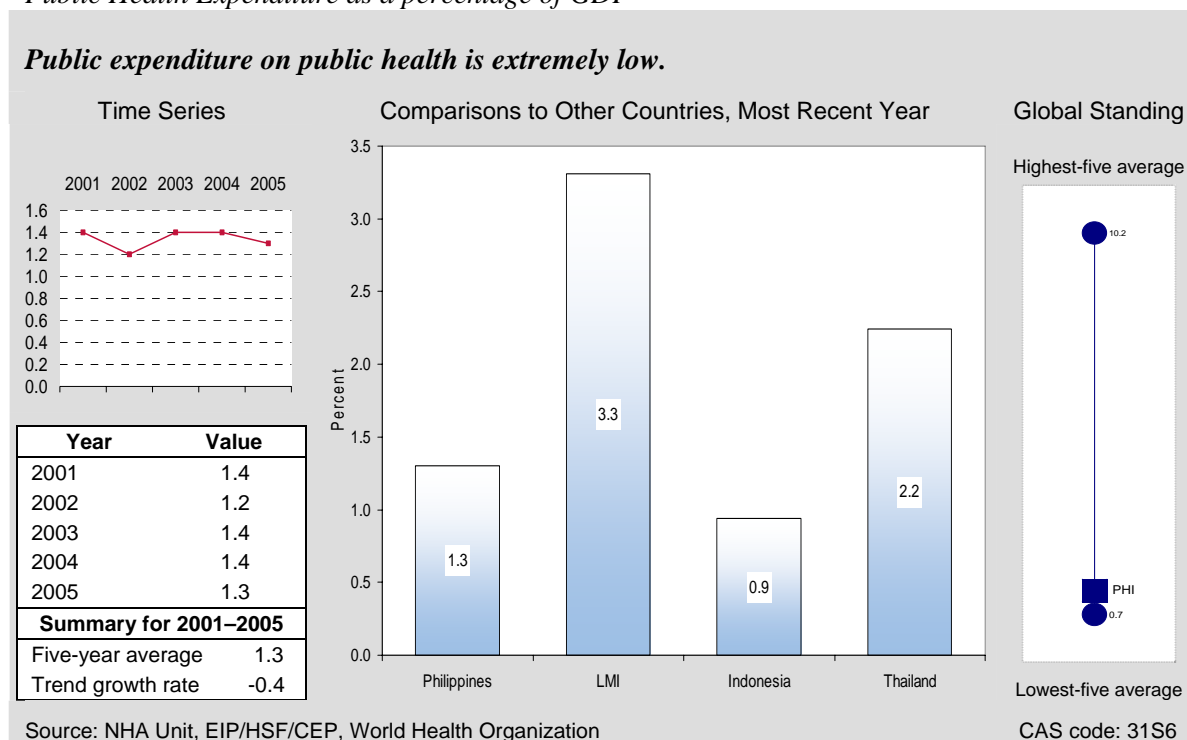Source: World Development Indicators 2006   CAS code: 31S3

The child malnutrition rate of 28 percent for 2004 (latest data) is another serious health problem. The malnutrition rate is equally high in Indonesia, but both countries are performing poorly in absolute terms, and in relation to the other benchmarks. By comparison, the LMI average is just 7.8 percent; for Thailand the corresponding figure is 19 percent (for 2003). This basic deficiency raises serious concerns about long-term growth prospects, because child malnutrition today can impair the health and productivity of the next generation of workers. The child immunization rate is similarly low, at 79.5 percent. In this case, the Philippines is doing better than Indonesia (71 percent) but is falling well short of the global LMI average of 87.5 percent, as well as Thailand's outstanding record of 97 percent.

These serious health problems are clearly associated with the poverty and income inequality discussed earlier. Government resources should be adequate to do a much better job of investing in better health for the poor. But government expenditure on health services amounted to just 1.3 percent of GDP in 2005. This is much better than the poor record in Indonesia (0.9 percent of GDP). But both of these governments invest significantly less than Thailand (2.2 percent), and all three fall short of the global LMI average of 3.3 percent (Figure 5-2). The Philippines' government has stated its intention to devote a large share of revenue gains from the VAT to

social services. The weak spots in the health statistics indicate that this decision is entirely warranted, and even long overdue.

Figure 5-2

Public Health Expenditure as a percentage of GDP

Public expenditure on public health is extremely low.

| Time Series | | Comparisons to Other Countries, Most Recent Year | Global Standing |

Year	Value
2001	1.4
2002	1.2
2003	1.4
2004	1.4
2005	1.3
Summary for 2001–2005	
Five-year average	1.3
Trend growth rate	-0.4

Source: NHA Unit, EIP/HSF/CEP, World Health Organization   CAS code: 31S6

EDUCATION

Investment in human capital is a cornerstone for economic growth and development. For the Philippines, most of the education indicators demonstrate good, but not especially strong, performance. At the primary level, the net enrollment rate is approaching the goal of universal attendance. Between 2001 and 2004, the enrollment rate rose from 92.7 percent to 94.0 percent.[24] Primary enrollment is in line with Indonesia's figure of 94.3 percent, slightly better than the LMI average of 92.2 percent, and (surprisingly) well ahead of Thailand, at 86.9 percent. As a result of high primary enrollments, the youth literacy rate is also very high, at 95.1 percent in 2004, with virtual equality between males and females (94.5 percent and 95.7 percent, respectively). The government's commitment to basic education is also evident in public expenditure on primary schools, which amounted to 2.8 of GDP in 2005. This figure exceeds all benchmarks.

Although primary enrollment rates look good in comparison with the benchmarks, a low rate of persistence in school to grade 5 raises concern. In 2003 (latest data), the persistence rate of
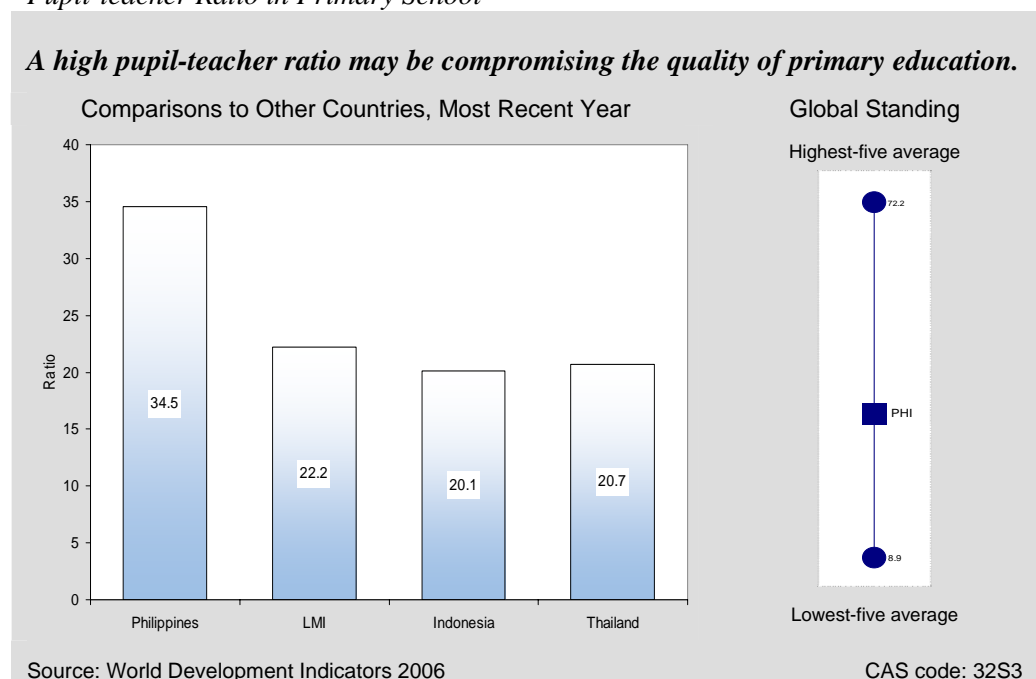
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[24] There are large discrepancies between the data obtained from UNESCO Institute of Statistics, as reported in the text, and data from the Philippines' NSCB. The latter show net primary enrollment *falling* from 96.8 percent in 2001 to 88.6 percent in 2004. We use the UNESCO numbers here, because they are more likely to be consistent with data from other countries.

75.3 percent was below that of Indonesia in the same year (92.1 percent), as well as the regression benchmark of 82.0 percent.[25] Furthermore, if the data are accurate, persistence to grade 5 is actually declining for both male and female students. In 2003, 79.6 percent of girls reached grade 5, but only 71.5 percent of boys. Evidently, boys have a higher dropout rate even at an early age, presumably to engage in labor market activities to support their families. This is symptomatic of underlying poverty in many areas of the country (see Poverty and Inequality, p. 7). Equally important, disruption to primary education for nearly 30 percent of male students demonstrates a serious lack of investment in human capital, with long-term implications for perpetuating the cycle of poverty.

For secondary school, the net enrollment rate is reasonably good, at 61.1 percent, and the gross tertiary enrollment rate is excellent, at 28.8 percent. Both figures exceed the regression estimates for the Philippines (of 56.2 percent and 15.7 percent, respectively). Even so, secondary enrollments fall below the global average for LMI countries (68.9 percent). For tertiary enrollments, however, the Philippines is already beating the LMI average (24.4 percent).

Education quality is difficult to measure. At the primary level, a crude but common proxy is the pupil–teacher ratio. In the Philippines, this ratio is remarkably high, at 34.5, which exceeds all the benchmarks (Figure 5-3). The combination of a high pupil–teacher ratio, high enrollment, and relatively high expenditure suggests that there may be serious inefficiencies in the primary school system that compromise the quality of basic education.

Figure 5-3
Pupil-teacher Ratio in Primary School

A high pupil-teacher ratio may be compromising the quality of primary education.

Comparisons to Other Countries, Most Recent Year

Global Standing

Source: World Development Indicators 2006

CAS code: 32S3

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[25] Neither the MDG data base nor the World Development Indicators provide a figure for Thailand.

The story is similar for post-primary education. One gauge of quality is the commitment of resources. For this purpose the best indicator calculates expenditure per student as a percentage of per capita GDP. At the secondary level, expenditure per student amounted to 10.0 percent of per capita GDP in 2003, compared to an LMI average of 15.7 percent and Thailand's 13 percent. No comfort can be taken from the fact that Indonesia lags far behind at 4.9 percent. For tertiary education, expenditure per student in the Philippines equaled 14.1 percent of per capita GDP in 2003, falling far short of the LMI average of 31.7 percent and Thailand's 22.7 percent. Again, Indonesia lags behind, at 13.4 percent. As with primary education, these figures call into question the quality of secondary and tertiary education in the Philippines.

Thus, the Philippines appears to have focused more on quantity than quality in the education system. Greater investment is needed at all levels of education to ensure that long-term competitiveness in the global arena will not be compromised by a lack of well-educated Filipinos entering the labor force in coming generations. This observation underscores the importance of further improvements in domestic revenue mobilization, as discussed in the Fiscal and Monetary Policy section.

EMPLOYMENT AND WORKFORCE

The Filipino workforce was estimated at 37.7 million in 2006. With a workforce growth rate of 2.6 percent per year, the economy needs to absorb one million new workers each year. This is difficult but achievable. Indeed, measured unemployment declined from more than 11 percent in 2004 and 2005 to 8.1 percent in 2006. In absolute terms, the unemployment rate is still very high, but the trend is encouraging. Moreover, there are good prospects for unemployment to decline further, because the trend in GDP growth, 5.2 percent per year, is fast enough to absorb the expansion of the labor force, even allowing for moderate growth in labor productivity (see Growth Performance, p. 5). The service sector is setting the pace, though productivity is much higher in the manufacturing sector (see Economic Structure, p. 9).

Despite the favorable trend in total employment, the data raise three serious concerns about labor market performance. First, there is a large gap between male and female labor force participation rates, which are 78.8 percent and 50.8 percent, respectively, for 2006. This differential is especially glaring in view of the high degree of gender equity in education. Greater efforts are needed to enhance opportunities for women to participate in the labor force, not only to redress inequality, but also to alleviate poverty and boost economic growth.

A second problem is that employment statistics mask important structural problems. In particular, the labor force count excludes more than 8 million Filipinos who have taken jobs overseas—about 20 percent of the labor force.[26] In addition, the National Statistics Office reports that one in five Filipino workers was underemployed in 2006.[27] These figures show that the economy has failed to provide adequate job opportunities for as much as 40 percent of the potential labor force.
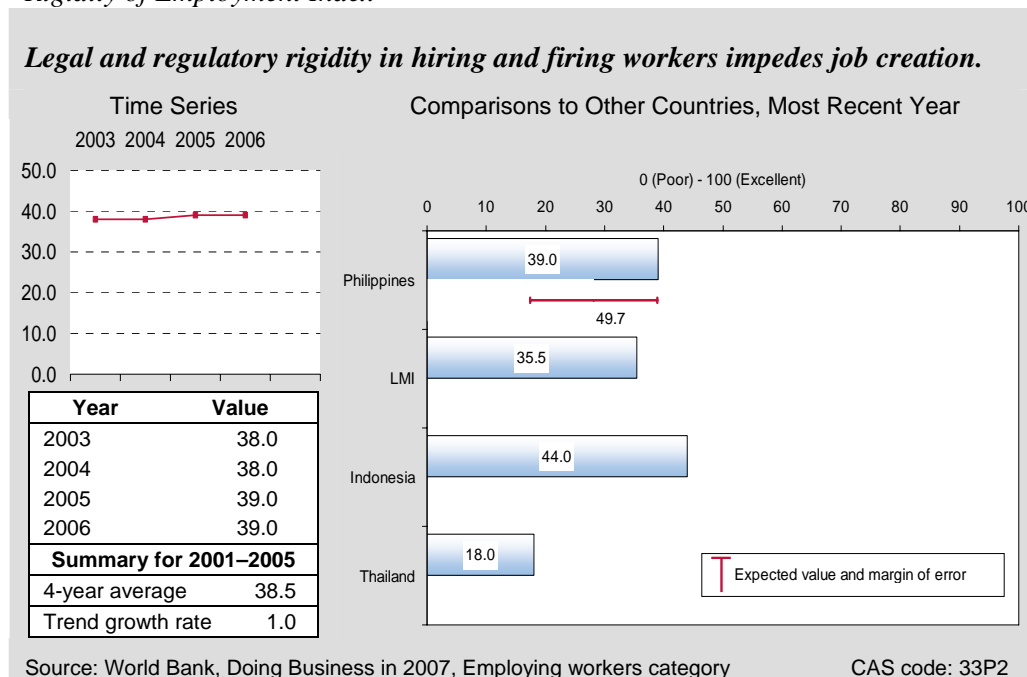
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[26] Philippines Overseas Employment Administration, at: www.poea.gov.ph/ .

[27] National Statistics Office, Household Statistics Department.
http://www.census.gov.ph/data/pressrelease/2007/lf0701tx.html, accessed April 23, 2007.

Yet another structural deficiency was discussed in the Economic Structure section (p. 9)—more than one-third of the labor force, with extremely low productivity, is occupied in agriculture.

The third major concern is that labor market rigidities are impeding investment and job creation. The World Bank's Rigidity of Employment index measures the difficulty that firms face in hiring and firing workers. If government policies and regulations increase the cost of firing workers, it is riskier for employers to hire workers in the first place. For 2006, the Philippines received a score of 39 on employment rigidity. This is the upper limit of the normal range from the benchmark regression and more than double Thailand's exemplary rating of 18.0 (Figure 5-4). To put this in perspective, the World Bank estimates that the cost of firing a worker, in a standardized situation, was an astronomical 91 weeks (almost two years) of wages in the Philippines in 2006, compared to 39 weeks as the LMI average and 54 weeks for Thailand. Once again, Indonesia looks even worse, with a firing cost of 108 weeks of wages.

Figure 5-4
Rigidity of Employment Index

Legal and regulatory rigidity in hiring and firing workers impedes job creation.

Source: World Bank, Doing Business in 2007, Employing workers category   CAS code: 33P2

Labor market reforms are very difficult to achieve because of strong resistance from workers who already have good jobs. Nonetheless, the analysis here points to job creation in highly productive sectors as a top priority for policymakers and donors. The legal and regulatory regime is impeding job creation and deterring investment that is needed to achieve more rapid growth.

AGRICULTURE
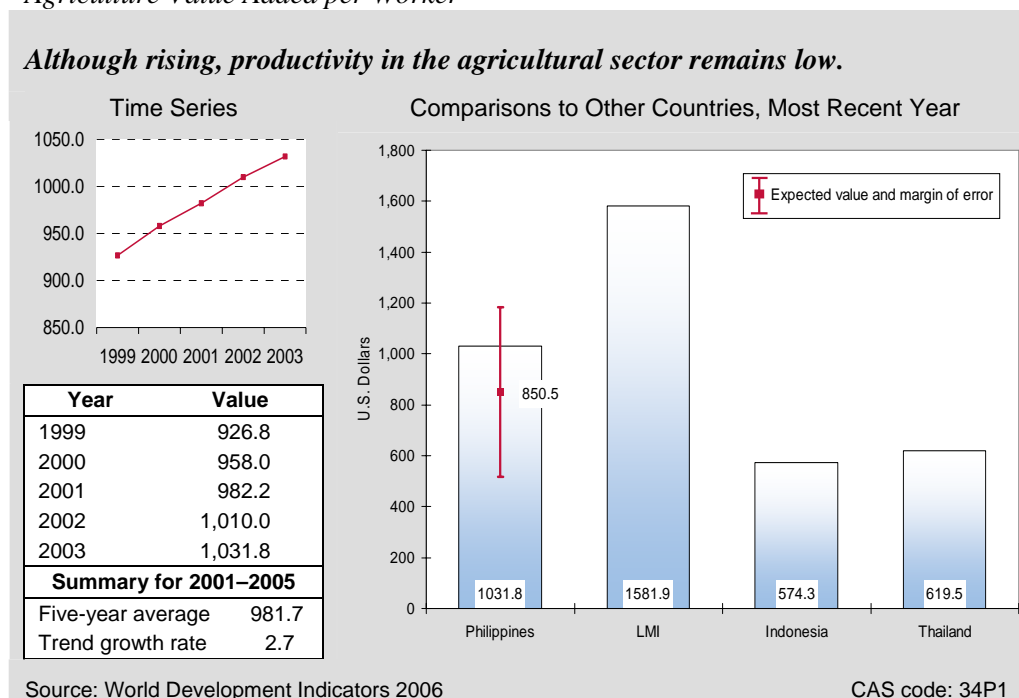
In some respects, agriculture is not an important sector of the economy in the Philippines. As seen earlier, agriculture accounts for only 14.2 percent of GDP and a mere 0.6 percent of total exports. And yet more than one-third of the labor force (36.7 percent in 2006) is engaged in agriculture, which includes the fisheries sector; and half of these households are classified as poor, according

to the 2000 FIES.[28] Thus, agricultural performance remains vitally important for poverty reduction and achievement of the Millennium Development Goals.

Efforts to increase agricultural productivity and competitiveness are showing signs of progress. Agricultural value added per worker (as measured in constant US dollars) rose from $927 in 1999 to $1,032 in 2003. This exceeds the regression benchmark ($851) as well as corresponding estimates for Indonesia ($574) and Thailand ($620). Still, there is much room for improvement— the global average for lower-middle income countries is of $1,582 (Figure 5-5). Overall, value added in agriculture grew at an average annual rate of 3.6 percent between 2000 and 2005. Within agriculture, fishing has been a leading sector.[29] Maintaining healthy growth in the fisheries sector requires effective and sustainable management of fishing stocks. This is a critical issue in view of evidence cited above that overfishing is one of the most serious environmental problems facing the country (see Demography and Environment, p. 10).

Figure 5-5
Agriculture Value Added per Worker

Although rising, productivity in the agricultural sector remains low.

Year	Value
1999	926.8
2000	958.0
2001	982.2
2002	1,010.0
2003	1,031.8
Summary for 2001–2005	
Five-year average	981.7
Trend growth rate	2.7

Source: World Development Indicators 2006   CAS code: 34P1

Key crops in the Philippines include rice (palay), sugarcane, cocoa, banana, pineapple, coffee, and mango. Self-sufficiency in rice is an explicit goal of the government. Cereal yields have increased by an impressive average rate of 3.5 percent per year, rising from 2,668 kilograms per hectare in 2001 to 3,023 kilograms per hectare in 2005. This achievement compares favorably with the LMI average of 2,485 kilograms per hectare and Thailand's yield of 2,723 kilograms per hectare. Still, the high cost of agricultural inputs, weak extension services, and distortionary land

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[28] We were unable to find corresponding figures from the 2003 FIES.

[29] Bureau of Agricultural Statistics, Rural Sector Statistical Information System. Accessed online at: http://www.bas.gov.ph/rssis/index.php?id=2&cont=gperformance# on April 23, 2007.

and pricing policies prevent the Philippines from reaching yields comparable to those in Indonesia, at 4,312 kilograms per hectare in 2005. According to the WEF's survey results, from the Global Competitiveness Report for 2004, the Philippines gets only a mediocre rating of 3.5 (on a scale from 1, for excessively burdensome, to 7, for well balanced) on Agricultural Policy Costs. This matches the LMI average but falls short of the ratings for Indonesia and Thailand (4.2 and 4.5, respectively).

Continued gains in agricultural productivity are needed to improve the lives of the rural poor and strengthen the base for economic growth. To this end, the government must address a number of fundamental constraints in the long term. Chief among them are land reform, access to financial services, and infrastructure development. In addition, the government and its international partners should focus on initiatives that modernize production methods, reduce post-harvest losses, and introduce improved technologies, as identified in the Medium-term Philippines Development Plan (2004–2010).

Appendix. CAS Methodology

CRITERIA FOR SELECTING INDICATORS

The economic performance evaluation in this report is designed to balance the need for broad coverage and diagnostic value, on the one hand, and the requirement of brevity and clarity, on the other. The analysis covers 15 economic growth–related topics, and just over 100 variables. For the sake of brevity, the write-up in the text highlights issues for which the "dashboard lights" appear to be signaling problems, which suggest possible priorities for USAID intervention. The accompanying table provides a full list of indicators examined for this report. The separate Data Supplement contains the complete data set for Philippines, including data for the benchmark comparisons, and technical notes for every indicator.[30]

For each topic, the analysis begins with a screening of *primary performance indicators*. These Level I indicators are selected to answer the question: Is the country performing well or not in this area? The set of primary indicators also includes descriptive variables such as per capita income, the poverty head count, and the age dependency rate.

When Level I indicators suggest weak performance, we review a limited set of *diagnostic supporting indicators*. These Level II indicators provide additional details, or shed light on *why* the primary indicators may be weak. For example, if economic growth is poor, one can examine data on investment and productivity as diagnostic indicators. If a country performs poorly on educational achievement, as measured by the youth literacy rate, one can examine determinants such as expenditure on primary education, and the pupil–teacher ratio.[31]

The indicators have been selected on the basis of the following criteria. Each must be accessible through USAID's Economic and Social Database or convenient public sources, particularly on the Internet. They should be available for a large number of countries, including most USAID client states, to support the benchmarking analysis. The data should be sufficiently timely to support an assessment of country performance that is suitable for strategic planning purposes. Data quality is another consideration. For example, subjective survey responses are used only when actual measurements are not available. Aside from a few descriptive variables, the indicators must also be useful for diagnostic purposes. Preference is given to measures that are widely used, such as Millennium Development Goal indicators, or evaluation data used by the Millennium Challenge Corporation. Finally, an effort has been made to minimize redundancy. If

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[30] The Data Supplement is available on line at
http://www.nathaninc.com/projects/projectdetails.asp?pid=138&pfid=0&rpid=4&rid=9 .

[31] Deeper analysis of the topic using more detailed data (Level III) is beyond the scope of this series.

two indicators provide similar information, preference is given to one that is simplest to understand, or most widely used. For example, both the Gini coefficient and the share of income accruing to the poorest 20 percent of households can be used to gauge income inequality. We use the income share because it is simpler and more sensitive to changes.

BENCHMARKING METHODOLOGY

Comparative benchmarking is the main tool used to evaluate each indicator. The analysis draws on several criteria, rather than a single mechanical rule. The starting point is a comparison of performance in the Philippines relative to the average for countries in the same income group and region —in this case, lower-middle-income countries in Asia.[32] For added perspective, three other comparisons are examined: (1) the global average for this income group; (2) respective values for two comparator countries approved by the Philippines mission (in this case Indonesia and Thailand); and (3) the average for the five best- and five worst-performing countries globally. Most comparisons are framed in terms of values for the latest year of data from available sources. Five-year trends are also taken into account when this information sheds light on the performance assessment.[33]

For selected variables, a second source of benchmark values uses statistical regression analysis to establish an expected value for the indicator, controlling for income and regional effects.[34] This approach has three advantages. First, the benchmark is customized to Philippines's specific level of income. Second, the comparison does not depend on the exact choice of reference group. Third, the methodology allows the quantification of the margin of error and establishment of a "normal band" for a country with Philippines's characteristics. An observed value falling outside this band on the side of poor performance signals a serious problem.[35]

Finally, where relevant, Philippines's performance is weighed against absolute standards. For example, a corruption perception index below 3.0 is a sign of serious economic governance problems, regardless of the regional comparisons or regression result.

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[32] Income groups as defined by the World Bank for 2004. For this study, the average is defined in terms of the mean; future studies will use the median instead, because the values are not distorted by outliers.

[33] The five-year trends are computed by fitting a log-linear regression line through the data points. The alternative of computing average growth from the end points produces aberrant results when one or both of those points diverges from the underlying trend.

[34] This is a cross-sectional OLS regression using data for all developing countries. For any indicator, Y, the regression equation takes the form: Y (or ln Y, as relevant) = a + b * ln PCI + c * Region + error – where PCI is per capita income in PPP\$, and Region is a set of 0-1 dummy variables indicating the region in which each country is located. When estimates are obtained for the parameters a, b, and c, the predicted value for the Philippines is computed by plugging in Philippines-specific values for PCI and Region. Where applicable, the regression also controls for population size and petroleum exports (as a percentage of GDP).

[35] This report uses a margin of error of 0.66 times the standard error of estimate (adjusted for heteroskedasticity, where appropriate). With this value, 25 percent of the observations should fall outside the normal range on the side of poor performance (and 25 percent on the side of good performance). Some regressions produce a very large standard error, giving a "normal band" that is too wide to provide a discerning test of good or bad performance.

STANDARD CAS INDICATORS

Indicator	Level[a]	MDG, MCA, or EcGov[b]
Growth Performance		
Per capita GDP, in Purchasing Power Parity Dollars	I	
Per capita GDP, in current US Dollars	I	
Real GDP Growth	I	
Growth of labor productivity	II	
Investment Productivity, Incremental Capital-Output Ratio (ICOR)	II	
Gross fixed investment, % GDP	II	
Gross fixed private investment, % GDP	II	
Poverty and Inequality		
Human Poverty Index	I	
Income-share, poorest 20%	I	
Population living on less than $1 PPP per day/ $2 PPP per day[36]	I	MDG
Poverty Headcount, by National Poverty Line	I	MDG
PRSP Status	I	EcGov
Population below minimum dietary energy consumption	II	MDG
Economic Structure		
Labor force or employment structure	I	
Output structure	I	
Demography and Environment		
Adult literacy rate	I	
Youth dependency rate/ elderly dependency rate[37]	I	
Environmental performance index	I	
Population size and growth	I	
Urbanization rate	I	
Gender		
Girls' primary completion rate	I	MCA
Gross enrollment rate, all levels of education, male, female	I	MDG
Life expectancy at birth, male, female	I	
Labor Force Participation Rate, Male and Female	I	
Fiscal and Monetary Policy		
Govt. expenditure, % GDP	I	EcGov
Govt. revenue, % GDP	I	EcGov
Growth in the money supply	I	EcGov

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[36] $1 PPP for lower income countries and $2 PPP for lower middle income countries

[37] Elderly dependency rate for Eastern Europe and Former Soviet Union countries and youth dependency rate for all others

Indicator	Level[a]	MDG, MCA, or EcGov[b]
Inflation rate	I	MCA
Overall govt. budget balance, including grants, % GDP	I	MCA, EcGov
Composition of govt. expenditure	II	
Composition of govt. revenue	II	
Composition of money supply growth	II	
Business Environment		
Corruption perception index	I	EcGov
Ease of Doing Business Ranking	I	EcGov
Rule of law index	I	MCA, EcGov
Regulatory quality index	I	MCA, EcGov
Government effectiveness index	I	MCA, EcGov
Cost of starting a business	II	MCA, EcGov
Procedures to enforce a contract	II	EcGov
Procedures to register property	II	EcGov
Procedures to start a business	II	EcGov
Time to enforce a contract	II	EcGov
Time to register property	II	EcGov
Time to start a business	II	MCA, EcGov
Total tax payable by business	II	EcGov
Business costs of crime, violence and terrorism	II	
Senior manager time spent dealing with government regulations	II	EcGov
Financial Sector		
Domestic credit to private sector, % GDP	I	
Interest rate spread	I	
Money supply, % GDP	I	
Stock market capitalization rate, % of GDP	I	
Credit information index	I	
Legal rights of borrowers and lenders	II	
Real Interest rate	II	
External Sector		
Aid , % GNI	I	
Current account balance, % GDP	I	
Debt service ratio	I	MDG
Export growth, Goods and Services	I	
Foreign direct investment, % GDP	I	
Gross international reserves, months of imports	I	EcGov
Gross Private capital inflows, % GDP	I	
Present value of debt, % GNI	I	
Remittance receipts, % exports	I	

Indicator	Level[a]	MDG, MCA, or EcGov[b]
Trade, % GDP	I	
Trade in services, % GDP	I	
Concentration of exports	II	
Inward FDI potential index	II	
Net barter terms of trade	II	
Real effective exchange rate (REER)	II	EcGov
Structure of merchandise exports	II	
Trade policy index	II	MCA, EcGov
Ease of trading across borders ranking	II	EcGov
Economic Infrastructure		
Internet users per 1,000 people	I	MDG
Overall infrastructure quality	I	EcGov
Telephone density, fixed line and mobile	I	MDG
Quality of infrastructure—railroads, ports, air transport, and electricity	II	
Roads paved, % total roads	II	
Science and Technology		
Expenditure for R&D, % GDP	I	
FDI technology transfer index	I	
Availability of scientists and engineers	I	
Science & technology journal articles, per million people	I	
IPR protection	I	
Health		
HIV prevalence	I	
Life expectancy at birth	I	
Maternal mortality rate	I	MDG
Access to improved sanitation	II	MDG
Access to improved water source	II	MDG
Births attended by skilled health personnel	II	MDG
Child immunization rate	II	MCA
Prevalence of child malnutrition (weight for age)	II	
Public health expenditure, % GDP	II	MCA, EcGov
Education		
Net primary enrollment rate – female, male, total	I	MDG
Persistence in school to grade 5 – Female, Male, and Total	I	MDG
Youth literacy rate – Female, Male, and Total	I	
Net secondary enrollment rate, Total	I	
Gross tertiary enrollment rate, Total	I	
Expenditure on Primary Education, % GDP	II	MCA, EcGov

Indicator	Level[a]	MDG, MCA, or EcGov[b]
Educational Expenditure per student, % GDP per capita—primary, secondary, and tertiary	II	EcGov
Pupil-teacher ratio, primary school	II	
Employment and Workforce		
Labor force participation rate, total	I	
Rigidity of employment index	I	EcGov
Size and growth of the labor force	I	
Unemployment rate	I	
Economically active children, % children ages 7-14	I	
Firing costs, weeks of wages	II	EcGov
Agriculture		
Agriculture value added per worker	I	
Cereal yield	I	
Growth in agricultural value-added	I	
Agricultural policy costs index	II	EcGov
Crop production index	II	
Livestock production index	II	
Agricultural export growth	II	

[a] *Level I— primary performance indicators, Level II— supporting diagnostic indicators*

[b] *MDG—Millennium Development Goal indicator*
MCA—Millennium Challenge Account indicator
EcGov—Major indicators of economic governance, which is defined in USAID's Strategic Management Interim Guidance to include "microeconomic and macroeconomic policy and institutional frameworks and operations for economic stability, efficiency, and growth." The term therefore encompasses indicators of fiscal and monetary management, trade and exchange rate policy, legal and regulatory systems affecting the business environment, infrastructure quality, and budget allocations.