

PHILIPPINES

Fostering More Inclusive Growth

MAIN REPORT



THE WORLD BANK GROUP

The World Bank Group
in the Philippines
**Making Growth
Work for the Poor**

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PHILIPPINES
**Fostering
More Inclusive
Growth**

*Human Development Sector Unit
East Asia and Pacific Region*

*Poverty Reduction and Economic Management Unit
East Asia and Pacific Region*

MAIN REPORT

Document of the World Bank





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ACRONYMS AND ABBREVIATIONS

4Ps	Pantawid Pamilyang Pilipino Program	NFA	National Food Authority
ADB	Asian Development Bank	NHIP	National Health Insurance Program
ARMM	Autonomous Region of Muslim Mindanao	NHTSPR	National Household Targeting System for Poverty Reduction
APIS	Annual Poverty Indicators Survey	NRA	Nominal Rates of Assistance
ASEAN	Association of Southeast Asian Nations	NSCB	National Statistical Coordination Board
BCG	Bacillus Calmette-Guerin	NSO	National Statistics Office
BPO	Business Process Outsourcing	OECD	Organization for Economic Cooperation and Development
BTr	Bureau of Treasury	OFWs	Overseas Filipino Workers
CALABARZON	Cavite, Laguna, Batangas, Rizal, and Quezon	OOP	Out-of-Pocket
CAR	Cordillera Autonomous Region	PAP	Program/ Activity/ Project
CCT	Conditional Cash Transfer	PESFA	Private Education Student Financial Assistance
DepED	Department of Education	PHILHEALTH	Philippine Health Insurance Corporation
DOH	Department of Health	PMT	Proxy Means Test
DOLE	Department of Labor and Employment	PPP	Purchasing Power Parity
DPT3	Diphtheria-Pertussis-Tetanus Vaccine 3	RRA	Relative Rate of Assistance
DSWD	Department of Social Welfare and Development	SBM	School-Based Management
FAOSTAT	Food and Agriculture Organization Statistics	SMEs	Small and Medium Enterprises
FIES	Family Income and Expenditure Survey	SNPLP	Study Now Pay Later Plan
GDP	Gross Domestic Product	SOCCSKSARGEN	South Cotabato, Cotabato, Sultan Kudarat, Sarangani and General Santos City
GNP	Gross National Product	SY	School Year
ILO	International Labor Organization	TESDA	Technical Education and Skills Development Authority
IMF	International Monetary Fund	TFP	Total Factor Productivity
LGU	Local Government Unit	TVET	Technical and Vocational Education and Training
LFS	Labor Force Survey	UNDP	United Nations Development Program
M3	Domestic Liquidity	USAID	United States Agency for International Development
MDGs	Millennium Development Goals	WB	The World Bank
MFN	Most Favoured Nation	WDR	World Development Report
MI	Macro International	WHO	World Health Organization
MIMAROPA	Mindoro Oriental, Mindoro Occidental, Marinduque, Romblon, and Palawan	WTO	World Trade Organization
MOOE	Maintenance and Other Operating Expenses		
MTPDP	Medium-Term Philippine Development Plan		
NA	National Accounts		
NAPC	National Anti-Poverty Commission		
NCR	National Capital Region		
NEDA	National Economic and Development Authority		
NDHS	National Demographic and Health Survey		

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Chapter II: Poverty in the Philippines

Chapter II - Annex I: Measuring Poverty in the Philippines

Chapter II - Annex II: Simulating the Impact of Inflation on Poverty

Chapter III: The Sectoral and Regional Patterns of Growth in the Philippines

Chapter IV: Revisiting Agricultural Growth as a Pathway out of Rural Poverty

Chapter V: Enhancing the Contribution of Manufacturing to Growth and Employment

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Dave Llorito

“Growth that is inclusive, or growth that works for the poor, provides a stronger platform for future expansion and competitiveness.”



EXECUTIVE SUMMARY

1. Slow economic growth has been a long-standing problem in the Philippines. During 1980-99, per capita growth of gross domestic product (GDP) averaged close to zero percent, far below the 6.5 percent average per capita growth recorded for the East Asia and Pacific region as a whole. This lackluster performance largely explains why the rate of poverty reduction was so much slower in the Philippines than elsewhere in East Asia during those two decades. While many East Asian countries such as China, Thailand, and Vietnam cut their poverty rates in half over that period, poverty in the Philippines fell by less than half that amount.

2. Although economic growth picked up significantly in the past decade, its sustainability remains in question. After two decades of stagnation, the Philippine economy began to grow again by the mid-2000s, with per capita growth accelerating to an annual average rate of 3.5 percent during 2003-06 and reaching a record high of 5.4 percent in 2007. Even before the global economic downturn of 2008 and 2009 set in, however, there were concerns that such growth would be difficult to sustain. These concerns revolved around the economy's dependence on an exceptionally favorable external environment and the prevalence of various long-term growth constraints, particularly the lack of adequate infrastructure coupled with low overall investment levels, the persistence of high unemployment and emigration rates that reflected a lack of domestic opportunities, and governance weaknesses that undermined the investment climate. An inability to sustain the tax revenue effort and a high public debt ratio also contributed to investor uncertainty.

3. At the same time, the Philippines' improved economic performance has not translated into greater progress in poverty reduction, indicating that growth has not been sufficiently inclusive. Despite the acceleration in economic growth after 2001, the share of the population living below the national poverty line did not decrease. Instead, official poverty estimates indicate that the overall incidence of poverty increased from 30.0 percent in 2003 to 32.9 percent in 2006.¹ The poverty gap, which measures how far households lie below the poverty line, also increased from 2000 to 2006 as did poverty severity, which takes into account the poverty gap but places a higher weight on households that are further away from the poverty line. These observations are corroborated by perception surveys (Social Weather Station reports) which indicate that poverty and hunger have increased in recent years, as well as by the slow progress made toward some key Millennium Development Goal (MDG) targets such as universal access to primary education and improved maternal and reproductive health.

4. The lack of progress in poverty reduction is partly explained by the limited dynamism of the growth experienced in 2000-06, coupled with high degrees of income inequality. Although strong by Philippine historical standards, the resurgence in growth since 2000 has been modest by regional standards, so its impact would have been expected to be relatively modest. At the same time,

¹ Other poverty estimates based on different methods of calculation yield similar increases in poverty incidence over this period. For example, (income-based) World Bank calculations yield an increase from 31.1 percent to 32.9 percent over this period, while (consumption-based) calculations by Balisacan (2008) yield an increase from 26.0 percent to 28.1 percent. See also the papers presented at the National Conference on Imperatives for Poverty Reduction Amidst and Beyond the Global Economic Crisis, held in Manila on March 31, 2009.



the Philippines has a very high level of income inequality. The World Bank's Development Data Platform currently identifies the Philippines as having the most unequally distributed income (or consumption) among the East Asian middle-income countries, whether measured by the Gini coefficient or the relative shares earned by the richest and lowest quintiles of the population. The high degree of income inequality has the effect of rendering poverty less responsive to increases in economic growth, thus slowing down the poverty reduction process.

5. Non-income indicators also reveal a high level of inequality in the Philippines. Large inequalities in health and education outcomes and in access to services persist across regions and income groups. In health, for example, one child in a thousand died between ages 1-5 among the wealthiest quintile of the population, compared to 25 per thousand in the poorest quintile and 33 per thousand in the Autonomous Region of Muslim Mindanao (ARMM). Similar disparities can be seen in education, with 82.9 percent of children 16 years or younger in the poorest quintile being in school compared to 98.0 in the richest quintile. In the ARMM, only 78 percent of children 16 years or younger attended school, compared to the national average of 90.2 percent and the National Capital Region (NCR) average of 94.3 percent. These discrepancies indicate a highly unequal distribution of human capital that becomes reflected in unequal earnings.

6. The failure of poverty to decline in 2000-06 is also linked to a worsening distribution of income. Although the economic growth experienced in the Philippines during 2000-06 may have been overestimated due to various statistical limitations associated with data collection and compilations of the National Accounts, the corroborating evidence indicates that, on balance, aggregate economic growth was positive. At the same time, various indicators show that poverty did not decline. This implies that the modest growth that did take place during 2000-06 must have resulted in a deteriorating distribution of income, meaning that the benefits of growth have not been shared with the poor.

7. Several factors have contributed to the apparent deterioration in the distribution of income and consumption. These factors include:

- *An unequal sectoral distribution of growth.* The main problem from a poverty reduction perspective has been that the sector that employs the bulk of low-skilled

workers (agriculture) has been growing very slowly, while the sectors that have been contributing most to the acceleration of GDP growth after 2000 (mainly manufacturing) have been very capital-intensive and have not generated many new jobs. Furthermore, the employment generated in the manufacturing and services sectors has mainly benefited the more skilled workers, who tend not to be poor.

- *An unequal pattern of regional development.* Income and poverty levels differ significantly across regions. The NCR, which accounts for only 13 percent of the entire population, is the richest region in the Philippines, with a per capita GDP (in constant 1985 Pesos) of P37,855 in 2006.² At the other extreme is the ARMM, with an average per capita GDP of P3,486. Notably, the regions with the lowest poverty incidence have higher degrees of economic activity. The NCR contributed 37.2 percent of national GDP in 2006 and had the lowest regional poverty headcount rate at 10.4 percent.
- *Intense demographic pressures due to rapid population growth.* Despite a modest decline in fertility rates over the last few decades, the country's population growth rate remains among the highest in the region. The continuous increase in the working-age population is putting tremendous pressure on the labor market, straining the economy's capacity to maintain full employment and generate adequate real wage growth. Between 2001 and 2007, employment grew by 13 percent, while the working-age population grew by 17.6 percent. Meanwhile, the average real wage declined by 5 percent between 2003 and 2006.
- *Declines in the relative price of labor provided by the poor.* A growth pattern that is biased toward sectors that are most intensive in the use of unskilled labor would put upward pressure on the unskilled wage economy-wide, thus raising the incomes of the poor. However, as noted above, the recent pattern of growth in the Philippines has been biased against the unskilled labor-intensive sectors.
- *An unequal distribution of human capital and access to social services* as well as in some cases, a decline of public spending on social services that mainly benefit

² NCR is also the most densely populated, with 16,100 persons per km², compared to a national average of 226.



the poor. Although the Philippines has made progress in building human capital through health and education and providing adequate social protection, major challenges remain in ensuring equity and access to quality basic services across the country.

8. Although the economic downturn in 2008-09 has refocused attention on the need to restore growth and economic recovery, it does not diminish the importance of ensuring that growth is more inclusive.

Clearly, more remains to be done to boost aggregate economic growth. However, a greater focus on distribution is also warranted given the limited poverty-reducing impact of the growth achieved in recent years, which suggests that more growth along the same lines as before will not be enough to yield the desired poverty reduction outcome. Broad-based participation in the growth process remains critically important to ensure that the benefits of growth are shared by the poor and most vulnerable. It also provides a stronger platform for future growth and competitiveness. For the Philippines to sustain development and reduce poverty going forward, it must therefore look beyond simple growth toward achieving more inclusive growth.

9. To reduce poverty and build a broader base for future economic prosperity, a two-pronged strategic approach to fostering more inclusive growth is needed.

Achieving such growth will not be easy while the global economic slowdown persists. Moreover, the post-crisis external environment is likely to be less favorable than before, which threatens to leave the Philippine economy on a lower growth plateau in the absence of reforms. This adds further urgency to the removal of growth constraints that already existed before the crisis.

10. The first prong of this strategic approach is to take actions that enhance income-earning opportunities, particularly for the poor.

Improving income opportunities for the poor requires both removing constraints to growth and productivity in labor-intensive sectors where the poor are concentrated as well as removing constraints to employment generation in well-performing sectors of the economy. At the same time, it is critical to foster greater labor mobility to facilitate the movement of workers to better employment opportunities. A first step would be to promote overall growth by addressing the main constraints of (i) a vulnerable fiscal situation; (ii) inadequate infrastructure, particularly in transport and electricity; and (iii) a weak investment climate due largely to governance concerns. In terms of sectoral emphasis, the agriculture

sector, where most of the poor are currently engaged, requires special attention. The manufacturing and higher-productivity services sectors are also important since they offer the most promise in terms of future income-earning opportunities. With regard to eliminating barriers to factor mobility, the labor market deserves special attention, both because labor is the poor's main asset and because the Philippines' labor market legislation appears to be among the most rigid in the region.

11. The key to generating better income-earning opportunities is the integration of lagging regions and sectors of the economy with the leading ones.

The 2009 World Development Report (WDR) argued that spatial disparities in income and production are inevitable, as they are driven by economies of scale and agglomeration effects, and that government efforts to spread out economic activity equally across the board have generally proven to be futile. The same can be said about government efforts to "pick winners" among different economic sectors. As noted above, the poor in the Philippines mostly reside in rural areas and work in agriculture, which has been stagnant for years. Rather than targeting productive investments directly to rural areas and the agricultural sector, the 2009 WDR argues in favor of hitching this lagging, rural-based sector to the more dynamic urban-based manufacturing and services sectors through the application of 'spatially blind' policies. Such policies primarily involve the elimination of market distortions that inhibit sector development and interfere with the functioning of markets, coupled with investments in spatially connective infrastructure and human capital and the maintenance of sound macroeconomic policies.

12. The second prong of the strategic approach is to ensure that poor households can participate in markets and benefit from growth by enhancing their human capital.

Given the implications for growth, employment, health, and other areas, reducing fertility rates will be critical to poverty reduction. Greater efforts are also needed to improve access to education, health, and social protection services, particularly among the poorest populations and in the poorest regions. Public spending in health, education, and social protection for the poor also needs to be improved. In general, spending levels in these sectors suffered from the fiscal crisis in the past decade, and the levels of spending are still much lower than in comparable countries. Furthermore, spending in these sectors has also not been adequately targeted to the poor. Other systemic problems in public spending, such as poor budget



execution, result in even best-laid plans not being achieved. Judiciously increasing spending in these sectors, better targeting the programs that would benefit the poor, and improving expenditure management will be important for allowing the poor to benefit from growth and to participate in it in the future. In addition, improving accountability in service delivery will help make services more responsive to the actual needs and demands of poor clients.

Summary of Recommendations

A. Enhancing Income Opportunities

13. Because more dynamic growth is essential for poverty reduction, the main constraints on growth identified in previous diagnostic studies for the Philippines need to be eliminated, which requires:

- Strengthening the government's revenue collection efforts, both on the tax policy side and on the tax administration side. A possible target would be to reestablish the tax ratio prevailing before the East Asian financial crisis – 17 percent of GDP – over a period of 5 years.
- Raising the public infrastructure investment effort. A possible target would be to double the GDP-share of public investment over a period of 5 years. At the same time, it would be advisable to set up a high-level commission to review the effectiveness of existing public-private partnership arrangements and consider ways of strengthening them.
- Strengthening public expenditure and financial management systems, both at the national and sub-national levels, with the aim of developing a well-planned public investment pipeline that complements private sector activities along lines of revealed comparative advantage and of improving budget execution performance.
- Improving the transparency of the public sector budget and in public financial management, to improve governance and the public's perceptions of governance. This includes reducing the scope for discretionary public sector management, both in terms of budget spending and civil service appointments.
- Improving the investment climate by reducing the 'behind the border constraints' that inhibit business development, especially in manufacturing.

14. Improved productivity is critical for agricultural growth, which can still make a significant contribution to poverty reduction in the Philippines. The agriculture sector's contribution to poverty reduction has been much

weaker in the Philippines than elsewhere in East Asia. The poor performance of agriculture primarily reflects the closing of the "land frontier" and low total factor productivity growth. Key factors contributing to low productivity growth are the (i) agrarian reform policies that interfere with the functioning of land markets, aggravate the problem of declining farm size, and render access to land more difficult for small-scale farmers; (ii) high tariff and non-tariff barriers in agriculture, in part linked to policies seeking to achieve self-sufficiency in basic food commodities, which have stifled competition; and (iii) inadequate public investment in the sector. These findings point toward the need to review the existing policy framework in agriculture, with particular attention to the strategy to achieve self-sufficiency in the production of rice and other basic commodities. In this context, policymakers may consider:

- Reducing the high tariff and non-tariff barriers to trade in agricultural commodities.
- Setting up a commission to review the current land reform policy with a view to improving the functioning of land markets.
- Reviewing the need for public infrastructure investments benefiting agriculture, but on a very selective basis in areas with revealed growth potential.

15. The non-farm sector has become an important steppingstone out of poverty for rural households and will continue to grow in importance. Even with the preceding reforms, agriculture will not become the main pathway out of poverty in the Philippines. Studies show that, increasingly, the main escape from poverty has been through the secondary and tertiary sectors. Agriculture can still play an important role in remote rural areas with high geo-physical endowments that give agricultural production a natural advantage. Nevertheless, public investment policy should seek to remain spatially and sectorally blind so as not to bias the development of farm versus non-farm economic activities.

16. The contribution of manufacturing to growth and employment could be strengthened by measures to improve sector performance. In manufacturing, three sets of factors have impeded a more dynamic growth performance and limited its employment generating impact: (i) lack of competition, (ii) shortcomings in the investment climate, and (iii) factor market distortions that tend to promote more capital-intensive production techniques, resulting in limited labor absorption. To remove these barriers, policymakers may consider:



- Introducing competition legislation and the establishment of an anti-monopoly authority.
- Setting up a working group to review potential bottlenecks in the financial system that inhibit access to financing by small and medium-sized enterprises.
- Addressing the most important shortcomings in the investment climate, which have been identified as (i) the low quality of governance, particularly the prevalence of corruption, and (ii) the low quality of public infrastructure, especially in regard to the power sector.
- Creating a high-level commission to review the country's labor market regulations and institutions with the aim of enhancing job creation.

17. Beyond creating opportunities, policies must enable workers to move to those opportunities and allow the labor market to function efficiently.

The mobility of labor in the Philippines may be hindered by labor market legislation that was designed to protect labor but that ends up interfering with the labor market clearing process and artificially raises the cost of labor. To facilitate greater labor mobility, it is necessary to review the existing labor market legislation and institutions—especially those associated with minimum wages and limitations on temporary contractual arrangements—while at the same time considering the introduction of alternative mechanisms of social protection that generate fewer distortions into the labor market. The recent debate in Organization for Economic Cooperation and Development (OECD) countries on the so-called *flexicurity* model provides useful insights for potential new approaches to tackle the problems of the Filipino labor market. The international evidence suggests that efficiency gains might be achieved by strengthening social protection—i.e. unemployment insurance, wage subsidies, safety nets—in a way that is inclusive and mobility-friendly.

B. Assisting Households to Participate in Markets

18. Improving health service delivery is critical to poverty reduction. Evidence from the Philippines and elsewhere shows how critical good health is to poverty reduction. For example, decreasing fertility can reduce demographic pressures and contribute to improved growth in per capita incomes, while better nutrition improves cognitive function and productivity and reduces loss of income from morbidity and mortality. In the Philippines, key sector concerns from a poverty perspective are the country's high fertility rates, highly disparate distribution of health

indicators across regions and income groups, and uneven progress toward attaining the MDGs. The major sector limitations contributing to these outcomes are (i) uneven access to health services across socio-economic and geographic locations; (ii) low and declining levels of health spending, particularly at the local levels, which results in high out-of-pocket expenditures for the poor; and (iii) lack of accountability by the service providers.

19. Given the implications for inclusive growth and health outcomes for the poor, one priority area is to strengthen family planning.

Population growth has major implications not only for health but also for future public expenditure requirements, employment, human capital investment, and environmental management. However, use of family planning has stagnated in the past decade, with persistent unmet needs for family planning and inadequate access to family planning services for poor women. In 2003, only 24 percent of women in the poorest quintile were using family planning, compared to 58 percent in Vietnam and 49 percent in Indonesia. Over half of pregnancies in the Philippines are unintended. While poorer women typically want more children than wealthier women, women in the poorest 40 percent of the population have between 1.5-2.1 more children than they desire (Guttmacher Institute, 2009). Social marketing could help encourage better family planning practices among the middle and upper classes, while the poor will require enhanced public service provision.

20. To address the wide disparities in access to health services among the rich and poor and among different regions, increased public spending for properly targeted interventions is needed.

- Such measures could include:
- Increasing public spending targeted to greater vaccination coverage, improving access to health professionals and facilities for deliveries, raising the nutritional status of children, and improving water supply and sanitation in marginal areas.
 - Providing more funding and appropriate incentives to local governments to increase expenditures on health and to upgrade the quality of, and access to, essential maternal and child health services.
 - Expanding coverage of the National Health Insurance Program (NHIP) by reviewing the voluntary component, expanding government-subsidized enrollment of the poor, and improving the benefit package—in particular, through revising the current inpatient benefit and provider payment schemes, and by introducing primary care and outpatient drug benefits.



21. Efforts are also needed to ensure better quality service provision in health, such as:

- Improving accountability in the health system by introducing performance benchmarks, holding hospital management accountable through explicit contracts, and scaling up performance-based financing.
- Increasing access to essential drugs and quality medicines by strengthening regulation, increasing procurement transparency, expanding government subsidies, and promoting further competition.
- Enhancing the overall stewardship of the health sector by improving monitoring and evaluation of the sector and the regulation of the private health care sector.

22. Improving education and skills is also critical for enabling households to take full advantage of the income-earning opportunities available to them.

Education clearly plays a key role in assisting households to participate in markets. In the Philippines, daily wages increase monotonically with education level, with university graduates earning P354 a day, while workers with no elementary education earn only P106 a day³. Although significant progress has been made in the education sector, some remaining concerns from a poverty perspective are the very disparate distribution of education attainment indicators across income groups with very high dropout rates among the poor, decelerating college enrollment rates, and increasing skill gaps in the manufacturing and services sectors. Key sector limitations contributing to these outcomes are (i) uneven access to education across regions due in part to an equally uneven distribution of public spending on education, (ii) declining public spending on education from an already very low overall level, (iii) inefficient sector resource management, and (iv) lack of accountability in the provision of services.

23. To help increase educational enrolments and reduce inequalities, it is necessary to expand demand-side interventions and scholarship programs, particularly among the poor. Conditional cash transfer programs, which provide transfers to families who fulfill certain criteria such as school enrollment for children, can be an effective demand-side intervention for the poor. Effective scholarship programs and student loan programs should also be expanded for the poorest income quintile to help reduce the financial burden of schooling for poor households.

24. Efforts are also needed to enable the provision of quality education services around the country, including:

- Raising the level and efficiency of education expenditures. Greater real per capita spending in basic education is crucial.
- Using the limited public funding for tertiary education more strategically.
- Ensuring that adequate resources reach schools in a timely manner, applying an equity- and poverty-based formula for allocating school maintenance and other operating expenses.
- Expanding the involvement of local communities and the private sector. Where available, private sector capacity should also be utilized in cases where it has been shown to be more effective, but under an improved quality assurance framework.

25. To help address the problem of skills gaps, which is critical to future economic growth, higher education and TVET need to be more responsive to the needs of the labor market. This requires:

- Improving the quantity and quality of information on the labor market, with better and more complete firm and labor force surveys.
- Strengthening the linkages between post-secondary and tertiary education and industries through greater collaboration in curriculum design, training, and research and development to make education more responsive to the demands of employers.
- Articulating better the skills supply system through strengthened skills certification and a better education and training quality assurance and accreditation system.

26. Strengthening social protection is another key component of assisting households to participate in markets. Having adequate protection from shocks helps minimize disruptions to income as well as prevent adverse coping behaviors—including reduced spending on education and health—which can lead to greater destitution in the long run. Therefore, providing adequate social protection is crucial for making growth more inclusive. In general, however, social protection programs in the Philippines have been ineffective in preventing poverty increases during recessions or calamities. This is primarily due to inadequate targeting and a lack of accountability in the provision of social protection services. As a result, households often are forced to resort to self-defeating coping mechanisms, while legislators pass employment protection legislation that ends up hurting the poor.

³ See World Bank (2009c).



27. A number of measures will be essential to making the system of social protection more effective, such as:

- Better targeting to reduce the amount of program leakage and ensure that social protection programs benefit the poor and vulnerable. The Proxy Means Test (PMT) methodology is one of the most advanced targeting systems for this purpose. Other targeting methods include simpler categorical targeting (e.g., elderly, disabled), geographical targeting (universal coverage in areas with high poverty incidence), and self-targeting, where limited assistance is offered to everybody but at some costs to households, such that only the neediest would participate.
- Improving policy coordination in social protection policy. Building on previous advances, the next step is for the implementing agencies of social protection programs, such as the Department of Education (DepEd), Department of Health (DOH), and Department of Labor and Employment (DOLE), to take greater ownership in the results of the National Social Welfare Program assessment, which are likely to involve budget reallocations within departments or across agencies.
- Developing the *Pantawid Pamilyang Pilipino* Program (4Ps) to serve as the backbone of a modern and more consolidated social protection system for the Philippines. The 4Ps is a Conditional Cash Transfer (CCT) program providing health and education grants to qualified households on the condition that the children be sent to schools and health centers for regular check-ups and vaccinations. It uses a PMT targeting mechanism based on best practice examples from other countries, and it appears to have performed well in the 4Ps pilot areas.
- Enhancing the capacity of government agencies involved in social protection to help ensure successful implementation. The 4Ps, in particular, requires significant administrative capacity in the Department of Social Welfare and Development (DSWD). To roll out the program successfully, extensive training will be needed on all the operational steps of the program for staff at the central and local levels.

C. Cross-Cutting Issues

28. To support the higher level of spending needed to implement the measures described above, tax revenue collection must be improved. The preceding discussion noted that the delivery of social services was seriously underfunded and recommended significant increases in public spending on education and health. A similar funding gap was noted earlier in public infrastructure

spending, also warranting higher public spending. Raising public spending in the amount needed to address the problems noted in each of these areas will run into fiscal constraints, however, unless the government is capable of reversing the ongoing decline in tax revenues. A key priority, therefore, is to introduce a new round of tax reforms and strengthen tax administration in order to provide a sustainable basis for expanding public spending in priority areas.

29. As a basis for formulating appropriate policies to foster more inclusive growth, the nation's statistical systems need to be strengthened. Both the National Accounts (NA) and the Family Income and Expenditure Surveys (FIES) exhibit problems that make it difficult to track the evolution of poverty. Some of these problems are not unique to the Philippines and result from measurement conventions in the compilation of national accounts. However, there also appear to be serious shortcomings in the quality of the data collected in the Philippines. Several programs, in part supported by the World Bank, are underway to analyze these shortcomings and begin to address them. These programs need to be implemented expeditiously. Economic and social problems are difficult to tackle when they cannot be adequately measured.





Dave Llorito

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INTRODUCTION

- 1. Slow economic growth has been a long-standing problem in the Philippines.** During 1980-99, per capita growth of GDP averaged close to zero percent, far below the 6.5 percent average per capita growth recorded for the East Asia and Pacific region as a whole. This lackluster performance largely explains why the rate of poverty reduction was so much slower in the Philippines than elsewhere in East Asia during that period. While many East Asian countries such as China, Thailand, and Vietnam succeeded in cutting their poverty rates in half over this period, poverty in the Philippines fell by less than half that amount.
- 2. Although economic growth picked up significantly since the East Asian financial crisis in the late 1990s, its sustainability remains in question.** After two decades of stagnation, the Philippine economy began to grow again by the mid-2000s, with per capita growth accelerating to an annual average rate of 3.5 percent during 2003-06 and reaching a record high of 5.4 percent in 2007. Though still modest by East Asian standards, this resurgence of growth represented a major improvement by historical standards. The Philippines had not seen such levels of growth since the 1970s. Even before the global economic downturn of 2008 and 2009 set in, however, there were concerns that such growth would be difficult to sustain. These concerns revolved around the economy's dependence on an exceptionally favorable external environment which was fueling economic booms worldwide and the prevalence of various long-term growth constraints, particularly the lack of adequate infrastructure coupled with low overall investment levels, the persistence of high unemployment and emigration rates that reflected a lack of domestic opportunities, and governance weaknesses that undermined the investment climate. An inability to sustain the tax revenue effort and a high public debt ratio, despite the fiscal reforms introduced in the first half of this decade, also contributed to investor uncertainty.
- 3. Equally worrisome is that the Philippines' improved economic performance did not translate into greater progress in poverty reduction.** Given the acceleration in economic growth after 2001, a surprising development is that the share of the population living below the national poverty line did not decrease. Rather, the overall incidence of poverty increased from 30.0 percent in 2003 to 32.9 percent in 2006, according to the official poverty estimates.⁴ The poverty level is now back to where it was at the end of the 1990s. This observation is corroborated by perception surveys (Social Weather Station reports) which indicate that poverty and hunger have increased in recent years, as well as by the slow progress made toward achieving some key MDG targets such as universal access to primary education and improved maternal and reproductive health. So, even if the resurgence of growth observed in the mid-2000s had been sustained, it would have offered little hope for rapid poverty reduction.

⁴ Other poverty estimates based on different methods of calculation also yield similar increases in poverty incidence over this period. For example, (income-based) World Bank calculations yield an increase from 31.1 percent to 32.9 percent over this period (see Table 1), while (consumption-based) calculations by Balisacan (2008) yield an increase from 26.0 percent to 28.1 percent. See also the papers presented at the National Conference on Imperatives for Poverty Reduction Amidst and Beyond the Global Economic Crisis, held in Manila on March 31, 2009.



4. The lack of progress in reducing poverty despite accelerating economic growth indicates that growth has not been sufficiently inclusive. The apparent combination of economic expansion and rising poverty flies in the face of the strong empirical regularity that has been observed worldwide between falling poverty and positive economic growth. A number of factors have weakened the link between poverty reduction and growth in the Philippines. One is that the resurgence in growth was rather limited in magnitude; though strong by Philippine historical standards, it remained weak by regional standards. Another factor is the degree of inequality in the Philippines, which is high by regional standards and has the effect of rendering poverty less responsive to increases in economic growth rates. Finally, the modest growth that has taken place in the Philippines since the late 1990s appears to have been accompanied by a worsening distribution of income. Factors contributing to that bias are the unbalanced sectoral and regional patterns of growth as well as the unequal distribution of human capital, which reduces the capacity to take advantage of growth opportunities.

5. This Report seeks to deepen the understanding of the factors impeding broad-based growth in the Philippines and to lay out options for addressing them. While the last two Development Policy Reports prepared by the World Bank⁵ have focused on bringing about sustained aggregate economic growth, this report focuses more on distributional considerations. More remains to be done to boost aggregate economic growth, so the findings and recommendations of the earlier reports remain valid. A greater focus on distribution is warranted, however, in view of the limited poverty-reducing impact of the growth achieved in recent years, which suggests that more growth along the same lines as before will not be enough to yield the desired poverty reduction outcome. Instead, a different, more inclusive type of growth is needed.

6. The economic downturn in 2008-09 has refocused attention on the need to restore growth and economic recovery, but it does not diminish the importance of ensuring that growth is more inclusive. On the contrary, broad-based participation in the growth process remains critically important to ensure that the benefits of growth

are shared by the poor and most vulnerable. It also provides a stronger platform for future growth and competitiveness. For the Philippines to sustain development and reduce poverty going forward, it must therefore look beyond simple growth toward achieving more inclusive growth.

7. A key strategic component for fostering inclusive growth is the improvement of income opportunities, particularly for the poor. Improving income opportunities for the poor requires both removing constraints to growth and productivity in labor-intensive sectors where the poor are concentrated as well as removing constraints to employment generation in well-performing sectors of the economy. At the same time, it is critical to foster greater labor mobility to facilitate the movement of workers to better employment opportunities.

8. Another critical strategic component is to ensure that the poor can take full advantage of improved income opportunities by assisting their market participation. In particular, stronger efforts are needed to build human capital through improved health and education service delivery, so workers can seize the improved opportunities available to them. Having a healthy and well-educated workforce will, in turn, contribute to poverty reduction and help spur economic growth. Given the large share of the population that is vulnerable to falling into poverty, greater attention to social protection is also needed. This helps to protect workers and households against shocks and from resorting to coping mechanisms with pernicious long-term consequences, thereby enabling them to engage more fully in productive activities.

9. Organization of the Report. The Main Report is organized into three parts:⁶ Part I provides the overall context by describing the level and evolution of poverty and inequality in the Philippines and by analyzing the factors that could be weakening the link between economic growth and poverty reduction. It also provides a brief profile of the poor. Part II addresses the first strategic component for fostering inclusive growth, which refers to the enhancement of income opportunities and ensuring greater labor mobility for the poor. It begins by reviewing recent economic developments, with particular attention to employment generation, and evaluates the

⁵ Further technical detail on each topic discussed here is provided in the Background Papers and Annexes that are collected in a separate volume which accompanies the Main Report and is available upon request.

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potential of key economic sectors to generate growth and productive employment. Part II then turns to the related challenge of ensuring labor mobility, identifying signs of labor market segmentation and factors that may be responsible for labor market rigidities which inhibit the fluid movement of workers toward the most productive activities. Part III discusses the other main component of fostering inclusive growth, which is to ensure that workers and households are well-equipped to take advantage of productive employment opportunities. It reviews the current state of health, education, and social protection in the Philippines and proposes measures for strengthening social service delivery.





Dave Llorito

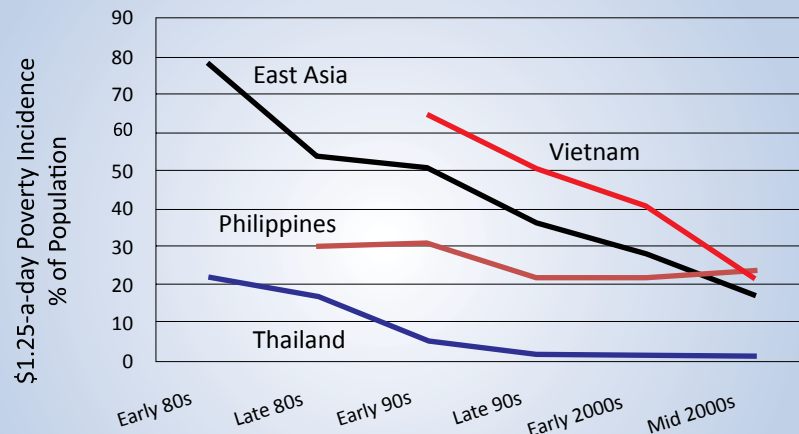
“The absence of more dynamic economic growth, coupled with high degrees of income inequality, partly explains why poverty failed to decline since 2000.”

Understanding Poverty and Inequality

A. Recent Trends in Poverty and Income Distribution

1. The Philippines made progress in the fight against poverty during the 1980s and 1990s, but at a relatively slow pace. Using the US\$1.25-a-day income threshold measure of poverty, it succeeded in reducing poverty from around 30 percent in the early 1980s to just over 22 percent at the end of the 1990s. Though significant, the decline of poverty in the Philippines over this period was quite weak compared to other countries in the region (Figure 1). As a result, the poverty rate for the East Asia and Pacific region as a whole is now below the Philippine rate, even though it was nearly twice as high just two decades ago. This notable difference in the pace of poverty reduction was mainly due to an equally notable difference in the pace of per capita economic growth, which averaged 0.1 percent in the Philippines over this period, compared to 6.5 percent in the rest of the region.⁷

Figure 1: Evolution of Poverty in the Philippines and Other East Asian Countries, 1980s to Mid-2000s



Note: The evolution of poverty in East Asia is strongly influenced by China, which weighs heavily in the regional average.

Source: World Bank, Development Data Platform.

2. Progress in poverty reduction was interrupted by the East Asia financial crisis in 1997-98. Although the Philippine economy recovered after the crisis, with GDP growth reaching a high of 7.1 percent in 2007, its poverty indicators remained unchanged or worsened. The poverty headcount ratio, or proportion of the population with incomes below the national poverty line, remained about the same between 2000 and 2003, and then increased between 2003 and 2006 (Table 1). The increase in poverty over this period has been confirmed by different sources using different

⁷ Also, the Philippines started out with lower poverty levels in the early 1980s and, thus, had already reaped the relatively easy gains to be had at the beginning of the poverty reduction process.

Table 1: Poverty Estimates Based on Constant (2006) National Poverty Line

	Poverty Headcount (% of population)			Poverty Gap (% of poverty line)			Poverty Severity (% of poverty line)		
	2000	2003	2006	2000	2003	2006	2000	2003	2006
Urban	16.8	17.3	19.5	4.6	4.7	5.4	1.8	1.8	2.2
Rural	44.7	44.4	45.9	14.0	14.4	14.6	5.9	6.3	6.2
Philippines	31.0	31.1	32.9	9.4	9.6	10.0	3.9	4.1	4.2
<i>Poverty headcount based on official estimates</i>									
Philippines	33.0	30.0	32.9						

Note: The estimates of poverty incidence are calculated on the basis of per capita income. For details on how the indices were computed, please refer to Annex I.

Source: World Bank estimates based on FIES 2000, 2003, 2006.

methodologies.⁸ The poverty gap, which measures how far households lie below the poverty line, also increased from 2000 to 2006 as did poverty severity, which takes into account the poverty gap but places a higher weight on households that are further away from the poverty line. The global food and oil price crisis in 2007 and the global financial crisis that followed in 2008 are likely to have raised poverty levels further.⁹

3. In addition to the population that lies below the national poverty line, a large proportion of the population is clustered just above the poverty line. Raising the poverty threshold to the international US\$2-a-day poverty line reveals that an additional 19.4 percent of the population in 2006 would be classified as poor. According to the Medium-Term Philippine Development Plan (MTPDP) 2004-2010, 22 percent of the country's population is chronically poor, while 32 percent moves in and out of poverty National Economic and Development Authority (NEDA, 2004). The large proportion of vulnerable population or "near poor" makes the challenge of poverty reduction even more daunting.

⁸The poverty headcount indicators in Table 1 represent World Bank staff calculations based on FIES data, with poverty lines adjusted in line with the consumer price index at the provincial level to render them comparable across time. These indicators differ from the official indicators, which show a decline in the overall poverty headcount indicator between 2000 and 2003. However, both measures coincide in showing a marked increase in poverty between 2003 and 2006. The World Bank's US\$1.25-a-day threshold indicator and Balisacan (2008), both of which use consumption-based measures, also show increasing poverty in this period.

⁹The updated poverty figures are scheduled to become available in early 2011. World Bank simulations using a micro-macro general equilibrium model indicate that the poverty rate will be 0.9 and 1.5 percentage points higher in 2009 and 2010 as a result of the global crisis than it would have been in the absence of the crisis.

4. Progress on the non-income dimensions of poverty reduction, as measured by the MDG indicators, has been mixed. Considerable progress has been made in areas related to child mortality, gender equality, and water supply and sanitation. However, the Philippines has fallen behind in critical areas such as universal access to primary education, with the net enrollment rate at the elementary level declining since 2002 and net enrollment rates at the secondary level leveling out to between 58-60 percent over the past five years. Based on progress to date, the MDGs for maternal health and reproductive health are unlikely to be achieved by 2015. The maternal mortality rate in 2006 was 162 deaths per 100,000 live births, which is high for a country at the Philippines' level of development. Malnutrition also remains a major issue, with the Philippines being among 20 countries in the world with the highest burden of child malnutrition.¹⁰

5. The Philippines exhibits a very unequal—and possibly worsening—distribution of income and consumption. The World Bank's Development Data Platform currently identifies the Philippines as having the most unequally distributed income (or consumption) among the East Asian middle-income countries, whether measured by the Gini coefficient or the relative shares earned by the richest and lowest quintiles of the population (Table 2). The evidence on the evolution of income distribution is less clear. Table 2 indicates no change in the Gini coefficient for the Philippines since the early 1990s and a modest increase in the relative quintile share, while the rest of the region exhibits declines in both. Meanwhile, the FIES

¹⁰ See NEDA-UNDP, Philippines Midterm Progress Report on the Millennium Development Goals, 2007.


Table 2: Inequality in Selected East Asian Countries, 1990-2008

	Gini coefficients (averages, %)		Hi-Lo quintile shares* (ratios; latest year)	
	1990-95	2002-08	1990-95	2002-08
China	n.a.	42	n.a.	8.4
Indonesia	n.a.	39	n.a.	6.7
Malaysia	49	38	12.2	6.9
Philippines	44	44	8.3	9.0
Thailand	45	42	9.4	8.0
Vietnam	36	39	5.6	6.4
Sample Average	44	41	8.9	7.6

*The Hi-Lo quintile shares refer to share of total income (or consumption) received by the richest quintile divided by the share of the poorest quintile; n.a. = not available.

Source: World Bank Development Data Base; based on household income (or, in some cases, consumption expenditure)

data indicates that overall income inequality has been declining since 2000. However, as discussed below, the national accounts and associated circumstantial evidence suggest that the distribution of income has worsened over the last decade once the richest households, which are usually under-represented in household surveys, are taken into account.

6. Non-income indicators also reveal a high level of inequality in the Philippines. Large inequalities in health and education outcomes and in access to services persist across regions and income groups. In health, for example, one child in a thousand died between ages 1-5 among the wealthiest quintile of the population, compared to 25 per thousand in the poorest quintile and 33 per thousand in the ARMM. Similar disparities can be seen in education, with 82.9 percent of children 16 years or younger in the poorest quintile being in school compared to 98.0 in the richest quintile. In ARMM, only 78 percent of children 16 years or younger attended school, compared to the national average of 90.2 percent and the NCR average of 94.3 percent. These discrepancies indicate a highly unequal distribution of human capital that becomes reflected in unequal earnings.

B. Why Has Poverty Not Been Declining in Recent Years?

7. Broadly speaking, increases in poverty must either be due to declines in average real income (or consumption), a worsening distribution of income or a shift of the poverty line. That is, standard measures of poverty are determined by (i) the mean level of income, (ii) the distribution around that mean, and (iii) where the poverty

line is drawn. The poverty headcount ratio in Table 1 is based on a constant poverty line. The increase in poverty observed between 2003 and 2006, therefore, would either have to be due to an absence of growth (resulting in falling incomes and consumption) or to a significant worsening of the distribution of income, or both. Compelling evidence can be found in favor of both explanations.¹¹

8. The absence of more dynamic economic growth, coupled with high degrees of income inequality, partly explains why poverty failed to decline since 2000. As noted at the beginning of this report, the absence of economic growth has a long-standing history in the Philippines, and the growth episode registered since 2000 has been modest by regional standards. Once the data biases discussed below are accounted for, economic growth in the Philippines is likely to have been even more modest than is indicated in the National Accounts. At the same time, the relatively high degree of income inequality exhibited by the Philippines has the effect of reducing the income elasticity of poverty, posing a further barrier to faster poverty reduction.¹²

¹¹ This conclusion is similar to one arrived at in the World Bank's last Philippines Poverty Assessment (World Bank, 2001b). After contrasting the evolution of poverty in the Philippines and other middle-income countries in East Asia over 1985-97, it states (para. 2.6), "This begs the question: has slower poverty reduction been on account of slower growth in the Philippines or rather due to growth being less pro-poor? The evidence based on household survey data suggests that probably both factors have been at work."

¹² To appreciate this difference, note that it would take 20 years to cut the Philippine poverty rate in half with an annual per capita income growth rate of 2.5 percent and the growth elasticity of -1.3 estimated for the Philippines. The time to achieve this target would be reduced to 10 years with an annual

Table 3: Per Capita Income and Expenditures in the Philippines (in Constant Pesos)*(Average annual growth rates, %)*

	1985-1997	2000-03	2003-06	2000-06
<i>Household Survey-based growth rates</i>				
Expenditures per capita	2.7	-0.9	-0.5	-0.7
Income per capita	N.A.	-1.7	-1.2	-1.4
<i>National Accounts-based growth rates</i>				
Consumption per capita	1.7	2.3	3.5	2.9
GDP per capita	1.4	1.7	3.6	2.7

Sources: Household survey-based figures are based on the FIES; figures up to 1997 are from World Bank (2001b), Philippines Poverty Assessment; figures as of 2000 are from the Philippines National Statistics Office. The National Accounts-based growth rates are from the World Bank Development Database.

9. The failure of poverty to decline after 2000 also appears linked to a worsening distribution of income. As argued below, the National Accounts-based figures are likely to have over-estimated income growth, while the FIES household survey-based figures are likely to have underestimated consumption growth and poverty reduction. However, the corroborating evidence indicates that, on balance, aggregate economic growth was positive and that poverty did not decline. That is, data on the growth of exports, corporate profits, and fiscal revenues and enterprise surveys all point toward positive economic growth during 2003-06. Meanwhile, the Social Weather Station reports, which regularly monitor perception data, corroborate the findings from the survey-based data that poverty and the incidence of hunger have been increasing in that period. These findings imply that the modest growth that did take place during 2003-06 must have been associated with a deteriorating distribution of income.

10. Several factors have contributed to the worsening distribution of income. They include: (i) an unequal sectoral distribution of growth, which slows progress in poverty reduction when the poor are concentrated in the sectors that are stagnating or contracting; (ii) an unequal spatial or regional distribution of growth, which has a similar effect as the unequal sectoral growth when the poor are concentrated in declining or stagnating regions

and population mobility is limited; (iii) strong demographic pressures, reflecting relatively high population growth rates; (iv) declines in the relative price of labor provided by the poor; and (v) an unequal distribution of human capital and access to social services and, in some cases, a decline of public spending on social services that mainly benefit the poor. These factors are described in more detail below.

C. The Puzzle of Diverging Per Capita Income Measures in the Philippines

11. While the National Accounts point to a significant improvement in GDP growth over 2000-06, the Philippines household survey data indicates that average real income has steadily declined during this period. The FIES, from which the poverty indicators are drawn, indicate that average real per capita consumption declined annually by an average rate of 1.4 percent between 2000 and 2006 (Table 3). This finding is consistent with the commonly observed negative relationship between poverty and consumption or income growth, and it squarely attributes the absence of progress in poverty reduction to an absence of growth. The National Accounts-based data, however, indicate that per capital consumption and GDP have been growing by well over 2 percent per annum during this period, so the failure of poverty to decline must be due to a substantial deterioration in the distribution of income. That is, it would mean that the benefits of growth since 2000 have accrued mostly to a sub-sample of mainly richer households that is not fully captured by the FIES.

growth rate of 5 percent, leaving everything else the same, or to 12 years if only the growth elasticity were -2.3 (which is the estimated average elasticity for all East Asian countries).



12. Ascertaining the nature of income and consumption growth during periods of rising poverty has important policy implications. If the survey-based findings that average real per capita consumption and income have been falling are taken at face value, the main challenge facing policymakers is to bring about faster growth. If the National Accounts-based findings that average per capita income has been increasing are taken at face value, the accompanying rise in poverty indicates that policymakers also have to be concerned about the distributional consequences of growth and ensure that it is sufficiently broad-based.

13. The divergence in the survey-based and National Accounts-based data is not unique to the Philippines. As noted by Deaton (2005) in his comprehensive review of cross-country and inter-temporal relationships between survey and national accounts estimates of consumption expenditures per capita, *“National Accounts estimates of consumption [levels] are typically, although not always, larger than survey-based estimates, and there is a tendency, both across countries and over time within important countries, for the NA estimate of consumption to grow more rapidly than does the survey-based estimate.”* Moreover, the differences in levels and growth rates are not trivial: Deaton finds that the ratio of survey-based consumption levels to National Accounts-based consumption averages 86 percent worldwide (82 percent in East Asia and the Pacific countries). Furthermore, while the annual growth of survey-based real consumption averaged between 1.9 and 2.3 percent over 1990-2000, the National Accounts yielded an average growth rate between 3.8 and 4.5, which is twice as large. Finally, it should be noted that there is no general presumption of greater accuracy in favor of either the surveys or the national accounts,¹³ as both exhibit significant biases.

14. What is unusual about the Philippines’ experience after 2000 is that the survey-based data exhibits lower growth (and rising poverty), just as the National Accounts exhibit a significant increase in growth. Deaton and Dupriez (2009) noted that while the survey-based and national accounts-based consumption figures may diverge significantly from each other, their year-to-year variation

¹³ As Deaton (2005) points out, there is no reason to presume that both data sources should yield the same figures considering that the National Accounts are designed to track money (or macroeconomic aggregates), while the household surveys are designed to track people and estimates of poverty.



is highly correlated. In a separate cross-country analysis using data for Latin America and the Caribbean, Perry et al (2006) reached the same conclusion when they regressed income growth according to the household surveys on income growth according to the national accounts, which yielded the following estimated regression line: $y = 0.977x - 0.864$. That is, the estimated slope of this regression line is very close to 1, so changes in national accounts-based growth are generally associated with equal changes in survey-based growth. In contrast, the recent experience of the Philippines suggests a negative relationship between both variables; that is, as the National Accounts show an increase in average annual per capita consumption growth from 1.7 percent over 1985-97 to 2.9 percent over 2000-06, the average survey-based per-capita growth rate declined from 2.7 percent to -0.7 percent.

15. The divergence in the survey-based and National Accounts-based growth pattern is most pronounced in the National Capital Region (NCR). The household survey-based income growth figures and the National Accounts-based GDP growth figures also exhibit a large divergence across the 16 regions in the Philippines: both sets of figures are uncorrelated, yielding an R-squared of less than 0.001. This lack of correlation is especially pronounced for the NCR, which shows an overall decline in survey-based per capita income of 20.6 percent between 2000 and 2006 and an overall increase in GDP per capita of 26.7 percent over the same period.¹⁴

16. The FIES most likely underestimates the growth of real household consumption and poverty reduction since 2000. Deaton and Dupriez (2009) notes that the main source of bias in household surveys worldwide is that they are not fully representative because the more affluent households are typically under-represented in survey samples and also more reluctant to disclose their full incomes.¹⁵ This means that true income growth is likely to be higher than the data suggest. One telling sign that the household surveys in the Philippines may not be capturing the top end of the income distribution is that according to the FIES data, total household income of the top decile in 2006 was only P620,000 (about US\$12,400), or P124,000 (about US\$2,700) in per capita terms. This would mean that the top decile earned just a little above the minimum wage,¹⁶ which is roughly equal to the expected income of a new graduate entering the labor force. Even though the FIES survey data may have underestimated household consumption growth, however, the finding

that poverty incidence has increased during that period is corroborated by independent perception surveys such as the Social Weather Station reports and by the decline in average real wages.

17. The National Accounts, in turn, are likely to be over-estimating real consumption and GDP growth, primarily on account of measurement conventions in the compilation of national accounts. These conventions exclude most non-exchanged services, such as home food preparation or home repairs, and the failure to capture intermediate consumption. As people become richer, they tend to substitute market-bought services for home-produced services (that are not captured in the national accounts), which biases estimated growth upward. While household surveys also tend to exclude non-exchanged services, Deaton (2005) identifies three important non-exchanged items of consumption that are included in the national accounts but not in the survey: imputed rents to homeowners, indirectly imputed financial services, and consumption by non-profit institutions serving households. Their inclusion in the compilation of the national accounts but not in the survey data contributes further to the divergence in the national accounts-based and survey-based expenditure data. In addition, Medalla and Jandoc (2008) have pointed to shortcomings in the quality of the National Accounts in the Philippines, which also appear to have contributed to an overestimation of GDP growth. As noted earlier, however, even though the National Accounts-based data may have over-estimated economic growth since 2000, the overall evidence suggests that growth has nevertheless been positive during this period, which means that its limited impact on poverty gives cause for concern.

D. Profile of the Poor

18. The preceding findings suggest that growth in the Philippines has not been sufficiently strong and sustained to make a significant dent in poverty and that the modest growth that did occur in recent years has largely bypassed the poor. Therefore, reducing poverty in a sustained manner will require both more dynamic economic growth as well as growth that is more inclusive than that experienced in the first half of this decade. This section presents a brief profile of the poor, describing who they are and where they live and work, as a first step toward identifying the types of policies and interventions that are needed to make growth more inclusive.

¹⁴ The large divergence in the NCR growth figures may be reflecting the rapid growth of profits in the Filipino corporate sector, which is largely concentrated in Manila and unlikely to be reported in the household survey figures for reasons discussed in paragraph 54. When NCR is excluded from the regressions, the cross-regional correlation is positive, but still weak, with an R-squared of 0.08.

¹⁵ This sampling bias is particularly important for countries with very unequal distributions of income, such as the Philippines. As noted in World Bank (2005a), pg. 16, the Philippines continues to stand out as a country with an unusually high concentration of family control over firms. In the mid-1990s, the top 15 families controlled over 50 percent of the stock market capitalization in the Philippines, which represents an ownership share equivalent to roughly 17 percent of Philippine GDP. Just leaving out these 15 families from the household survey would result in a major omission in the estimation of average household income figures.

¹⁶ In 2006, the daily minimum wage in the National Capital Region was around P340 for non-agricultural workers; in 2008, it was around P375 (Source: National Wages and Productivity Commission).



Table 4: Profile of the Poor in the Philippines, 2006

Out of 100 Filipinos...		Out of 100 POOR Filipinos...	
51	live in rural areas	71	live in rural areas
18	do not have access to electricity	40	do not have access to electricity
52	do not have their own water source	78	do not have their own water source
85	belong to male-headed households	90	belong to male-headed households
52	belong to families with more than five members ^a	71	belong to families with more than five members ^a
35	belong to families whose head works in agriculture	59	belong to families whose head works in agriculture
44	belong to families whose household heads are informal sector workers ^b	55	belong to families whose household heads are informal sector workers ^b
15	belong to families with unemployed household heads	8	belong to families with unemployed household heads
3	belong to families whose household heads did not attend school	6	belong to families whose household heads did not attend school
44	belong to families whose heads did not reach high school	66	belong to families whose heads did not reach high school

^a The average family size at the national level is five.

^b Informal sector workers as used here include (i) informal sector operators who are either self-employed without any paid employee or employer in own-family operated farm or business (NSO, 2009) and (ii) workers who do not receive wages from own family-operated farm or business.

Source: World Bank estimates based on the 2006 FIES.

Geographic location

19. Poor Filipinos differ from the rest of the population along various dimensions. Table 4 shows how the poor are distributed spatially and sectorally relative to the population as a whole. It also shows how poor families differ from the average Filipino family in terms of household characteristics and access to basic services. In particular, the poor are concentrated in rural areas and in agriculture, have less access to basic services, lower levels of education, and larger families.

20. While rural areas continue to be home to most of the poor, the gap between rural and urban poverty has declined. The share of the poor population living in rural areas has declined since 2000, but rural poverty still comprised 70.8 percent of all the poor in 2006 (Table 5). The rural-urban shares of the overall population have not changed much since 2000, as the population has remained split almost equally between rural and urban areas. However, increases in the poverty incidence in urban areas as well as in the share of the poor population living in these areas have reduced the gap between urban and rural poverty. The poverty gap and poverty severity in urban areas have also worsened since 2000.

Table 5: Rural and Urban Poverty in the Philippines, 2000-2006

	Poverty Headcount (% of population)			Share of the Poor (% of poor population)			Population Share (% of population)			Change in Per Capita Income (%)
	2000	2003	2006	2000	2003	2006	2000	2003	2006	2000-2006
Urban	16.8	17.3	19.5	26.8	27.3	29.2	49.4	49.1	49.3	-11.0
Rural	44.8	44.4	45.9	73.2	72.7	70.8	50.6	50.9	50.7	-1.4

Source: World Bank estimates based on FIES data.

Table 6: Poverty by Administrative Region in the Philippines, 2000-2006

	Poverty Headcount (% of population)			Share of the Poor (% of poor population)			Population Share (% of population)			Change in Per Capita Income (%)
	2000	2003	2006	2000	2003	2006	2000	2003	2006	2000-06
Region I – Ilocos	30.3	28.5	32.7	5.2	4.8	5.3	5.3	5.3	5.3	-8.8
Region II – Cagayan	25.5	25.2	25.6	2.9	2.8	2.6	3.5	3.4	3.4	3.22
Region III – Cen. Luzon	15.1	17.3	20.6	4.9	6.1	6.9	10.1	11.1	11.0	2.9
Region IV – Sou. Luzon	22.3	25.1	27.2	10.6	12.9	13.0	14.7	16.1	15.8	-9.4
Region V- Bicol	50.8	49.2	51.1	10.3	9.6	9.6	6.3	6.1	6.2	1.1
Region VI – W. Visayas	42.5	39.8	38.6	11.1	9.7	9.0	8.1	7.6	7.7	-2.1
Region VII – C. Visayas	36.5	34.9	35.3	8.5	8.2	8.0	7.2	7.4	7.5	5.5
Region VIII – E. Visayas	49.2	47.2	48.6	7.5	7.2	7.1	4.7	4.7	4.8	3.6
Region IX - Zamboanga	48.0	51.0	45.4	6.3	6.0	5.1	4.0	3.6	3.7	13.7
Region X – N.Mindanao	39.3	44.3	43.2	4.6	6.4	6.0	3.7	4.5	4.6	-0.9
Region XI – Davao	38.2	36.5	36.6	8.5	5.7	5.3	6.9	4.9	4.7	-5.0
Region XII – SOCCSKSARGEN	46.9	40.8	40.8	5.3	5.7	5.3	3.5	4.3	4.3	0.7
Region XIII – NCR	5.8	6.9	10.4	2.7	3.0	4.2	14.4	13.5	13.2	-20.6
Region XIV – CAR	32.4	32.6	34.5	1.9	1.8	1.8	1.8	1.7	1.7	9.1
Region XV – ARMM	53.5	51.0	61.9	5.2	5.3	6.4	3.0	3.3	3.4	-16.8
Region XVI – Caraga	51.4	55.2	52.6	4.5	4.6	4.2	2.7	2.6	2.6	8.4
Philippines	31.0	31.1	32.9	100.0	100.0	100.0	100.0	100.0	100.0	-8.2

Source: World Bank estimates based on FIES data.

21. The ARMM, Caraga, and Bicol continue to be the poorest regions of the country (Table 6). All three of these regions had poverty headcount rates of over 50 percent in 2006. The Mindanao regions, with the exception of Davao, had poverty rates of more than 40 percent. Although the Zamboanga Peninsula, Northern Mindanao, and Caraga have recorded improvements in poverty incidence, they continue to account for a disproportionate share of total poverty. For example, the Mindanao regions together account for 32 percent of poverty but only for 23 percent of the total population. In contrast, the NCR, home to about 15 percent of the population, accounts for less than 5 percent of total poverty. However, poverty incidence in the NCR has risen steadily since 2000.

22. The regions with the lowest poverty incidence have higher degrees of economic activity. The NCR contributed 37.2 percent of national GDP in 2006 and had the lowest regional poverty headcount rate at 10.4 percent (Figure 2). Southern Luzon, which makes the second highest contribution to national GDP, also has one of the lowest poverty headcount ratios. However, it is noteworthy that the regions that experienced the greatest reductions in poverty between 2000 and 2006 were not necessarily the ones that enjoyed the fastest economic growth during this period.

Employment and income

23. Poverty is much more prevalent among agricultural households than among non-agricultural households. In 2006, poverty incidence among agricultural households, defined here as households with total income from agricultural activities equal to or greater than income earned from non-agricultural activities, was three times higher than poverty incidence among non-agricultural households. Poverty incidence among households whose family heads were employed in mining and quarrying were almost as high as in agriculture, while poverty rates were lowest among households whose family heads were employed in finance or public utilities.

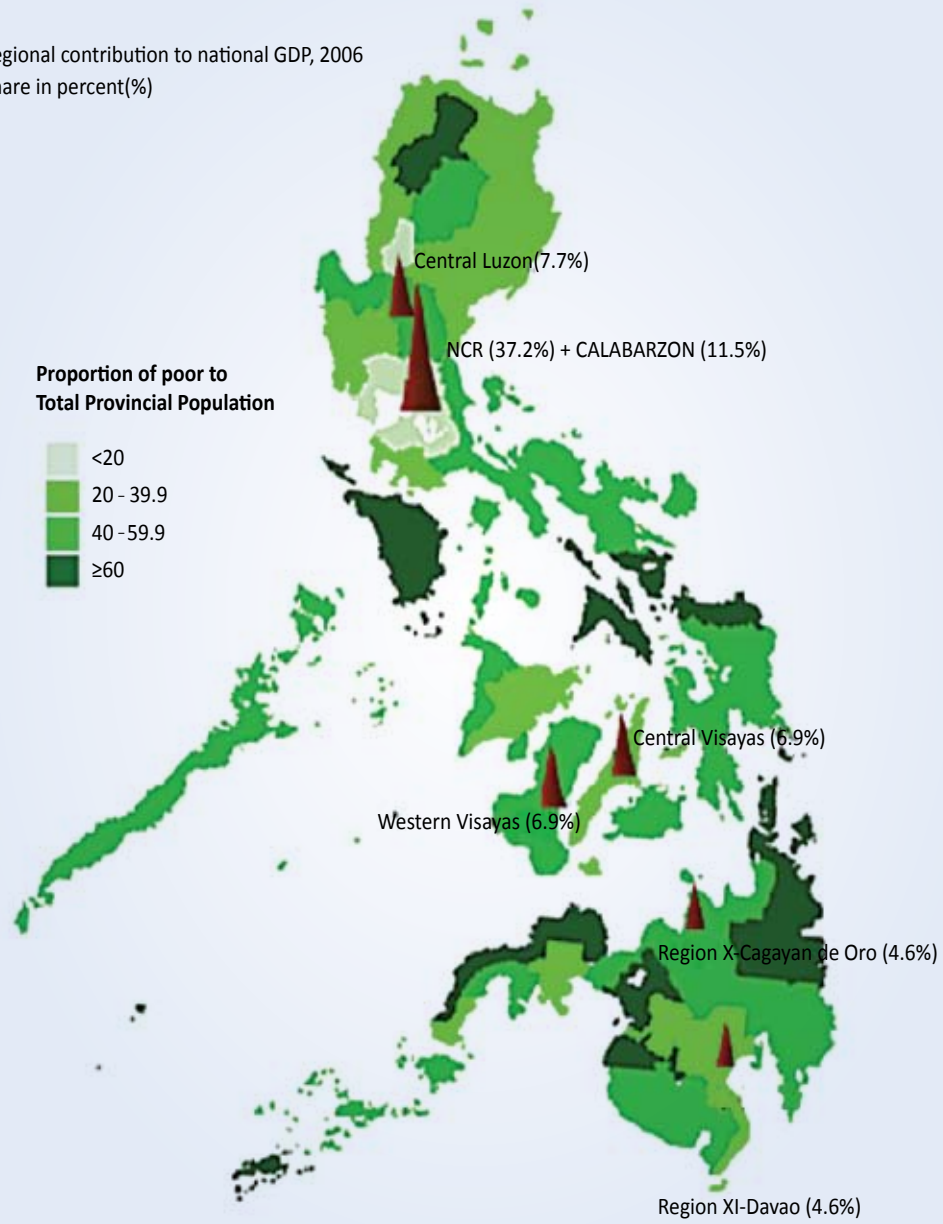
24. The majority of the poor are engaged in the informal sector. According to the 2006 Labor Force Survey (LFS) and FIES data, nearly 60 percent of poor workers are in the informal sector. Poor households tend to be headed by individuals who are working without pay in their own family-operated businesses or who are self-employed without any employees, which is not surprising since this category includes many poor rural farmers. The fact that the poor are concentrated in the low-productivity agricultural sector, which can be seriously affected by natural disasters, and in informal jobs indicates that the poor face higher vulnerability from income and labor market shocks than the non-poor.



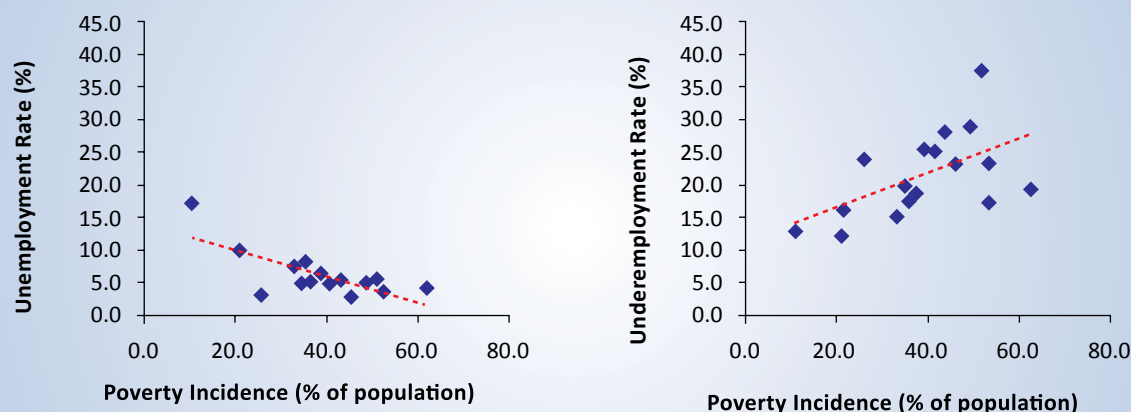
Figure 2: Poverty and Regional Contribution to National GDP in the Philippines, 2006

Regional contribution to national GDP, 2006
Share in percent(%)

**Proportion of poor to
Total Provincial Population**



Sources: Poverty rates are World Bank estimates based on FIES 2006; Regional GDP data are from National Statistical Coordination Board (NSCB).

Figure 3: Poverty Incidence and Unemployment/Underemployment, 2006

Note: Each observation corresponds to the combination of poverty incidence and unemployment/underemployment observed in a particular region.

Source: World Bank estimates based on FIES and LFS 2006

25. Poverty in the Philippines appears to be correlated more with underemployment than with unemployment.

In 2006, only 17 percent of the unemployed were poor. The fact that the non-poor are disproportionately over-represented among the unemployed is not surprising, since the poor cannot afford to stay out of work for long periods. In contrast, Figure 3 shows that poverty incidence is correlated with underemployment.

26. The poor derive most of their income from wages and rely more on domestic remittances.

Both poor and non-poor households derive most of their income from wages, although wages comprise a larger share of the non-poor's total income at 45.2 percent. The poor are more diversified between wage income (39.5 percent) and entrepreneurial incomes at (35.6 percent). Poor households are more dependent on domestic remittances (5.4 percent of total income), while non-poor households are more dependent on remittances from abroad (12.5 percent).¹⁷ That is, poverty incidence among households living on foreign remittances is only 6.3 percent, versus poverty incidence of 43.6 percent among households that rely mainly on domestic remittances (Table 2.12 of the Background Papers).

27. The increased share of poor in the services sector between 2003 and 2006 might be explained by a net transfer of workers into that sector, together with a decrease in the average real daily wage in the services sector over this period. Between 2003 and 2006, the share of the poor whose main source of income was wages (primarily non-agricultural wages) increased by 2 percentage points. This corresponded to a similar reduction in the share of poor in agriculture as well as a net transition of workers from agriculture and industry to the services sector during this period based on panel data. Moreover, the average real daily wage for the services sector declined by 5 percent during that time period. This could have contributed to the increased share of poor in the services sector over this time period (from 23.9 percent to 26.8 percent).¹⁸

Household characteristics

28. Poverty rates are higher among households with less-educated household heads.

The poverty rate for households headed by individuals with no education (no grade completed) was 65.2 percent in 2006, nearly twice as high as the national poverty rate of 32.9 percent (Table 7). More than two-thirds of the poor have household heads who had no highschool education.

¹⁷ The causality between poverty and source of remittances is not clear. One possibility is that the more affluent households are better off because their remittance providers succeeded in finding better paying jobs abroad, while those of less affluent households have not.

¹⁸ See the Background Papers for this Report, Chapter VI, Tables 6.6, 6.7, 6.8, and 6.10.


Table 7: Poverty by Education Level of Household Head, 2000-2006

	Poverty Headcount (% of population)			Share of the Poor (% of population)			Population Share (% of population)		
	2000	2003	2006	2000	2003	2006	2000	2003	2006
No grade completed	58.2	62	65.2	6.9	5.6	4.8	3.7	2.8	2.4
Some elementary	49.9	52.1	52.2	35.3	36.8	34.9	22.0	22.0	22.0
Elementary completed	38.3	38.8	43.8	26.5	25.6	26.2	21.5	20.5	19.6
Some high school	34.2	33.7	37.0	13.3	13.9	14.4	12	12.9	12.8
High school completed	21.2	20.3	22.8	14.2	13.9	15.2	20.8	21.3	21.9
Some college	9.5	9.7	10.8	3.3	3.5	3.8	10.7	11.2	11.5
College completed	1.7	2.5	2.4	0.5	0.7	0.7	9.1	9.2	9.5
Postgraduate	0.0	1.0	0.0	0.0	0.0	0.0	0.3	0.2	0.2

Source: World Bank estimates based on the 2006 FIES.

Table 8: Poverty by Household Size and Number of Children, 2000-2006

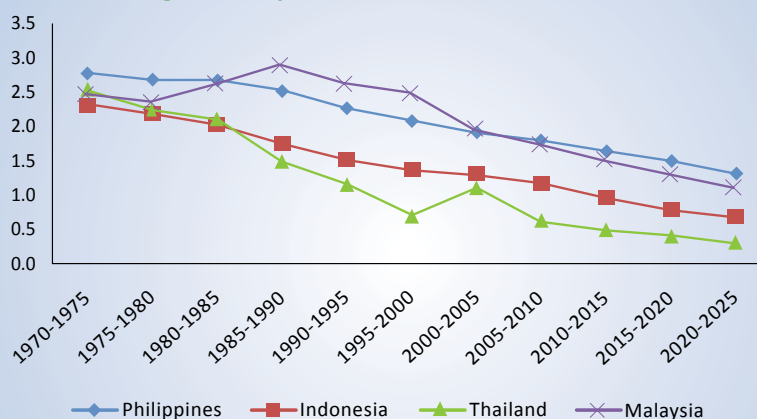
	Poverty Headcount (% of population)			Share of the Poor (% of population)			Population Share (% of population)		
	2000	2003	2006	2000	2003	2006	2000	2003	2006
Household size									
1 member	7.6	6.3	4.6	0.2	0.2	0.1	0.7	1.0	1.0
2	10.8	9.7	10.6	1.2	1.4	1.4	3.4	4.4	4.4
3	12.9	13.5	14.2	3.4	4.5	4.3	8.2	10.4	9.9
4	17.0	19.3	19.8	8.0	10.7	10.2	14.7	17.2	16.9
5	24.3	26.7	29.7	14.8	16.7	17.5	18.8	19.4	19.4
6	33.5	35.3	38.2	19.4	18.9	19.7	18.0	16.7	17.0
7+ members	45.4	47.9	49.1	53.0	47.6	46.8	36.2	30.9	31.4
Number of Children									
0 child	11.2	10.7	11.7	6.6	6.2	6.8	18.3	17.9	19.2
1	15.0	15.2	18.3	8.7	9.4	11.1	17.9	19.1	20.0
2	23.6	24.3	26.7	14.8	16.8	17.6	19.4	21.5	21.6
3+ children	48.8	50.8	54.2	69.9	67.7	64.5	44.4	41.5	39.1
Philippines	31.0	31.1	32.9	100.0	100.0	100.0	100.0	100.0	100.0

Source: World Bank estimates based on FIES data.

29. As in many other countries, larger households in the Philippines tend to be poorer. Poverty incidence steadily increases with household size, with nearly half of households with seven or more members living below the poverty line (Table 8). In 2006, more than half of households with three or more children were poor, and nearly two-thirds of poor households had three or more children. On average, women in the wealthiest quintile have only two children, compared to nearly six births for poor women—one of the widest disparities in the East Asian region (NSO and Macro International (MI), 2003).

In contrast, the fertility rate for women in the poorest quintile is 2.2 in Vietnam, 3.0 in Indonesia, and 4.7 in Cambodia. A regression analysis shows that household size is one of the most important determinants of poverty in the Philippines, with larger households and households with higher ratios of children and elderly tending to have lower per capita expenditures. The country's dependent population still exceeds the working-age population, resulting in a relatively high dependency ratio within households.

Figure 4: Population Growth Rates, 1970-2025



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, *World Population Prospects: The 2008 Revision*, <http://esa.un.org/unpp>. Population projections based on Medium Fertility Assumptions.

30. The link between household size and poverty is particularly significant in the Philippines due to its high population growth rate. Despite a modest decline in fertility rates over the last few decades, the country's population growth rate remains among the highest in the region (Figure 4). The annual population growth rate in the Philippines is 2.0 percent, compared to an average rate of 0.8 percent in East Asia and the Pacific and 1.2 percent for lower middle-income countries worldwide (NSO 2008; World Bank Development Data Platform). While total fertility rates have declined from 4.1 births per woman on average in 1991 to 3.3 births in 2006 (NSO and USAID, 2009), this decline is among the slowest in Southeast Asia. As shown in Table 8, over 30 percent of the population belong to households with seven or more members.

31. Evidence indicates that the continued high fertility among the poor may be hindering poverty reduction. Although it can be difficult to disentangle the extent to which high fertility and population growth is a cause or consequence of slow progress in poverty reduction, a convincing range of macro and micro evidence suggests that continued high fertility by the poor has affected progress in poverty reduction in the Philippines (Racelis, 2008). At the macroeconomic level, simulation models using economic and demographic data for the Philippines showed that

higher population growth lowered GDP per capita (Orbeta, 2002). Similar models also found that while expenditures on human capital rise with population growth, the increases are not sufficient to maintain per capita expenditure levels (Orbeta, 2002). The growth of provincial per capita income is negatively correlated with the proportion of young dependents in the province (Mapa, Balisacan, and Briones, 2006). At the household level, large family size is strongly correlated with higher poverty incidence, lower savings and asset accumulation, and reduced per capita household expenditures for education and health (Orbeta, 2002; Orbeta, 2005; Racelis 2008). The issue of population growth is discussed in greater detail in Parts II and III below.

32. The preceding analysis underscores the challenges in ensuring that growth in the Philippines is broad-based and inclusive. These findings point to a number of challenges in reducing poverty in the Philippines, including rapid population growth, dependence on agriculture, insufficient wage-earning opportunities, imbalances across urban/rural and geographic regions, and low educational attainment levels. To tackle these barriers, enhancing the income opportunities of the poor and improving their ability to participate in markets will be critical.





Courtesy of Manila Water

“To generate better income opportunities in lagging regions and sectors of the economy, it is best to integrate them with the leading ones.”

Part 2

Enhancing Income Opportunities

33. Accelerating growth is essential for poverty reduction. As argued earlier, poverty has failed to decline significantly since the East Asian Crisis due to insufficiently dynamic growth, a high degree of income inequality that reduces the income elasticity of poverty reduction, and an apparent worsening of the income distribution. The first step toward addressing this failure is to accelerate growth, which will not be easy in the short run while the global slowdown continues to run its course. Moreover, even though the global crisis is gradually bottoming out, the post-crisis external environment is likely to be much less favorable than before, which threatens to leave the Philippine economy on a lower growth plateau in the absence of reforms. This adds further urgency to the removal of growth constraints that already existed before the crisis, and which are examined below.

A. The Key Constraints to Economic Growth

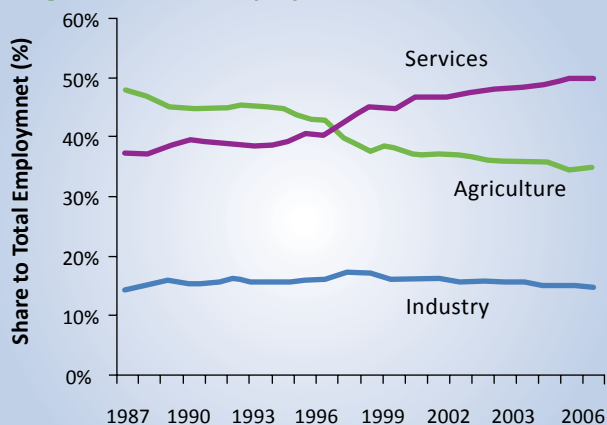
34. From a sector development perspective, per capita GDP can be increased by: (i) raising the productivity of workers within sectors and (ii) reallocating workers (and other factors of production) from lower- to higher-productivity sectors.¹⁹ In the post-World War II period, the sectors with high productivity worldwide have tended to be those that produce tradables—within this category, it is generally the industrial goods, although tradable services are becoming increasingly important. The least productive sectors, in turn, have tended to be associated with traditional agriculture and the informal services sectors. This sector ranking by labor productivity is also observed in the Philippines, where the industry sector is the most productive, followed by services and agriculture as the least productive (Figure 5). Historically, the most rapidly growing developing economies were those that were able to shift their labor force from the agriculture sector to the industry sector without sacrificing the latter's labor productivity levels.²⁰



¹⁹ A third way is by raising the ratio of workers to population, either through increased labor participation or reduced dependency ratios, but there are natural limitations to the potential growth impulse arising from this source.

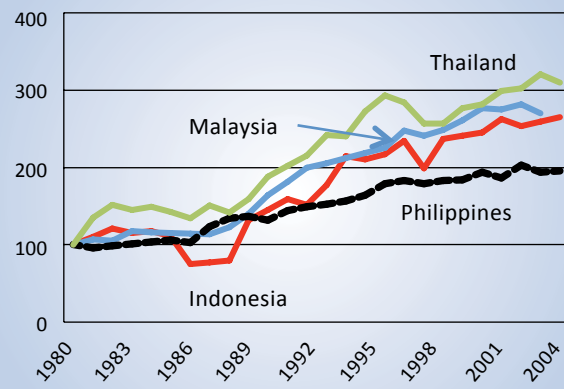
²⁰ In this discussion, the reference to industrial activity serves as a proxy for non-traditional, technologically more advanced production. Although such production also includes technologically sophisticated agricultural and service sub-sectors, most of it has tended to be concentrated in the industry sector. The focus on industry, therefore, is entirely due to limitations in the classification of data, which is only readily available in the traditional agriculture/services/industry disaggregation.

Figure 6: Sector Employment Shares, 1987-2008



Source: LFS, various rounds.

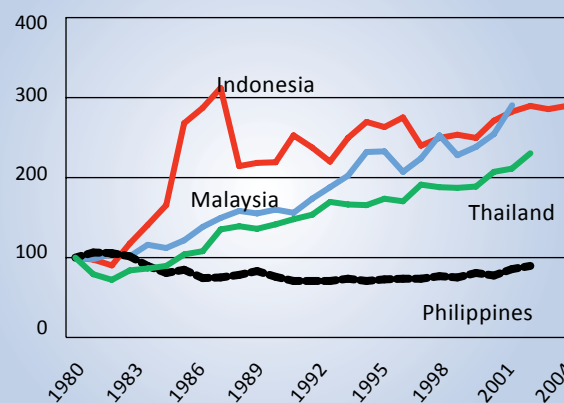
Figure 7: Evolution of Industrial Employment, 1980-2004



Source: World Bank, Development Data Platform

35. The Philippines has been exhibiting a slower structural transformation than other East Asian countries. Although its share of total employment devoted to agriculture has continued to decline over the last 20 years (Figure 6), the share of labor released from that sector has not been absorbed by industry. Rather, this labor was entirely absorbed by the services sector, which displays significantly lower labor productivity levels than industry. Had the labor that was released from agriculture been absorbed by industry, annual economic growth in the Philippines would have been around 0.7 percentage points faster, (see Technical Annex I Scenario B). At the same time, the levels of labor productivity growth within each sector have remained largely unchanged (Figure 5) except for a surge after 2002, which largely reflects temporary increases in capacity utilization during the economic expansion of 2003-07.²¹

Figure 8: Labor Productivity in Manufacturing, 1980-2004



Source: World Bank, Development Data Platform

36. One manifestation of the Philippines' uneven structural transformation is the slow growth of industry sector employment. The other East Asian economies were able to absorb the workers released from their primary sectors at a much faster pace than the Philippines (Figure 7). Between 1980 and 2005, the Philippines managed to double the size of its industrial labor force, but the other middle-income economies in the region almost tripled theirs. At the same time, the other economies were able to increase labor productivity within manufacturing at a much faster pace than the

Philippines (Figure 8). That is, they succeeded both in transferring more workers into the industry sector and in continually raising the level of productivity within the sector. In doing so, they have been able to achieve significantly higher rates of economic growth.

37. The expansion of tradables or industrial production, in particular, is empirically associated with faster economic growth. There are at least two schools of thought on why tradables are important for growth: one focuses on the act of trading, and the other focuses on the act of producing tradable goods and services. The first viewpoint holds that there are learning or other spill-over effects from exporting because of technological or marketing externalities that are created when exporters

²¹ Had sector productivity growth rates in the Philippines been as fast as in other East Asian countries (Technical Annex I, Scenario C), overall annual output per worker would have grown 1.3 percentage points faster.


Table 9: Sources of Growth in Selected East Asian Countries (%), 1990-2003

	Output	Output per Worker	Contribution of:		
			Physical Capital	Education	Factor Productivity
Philippines*	3.3	0.4	0.3	0.4	-0.3
Indonesia	4.1	1.7	1.7	0.5	-0.5
Malaysia	6.2	3.2	2.0	0.5	0.7
Thailand	4.5	3.4	1.9	0.4	1.0
Ave (excl. PHL)	4.9	2.7	1.9	0.5	0.4
<i>Difference w/PHL</i>	<i>1.7</i>	<i>2.3</i>	<i>1.6</i>	<i>0.1</i>	<i>0.7</i>

* output per worker in the Philippines increased significantly during 2004-07, all of which became reflected in an increase in factor productivity and with no changes in the contribution of capital.
Source: Bosworth, Barry and Susan Collins (2003)

have to compete abroad. This makes tradables special, since non-tradables cannot be exported. The second viewpoint holds that the production of tradables is special, independent of whether the products are exported or displace imports. The starting premise is that a number of different activities with different marginal productivities coexist within developing economies at any given time. In this context, as more workers shift from low-productivity to high-productivity activities, GDP increases independent of whether the goods produced are sold domestically or abroad.²² Even in the absence of technological externalities from export activities, however, it is difficult to envisage a significant expansion of tradables production in the absence of export markets, given the limited size of the Philippine domestic market for achieving economies of scale.

38. From a factor accumulation perspective, the slow growth exhibited by the Philippines relative to other economies in the region is mainly explained by a low rate of physical capital accumulation, although low rates of total factor productivity growth also played a role. As shown in the last row of Table 9, the average annual growth of output per worker in Indonesia, Malaysia, and Thailand over the period 1990-03 was 2.3 percent higher than in

the Philippines. About two-thirds of that difference (1.6 percent) was due to faster physical capital accumulation and the remainder (0.7 percent) was due to higher total factor productivity growth.²³ Differences in human capital accumulation, on the other hand, do not appear to have played a significant role.

Identifying the main constraints to growth in the Philippines

39. Economic growth in the Philippines has been held back by low investment and limited factor mobility. The factor accumulation approach draws attention to the low level of investment in physical capital as a key difference in the rapid growth observed in other countries in East Asia compared to the Philippines. This suggests that the problem of slow growth may be due to inadequate public investment and a poor investment climate for the private sector. The sector development approach, in turn, draws attention to the slow pace of structural transformation in the economy. This suggests that there may be barriers to factor mobility across sectors, either in the form of labor market rigidities, capital market distortions, or anti-competitive practices that are preventing a more fluid market entry and exit of firms.

²² A recent empirical study (Rodrik, 2009) finds that while economic growth is positively correlated both with the GDP share of industry and the share of exports, the former relationship is stronger and more robust than the latter. Insofar as the post-crisis external environment is less accommodating of trade surpluses, this is good news for the growth prospects of newly industrializing economies. It does not, however, provide support for pursuing an inward-oriented industrialization strategy.

²³ The difference in total factor productivity growth happens to be very close to the growth foregone on account of the incomplete structural transformation in the Philippines; see Technical Annex I. That is, had the Philippines been able to fully absorb the labor released by agriculture into the industry sector, it would have been able to close about one-third of the average growth gap vis-à-vis its three regional neighbors.

40. To help identify the most binding constraints on growth, it is useful to recall the assessment of the Philippine economy presented in Krugman, et al. (1992).

This assessment noted significant problems in several areas, especially the presence of high protectionist barriers in manufacturing, a low public revenue base, and inadequate investment in public infrastructure.²⁴ Such an economy, the Krugman team concluded, could only count on a very low growth rate—perhaps as low as three percent—barely keeping up with population growth. This turned out to be a prescient observation, as annual GDP growth averaged 3.3 percent over the decade that followed (Table 9). A review of economic developments in the Philippines since the early 1990s reveals that some progress has been made in a few problem areas identified by the Krugman, et al. (1992) report, but many others remain as relevant today as they were two decades ago.

41. A number of recent diagnostic studies²⁵ have identified the following key constraints to growth in the Philippines: (i) a vulnerable fiscal situation due largely to a very low public revenue base; (ii) inadequate infrastructure, particularly in transport and electricity; and (iii) a weak investment climate due largely to governance concerns.

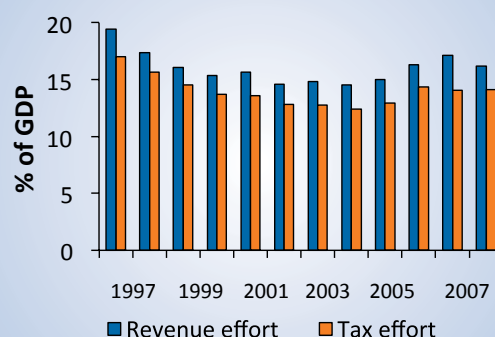
A number of other constraints have also been mentioned as potentially serious obstacles, including shortcomings in the financial sector, labor market rigidities, market failures in certain sectors, and an inadequate composition of skills. However, there appears to be a broad consensus that the first three constraints mentioned above are the most critical.

42. The vulnerable fiscal situation constitutes a threat to macroeconomic instability and undercuts the government's capacity to intervene in the economy and provide essential public services. The East Asian financial crisis triggered a precipitous decline in public revenues, particularly tax revenues, resulting in widening fiscal deficits and a rapidly rising public debt ratio

²⁴ The Krugman team found that the essential structure of the Philippine economy was characterized by a highly inefficient manufacturing sector sheltered behind high protective walls and using excessively capital-intensive techniques, while the rapidly growing labor force was not being absorbed into industrial jobs, but into subsistence agriculture and marginal service-sector employment. Although the government was found to have done a reasonable job of maintaining macroeconomic stability, its limited revenue base constrained its ability to undertake socially necessary spending, especially on infrastructure, which was very low by regional standards.

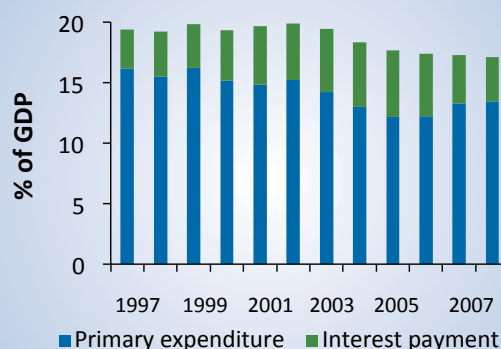
²⁵ See World Bank 2005a, 2007; and Asian Development Bank, 2007.

Figure 9: Public Revenues, 1997-2007



Source: Bureau of Treasury (BTr)

Figure 10: Public Expenditures, 1997-2007



Source: BTr

(Figure 9). A series of tax reforms in 2004-05 succeeded in temporarily reversing the decline in tax revenues and halting the rise in the public debt ratio, but these efforts began to weaken again in 2007, putting renewed pressure on the fiscal balances. The government was able to maintain macroeconomic stability, in part through prudent monetary management but also in part through the decline in public expenditures (Figure 10), raising concerns about the government's capacity to sustain the provision of essential public services. The economic slowdown associated with the current global crisis has exacerbated the decline in tax revenues and resulted in a further buildup of public debt. Restoring the stability and integrity of the tax system in the Philippines is essential for removing the fears of macroeconomic instability that periodically impair the investment climate and for providing a sustainable basis for public services.

43. Infrastructure shortcomings in the Philippines are particularly pronounced in the transport and power sectors. The Global Competitiveness Report for 2009 ranks


Table 10: Ranking the Quality of Infrastructure in Selected East Asian Countries

Overall		Transport				Electricity	
	Rank	(Roads)	Rank	(Ports)	Rank		Rank
Malaysia	27	Malaysia	24	Malaysia	19	Malaysia	39
Thailand	41	Thailand	35	Thailand	47	Thailand	41
China	66	China	50	China	61	China	61
Cambodia	82	Cambodia	77	Cambodia	89	Philippines	87
Indonesia	96	Indonesia	94	Indonesia	95	Indonesia	96
Philippines	98	Vietnam	102	Vietnam	99	Vietnam	103
Vietnam	111	Philippines	104	Philippines	112	Cambodia	121

Note: The rankings refer to a total of 133 countries. Source: World Economic Forum, *The Global Competitiveness Report 2009-2010*

the Philippines 98th out of 133 countries in terms of the quality of its overall infrastructure, ahead of only Vietnam among the countries in the region (Table 10).²⁶ In the Transport sector, it ranks last in the region. As pointed out in the most recent transport sector expenditure review (World Bank, 2009a), the Philippines scores lowest on the Logistics Performance Index in the East Asia region. Even though the quantity of transport infrastructure in network and facility density in the Philippines compares well with other countries in the region, capacity and quality do not. While the Philippines ranks somewhat better in the region in terms of electricity quality, it still falls far below the world average and is an area highlighted in the 2005 investment climate assessment as a major negative influence on firms' productivity and investment decisions.

44. The lack of adequate infrastructure in the Philippines is indicative of a poor investment climate that reflects a weak public investment effort and contributes to a poor private investment effort. Compared to other countries in the region, the Philippines has relied more on the private sector for its capital investment needs. Most noteworthy, however, is that the amount of total spending on fixed capital formation is significantly less in the Philippines than in East Asia and the Pacific on average (Figure 11). Moreover, this gap has been increasing since the East Asia financial crisis, raising further questions

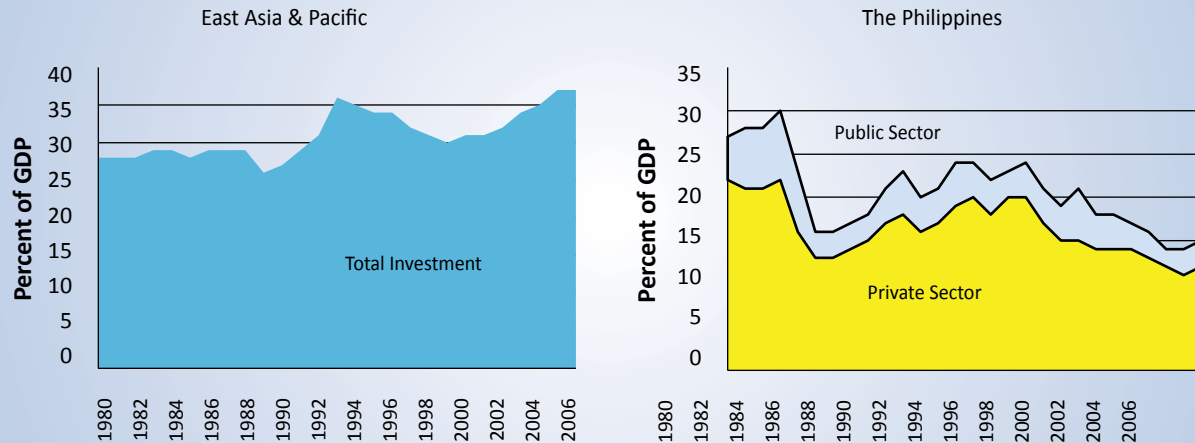
about the sustainability of economic growth. The drop in public investment since the early 1980s was part of a deliberate strategy to place more emphasis on private participation to satisfy the country's infrastructure needs. After 1997, the drop in public revenues, together with poor project preparation and implementation capacity, has rendered the country even more reliant on private infrastructure investment. Such a strategy puts a premium on maintaining a good investment climate for private investors. Unfortunately, the investment climate in the Philippines has not been sufficiently good to attract enough private investors to make up for the gap in public investment, while the laudable increases in public infrastructure spending between 2007 and 2009 were short-lived as the fiscal position deteriorated.

45. Governance-related factors ranked as the main impediment to firms' productivity and investment decisions in the 2005 investment climate assessment. Payments of administrative bribes and the threat of civil unrest, crime and disorder were reported to be among the most important barriers to a good investment climate. As indicated in Figure 12, the Philippines ranks below the world mean in four of the six categories that make up the World Bank's governance indicators. The Philippines ranks particularly poorly in the categories of political stability and control of corruption, both of which had declining scores between 2000 and 2008.

46. Several factors do not appear to be critical constraints to growth at this time. The Krugman, et al. (1992) report noted that, as of mid-1990, the trade policy regime remained highly biased against trade. Accordingly, it

²⁶ This represents a deterioration since 2006, when the Philippines was ranked 88th out of 125 countries.

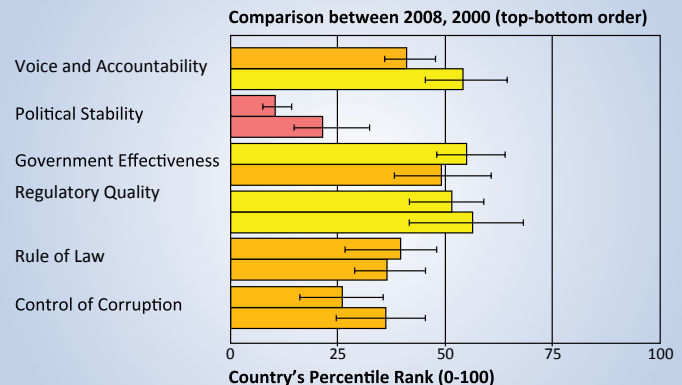
Figure 11: Public and Private Fixed Capital Formation, as % of GDP



Source: World Bank, Development Data Base.

recommended that ‘the nation should pursue a strategy of export-led recovery driven by a depreciation of the exchange rate, complemented by trade liberalization.’ In view of the serious trade deficit and modest export growth that prevailed at the end of the 1980s, the challenging part was how to introduce trade liberalization without immediately generating unsustainable trade deficits. The current situation is significantly different in at least two respects: trade barriers are much lower than in the early 1990s, and the current account balance is in surplus even though the real exchange rate has been appreciating in recent years and is currently above its 1990 level. The main factor responsible for this difference is the tremendous growth in workers’ remittances. The presence of a current account surplus driven by remittances growth means that the Philippines is exporting capital and labor, which raises questions about the country’s long-run growth prospects. The binding constraint on growth does not appear to be the availability of capital or labor but the lack of adequate domestic incentives to employ that capital and labor at home rather than abroad. It is not evident, therefore, that a more depreciated exchange rate coupled with trade liberalization—as recommended by Krugman, et al. (1992)—would make much difference as long as the key constraints that depress the investment climate as described earlier persist.²⁷

Figure 12: The Philippines: Governance Indicators, 2000 vs. 2008



Source: Kaufmann D., A. Kraay, and M. Mastruzzi 2009: Governance Matters VIII: Governance Indicators for 1996-2008

47. It is difficult to envision the resumption of economic growth in a sustained manner in the absence of major improvements in the tax collection effort, infrastructure investment, and governance. A number of policy options and possible reforms to bring about such improvements are contained in previous reports (e.g., World Bank, 2005a and 2007; International Monetary Fund (IMF) and World Bank, 2007; Asian Development Bank, 2007) and are summarized in the concluding section. They are flagged here as necessary conditions for resuming growth and reducing poverty.

²⁷ A similar argument also applies to the gross domestic savings rate. Currently averaging 15 percent of GDP, this rate is very modest compared to the 40 percent average observed in the East Asia & Pacific region as a whole or the 28 percent average for all lower middle-income countries worldwide.

However, this rate is adequate enough to satisfy the current limited demand for investment funds in the Philippines so does not seem to be a constraint to higher domestic investment spending at this time.



48. While resuming growth is essential for poverty reduction, the recent experience of the Philippines indicates that growth must also be rendered more pro-poor. As indicated in Part I, the resurgence of GDP growth in the first half of this decade did little for poverty reduction in the Philippines, raising concerns about its uneven distributional impact. The next section looks at the sectoral, regional, and demographic dimensions of growth in the Philippines to gain a better understanding of what may have caused the impact of growth on poverty to be so low in recent years.

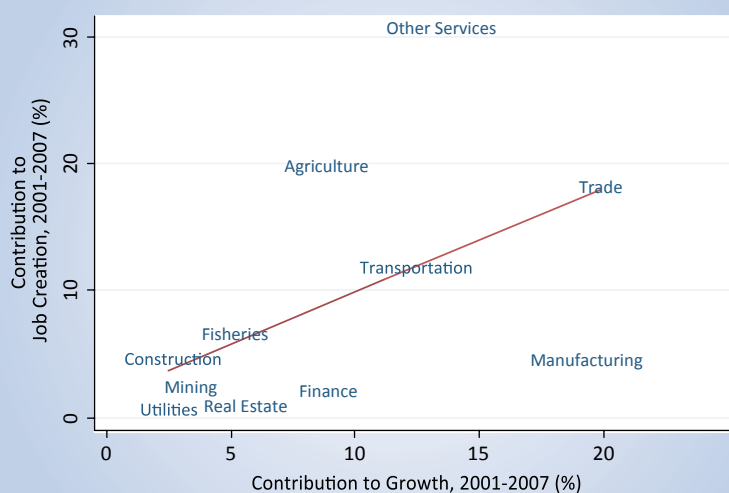
B. The Sectoral, Regional and Demographic Dimensions of Growth and Employment

49. The sectoral and spatial composition of growth matter for poverty reduction. If labor markets are strongly segmented across sectors, growth will have a larger impact on poverty alleviation if it occurs in the sectors where most poor people work. However, even without labor market segmentation, uneven sectoral growth may result in changes in relative prices (both in product and factor markets) that can either favor or hurt the poor. For instance, the poor would benefit if rapid growth in agriculture led to a reduction in the relative price of foods that are consumed more intensively by the poor. Alternatively, considering that the poor tend to be less endowed with skills, they stand to gain the most from increases in the wage for unskilled labor. A growth pattern that is biased towards sectors that are most intensive in the use of unskilled labor, therefore, would put upward pressure on the unskilled wage economy-wide, raising the incomes of the poor and thereby reducing poverty more than would be the case if all sectors were growing at the same uniform rate as GDP.

The sectoral dimensions of growth

50. The sectors that contributed most to GDP growth during the last decade have generated few jobs. A sector's potential impact on wages and poverty reduction depends on its growth rate and size—which together determine its contribution to overall GDP growth—as

Figure 13: Sector Contribution to Growth and Employment



Source: World Bank calculations based on data from the NSCB Philippines Statistical Yearbook (various years)

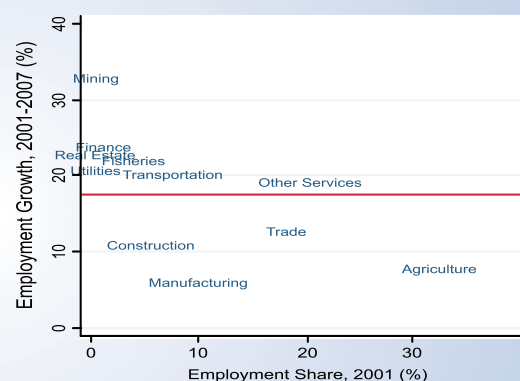
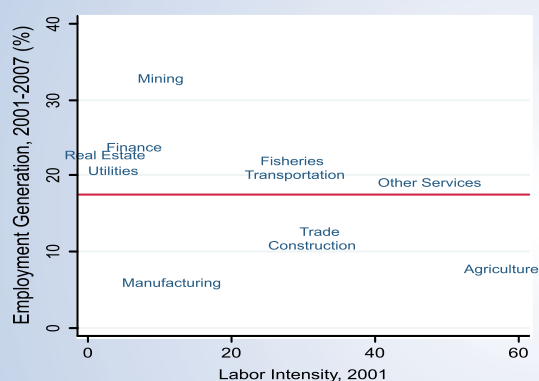
well as on its unskilled labor-intensity ratio.²⁸ Economic growth in recent years has been driven primarily by the manufacturing, wholesale & retail trade, and transport & communications sectors. These sectors have accounted for a sizeable share of GDP, with a combined value-added averaging just under 45 percent during 1997-07. Apart from wholesale & retail trade, however, these sectors have generated little employment. Manufacturing, in particular, which contributed around 20 percent to GDP growth over 2001-07, only contributed around 5 percent to job creation (Figure 13).

51. The limited employment growth that has taken place mainly favored the more educated workers, contributing even less to poverty reduction. The pattern of growth in the Philippines has been biased against the unskilled labor-intensive sectors. The fastest-growing sectors such as manufacturing are relatively capital-intensive and skills-intensive, posing a barrier to employment of the poor in these sectors. Although the overall skills level of the labor force has improved, the poor are mostly unskilled. Among the fastest-growing sectors (manufacturing, wholesale & retail trade, and transport & communications), only the wholesale & retail trade sector exhibits a positive unskilled labor intensity ratio.²⁹

²⁸ The labor intensity ratio is defined as the ratio of a sector's share of unskilled employment to its share in total GDP, minus one.

²⁹ See Figure 3.5 in Chapter III of the Background Papers.

Figure 14: Employment Generation, Labor Intensity, and Sector Size



The red line represents growth in working age population.

Source: World Bank calculations based on data from the NSCB Philippines Statistical Yearbook (various years)

52. Agriculture, which employs the majority of the poor and is intensive in the employment of unskilled labor, has grown more slowly than other sectors. Its overall contribution to total GDP growth was only around 13 percent over 1997-07 — the same as the transport & communications sector, which accounts for a much smaller share of GDP. As a result, the share of agriculture in GDP fell from 19 to 14 percent over the last 10 years. Although agriculture continues to play a significant role as the most employment-intensive sector, its employment generation record in recent years has been disappointing.

53. The services sector has become the main contributor to job creation. Services sector employment grew by 17 percent between 2001 and 2007, compared to 9.4 percent in the agriculture sector and 8.5 percent in manufacturing. As shown in Figure 14, the services sector has overtaken the agriculture sector to account for the largest share of total employment. It accounted for almost 50 percent of total employment in 2007, while agriculture and manufacturing accounted for 35 percent and 15 percent, respectively.

54. As in manufacturing, growth in the services sector also has mainly benefited the more skilled workers. The services sector is the most skills-intensive, with skilled workers comprising 70 percent of its workforce, compared to 60 percent in manufacturing and 26 percent in agriculture. Given that the more skills-intensive services sector has had the highest job creation rate, it is not surprising that employment growth has been more pronounced among skilled workers. The Labor Force Surveys show that total employment of skilled workers

has increased rapidly: during 2001-07, employment of workers with college and high school degrees grew by 23.4 percent and 25.5 percent, respectively. In contrast, employment of workers with no education or a primary degree increased by only 3.2 percent and 0.6 percent, respectively.

55. The combined growth performance of all sectors in recent years has not been strong enough to outweigh the negative influence yielded by the uneven sector growth pattern. The sectoral composition of growth appears to explain in part the observed lack of poverty reduction and the decline in real wages in recent years. Based on this sectoral pattern, the evolution of unskilled wages and changes in poverty can be simulated.³⁰ Simulations reveal that despite the positive GDP growth observed during most of the period since 1997, there are several periods of increase in the poverty headcount index that would be explained by the negative contribution of the sectoral growth pattern to poverty reduction. For example, projected poverty reveals an increase in 2005, despite a positive overall growth rate of GDP per worker of about 2 percent³¹ (Figure 15). The model predicts a fluctuating headcount index that increases slightly over the decade,

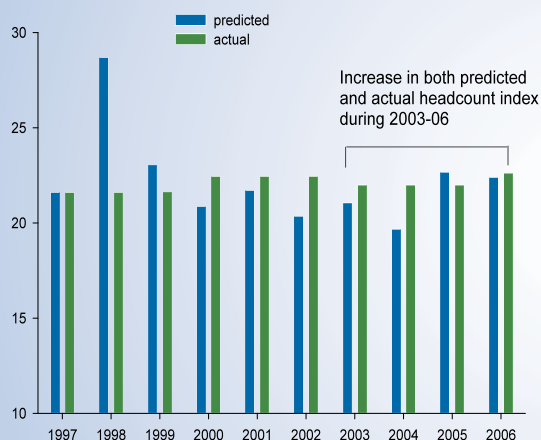
³⁰See, Chap. 3 of the Background Papers, Box 3.1.

³¹The predicted pattern of the headcount index can be obtained using its predicted growth rate and initial value. The evolution of changes in the headcount index is predicted according to the equation: headcount index growth = $-1.936 \times \text{GDP growth} - 13.622 \times \text{labor intensive growth}$, where the coefficients are obtained based on cross-country regressions (based on Loayza and Raddatz, 2006 and Raddatz, 2008).

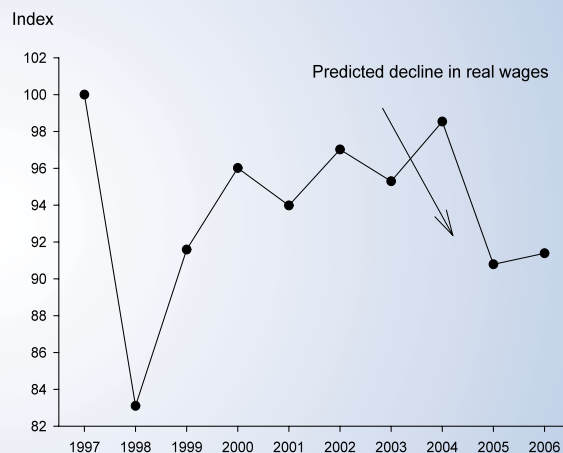


Figure 15: Simulation Results on Changes in Poverty and Unskilled Wages, 1997-2006

Predicted vs. actual poverty headcount index



Predicted evolution of unskilled real wage



Note: wage indexed at 100 in 1997

Source: Raddatz (2008)

and although the predicted increase is smaller than the actual increase, it is still remarkably close. The predicted pattern of real unskilled wages shows that unskilled wages decline by about 8 percent and experience a 4 percent decline during the last few years.³² This is consistent with recent data on actual wages, which also show a decline in real wages of unskilled labor.

The regional dimensions of growth

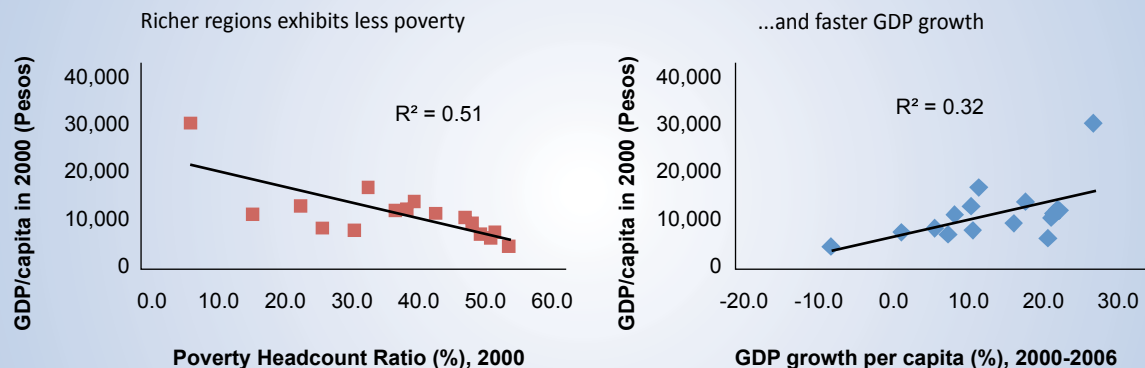
56. There are significant differences in income and poverty levels across regions in the Philippines. The NCR, which accounts for 31 percent of total GDP and only 13 percent of the entire population, is the richest region in the Philippines, with a per capita GDP (in constant 1985 Pesos) of P37,855 in 2006.³³ This is over two and a half times the national average of P14,676. At the other extreme is the region of ARMM, with an average per capita GDP of P3,486 which represents only one-quarter of the national average.



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³² The equation for the evolution of real wages is given by: real wage growth = GDP growth + 7.03x labor intensive growth, where again the coefficient on labor intensive growth is obtained from cross-country regressions. Although Loayza and Raddatz (2006) do not directly estimate the parameters of the wage equation due to data availability constraints, these parameters can be derived from the parameters of the wage equation under certain assumptions.

³³ NCR is also the most densely populated, with 16,100 persons per km², compared to a national average of 226.

Figure 16: Poverty and Economic Performance in the Philippines, by Region

Note: The data points refer to the 16 administrative regions in the Philippines.
Source: FIES 2000; NSCB.

The regions of Bicol, Eastern Visayas and Caraga, also rank among the poorest regions, with average per capita GDP levels of approximately one-half the national average. As shown on the left of Figure 16, the regional disparities in per capita GDP also are fairly closely and inversely correlated with the regional distribution of poverty rates. At the extremes, the richest region (NCR) had a poverty headcount ratio of 5.8 percent in 2000, while the poorest regions (ARMM) had 62 percent.

57. The uneven pattern of per capita growth across the regions may have contributed to the increase in poverty observed during 2003-06. Some regions have exhibited increased per capita income growth since 2000, while others have reported declines. It is conceivable, therefore, that overall poverty stopped declining during 2000-06 due to an uneven pattern of growth. When aggregate GDP growth is positive, however, this can only happen if the overall income distribution across regions worsens. That is, the pattern of growth would have to be such that the rich regions are becoming richer on average, while the poor regions are becoming poorer.³⁴ Such a pattern is observed on the right hand side of Figure 16, which shows that the regions with a higher per capita GDP in 2000 tended to exhibit faster GDP growth during 2000-06.³⁵

³⁴ See Technical Annex II for an analytical justification.

³⁵ It turns out, however, that the correlation between the poverty headcount ratios and per capita GDP growth across regions is insignificant. That is, the regions with the highest poverty headcount ratios have generally not tended to exhibit slower growth than the regions with lower headcount ratios. This result is largely attributable to the statistical divergence problem identified

The demographic dimensions of growth

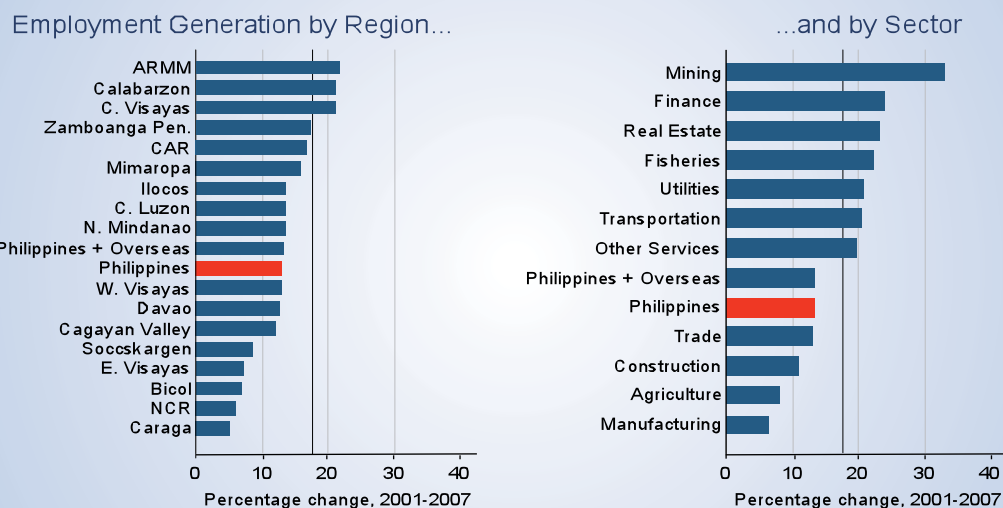
58. The Philippines' labor market faces difficult demographic challenges. As discussed in Section I, the Philippines' population growth rate is among the highest in the region. Given that the country is still in the early stages of demographic transition, dependency ratios—defined as the ratio of children under 15 and adults over 65 divided by the total working-age population—are also high. The dependency ratio for the Philippines was calculated as 65 percent in 2005, exceeding the dependency ratios of Thailand (by 50 percent), Indonesia (by 27 percent), and Malaysia (by 16 percent).

59. The economy has not created enough jobs to keep up with the country's rapid population growth, and real wages have been declining. These population dynamics, which have resulted in a continuous increase in the working-age population (15-64 years of age), are putting tremendous pressure on the labor market, straining the economy's capacity to maintain full employment and generate adequate real wage growth. Between 2001 and 2007, employment grew by 13 percent, while the working-age population grew by 17.6 percent. Meanwhile, the average real wage declined by 5 percent between 2003 and 2006. This problem is also evident across regions: only three regions have been generating employment at a rate higher than the increase in working-age population (Figure 17).

earlier (Part 1), given that the poverty headcount ratios are derived from the FIES household surveys and the per capita GDP figures are derived from the national accounts.



Figure 17: Employment Generation by Region and Sector, 2001-2007



Note: The vertical red line represents the increase in working-age population.
 Source: World Bank calculations based on NSCB, Philippines Statistical Yearbook, various years.

60. Labor supply pressures have been only partly mitigated by a surge of international migration and a decline in labor force participation. According to the Labor Force Survey, the number of individuals registered as Overseas Filipino Workers (OFWs) doubled during 2003-2007, reaching 1.9 million individuals in 2007. The share of OFWs in the working age population has increased from 2.1 percent in 2003 to 3.3 percent in 2007 (Table 11). At the same time, labor force participation rates have declined by 3.0 percentage points if migrants are excluded in the calculation and 2.2 percentage points if they are included. In particular, labor force participation rates among the youngest and most educated workers have fallen steadily over time. Compared to other East Asian countries, the labor force participation rate in the Philippines is low, while the gender gap in labor force

participation is particularly high, with female labor supply being about 30 percentage points lower than male labor supply.³⁶

61. Labor market indicators vary widely across regions, especially between the NCR and the other three island regions of Luzon, Visayas, and Mindanao. Moreover, these differences are significant even after accounting for differences in education attainment and labor market experience. The daily wage in the NCR is one-third higher than the national average, and real wages have declined

³⁶ The implications of this high gender gap are not clearly understood at this time and deserve further attention.

Table 11: Trends in Migration and Labor Force Participation, 2003-2007

Year	Population of 15-64 years old (thousands)	Overseas Filipino Workers (Share of working-age population)	Labor Force participation rate (excl. migrants)	Labor Force participation rate (incl. migrants)
2003	49,900	2.05	62.53	63.83
2004	51,100	2.31	61.64	63.10
2005	52,400	2.57	62.40	64.05
2006	53,600	2.87	61.19	63.00
2007	54,900	3.30	59.56	61.60

Source: LFS, 1997 to 2007 (October rounds).



less than in other regions. However, the unemployment rate in the NCR is almost double the national average. This suggests that individuals in the NCR face tougher competition in obtaining jobs but are likely to be better remunerated if employed. In contrast, individuals in Ilocos, Central Luzon, and Central Visayas face the toughest conditions, with low employment/high unemployment and low wage levels.

C. Generating Productive Employment Opportunities

62. Because the poor are still largely engaged in sectors and regions that are not growing or not creating employment, generating better income-earning opportunities for the poor is critical for poverty reduction. The poor work mainly in the low-growth, low-productivity agricultural sector, while the capital-intensive and skills-intensive nature of the more dynamic sectors makes it difficult for them to gain entry. Meanwhile, demographic pressures are pushing real wages down in the absence of more dynamic growth in labor-absorbing activities. This leaves policymakers with two broad alternatives for generating better income-earning opportunities for the poor. One approach would seek to promote faster growth in the poorer regions and low skill-intensive sectors in hopes of catching up to the other, faster-growing regions and sectors of the economy. An alternative approach is to allow the marketplace to take the lead in determining the most dynamic sectors with the greatest growth potential, while focusing government efforts on providing a growth-friendly macro-environment, eliminating barriers and distortions that prevent a faster labor absorption into the most dynamic sectors, facilitating greater labor mobility across regions and sectors, and promoting human capital development.

63. The key to generating better income-earning opportunities is the integration of lagging with leading regions and sectors of the economy. The 2009 WDR argued that spatial disparities in income and production are inevitable, as they are driven by economies of scale and agglomeration effects, and that government efforts to spread out economic activity equally across the board have generally proven to be futile. The same can be said about government efforts to “pick winners” among different economic sectors. The more promising approach, therefore, is to seek the integration of lagging and leading regions and sectors of the economy. As outlined in the 2009 WDR, this approach begins with the application of ‘spatially blind’ policies (such as the definition and

enforcement of property rights and the removal of distortions that interfere with the functioning of markets), investment in social services, and maintenance of sound macroeconomic policies. Where there is limited labor or population mobility, the spatially blind policies need to be complemented with spatially connective infrastructure and social investments, to enable people and workers in the lagging regions and sectors to integrate more easily with the leading regions. According to this approach, spatially or sectorally targeted interventions to promote growth should only be considered as a last resort.

64. The effective integration of leading and lagging regions or sectors requires investing in both people and places. A common question facing policymakers in countries with very disparate levels of development across regions and sectors is whether to invest the limited public resources in places (physical infrastructure) to promote faster growth or in people (human capital) to promote faster poverty reduction. The answer offered in the 2009 WDR is that countries should invest in activities that produce the highest economic and social returns nationally. This means emphasizing durable infrastructure investments that increase national economic growth in the leading places with a revealed capacity to grow and emphasizing human capital investments in lagging places—that is, providing portable investments that stimulate mobility and accelerate poverty reduction.³⁷

65. The analysis below addresses the challenge of improving income-generating opportunities in the Philippines, focusing first on the agricultural sector before turning to the non-farm sector in rural areas, which shows a great deal more promise for rural poverty reduction. This is followed by a closer look at the potential within the manufacturing sector, which has contributed significantly to GDP growth but generated little employment. Given the positive track record of employment generation in the services sector, the analysis will not cover the services sector separately. However, the role of the services sector, particularly in providing employment opportunities for unskilled workers, merits further study.

³⁷Investments in human capital development in effect seek to transform low-skill labor into the higher-skill labor that was already revealed to be most in demand in the leading industrial and services sectors.


Table 12: Growth Rates of Key Productivity Indicators in Agriculture, 1980-2007

	Agriculture Real Value Added		Agriculture Real Value Added per Worker		Agriculture Value Added per Hectare		Agricultural Land per Worker	
	1980-2000	2000-2007	1980-2000	2000-2007	1980-2000	2000-2007	1980-2000	2000-2007
Indonesia	3.0	3.1	1.1	2.7	1.9	1.9	(0.7)	0.8
Malaysia	2.0	3.7	2.8	4.7	(0.1)	3.2	3.0	1.4
Philippines	1.6	3.9	0.3	2.6	1.0	3.6	(0.6)	(1.0)
Thailand	2.8	3.4	2.0	3.0	2.6	4.3	(0.5)	(0.9)
Vietnam	3.7	3.9	1.9	2.5	1.5	2.1	(0.3)	0.5

Source: World Bank, FAOSTAT.

Revisiting growth in agriculture as a pathway out of rural poverty

66. The agriculture sector is of special interest from a poverty perspective, since the greatest proportion of the poor lives in the rural sector and derives income from agriculture.

Agriculture is generally assumed to be more labor-intensive than other sectors and to have important backward and forward linkages, so increasing its participation in the overall growth process would be expected to enhance the sector's contribution to poverty reduction. It is natural to assume, therefore, that the path to prosperity for the poor will require rapid agricultural sector growth. These assumptions have largely guided Philippine policymakers, resulting in policies aimed at sustaining agricultural growth as part of a broader agenda to reduce poverty and achieve self-sufficiency in rice, corn, and sugar. However, as discussed below, even though agricultural growth can make an important contribution to poverty reduction, it is unlikely to provide the main impetus in this effort.

67. The agriculture sector's contribution to poverty reduction has been much weaker in the Philippines than elsewhere in East Asia.

One reason for this weak contribution is that the performance of Philippine agriculture over the last 28 years has been less dynamic than in most neighboring economies. The pace of agricultural growth has accelerated in recent years, rising from an average growth rate of 1.6 percent during 1980-00 to 3.9 percent in 2000-07, and placing it on a par with sector growth rates elsewhere in the region (Table 12). It is unclear how long the Philippines can sustain this pace in sector growth, however, given the low productivity growth in the sector.

68. Improved productivity is critical for agriculture growth in the Philippines.

In countries such as the Philippines, where the "land frontier" has virtually closed, sustained growth of agricultural output can only come about through increases in productivity. However, TFP growth in agriculture has stagnated in the Philippines at 0.2 percent per year over the past two decades, compared to 1.0 percent per year in Thailand, 1.5 percent per year in Indonesia, and 4.7 percent in China (Mundlak, et al, 2004). The Philippines has also had the weakest performance in the region in terms of growth in real value-added per worker, although it has fared slightly better than Vietnam during the past decade (Table 12).

69. These productivity trends reflect a growing scarcity of land and a progressive reduction in the amount of land per worker, aggravated by agrarian reform policies.

Agricultural productivity has stagnated over the past three decades due to a long-term decline of investment in public infrastructure and the gradual decline in farm size, due to rapid population growth in rural areas. This decline in farm size has been intensified by agrarian reforms that have negatively affected the functioning of land markets and made access to land more difficult for small-scale farmers, aggravating the farm fragmentation problem that contributes negatively to TFP growth.

70. Agriculture sector policies have contributed to the low productivity growth in agriculture.

While bringing short-term relief to select groups—though not necessarily the groups that would be targeted on poverty grounds—current agricultural policy has failed to sustain growth in productivity and farm incomes. Instead, the country's strategy to achieve rice self-sufficiency has stifled efficient resource allocation and impeded rural income diversification. Except for a brief spell during the

Table 13: Nominal Rates of Assistance (NRA) to Agriculture, 1980-2004

	1980-84	1985-89	1990-94	1995-99	2000-04
Agriculture NRA ^a	-3.6	14.4	15.4	33.0	26.0
All agricultural tradables	-4.0	15.8	16.7	35.7	27.9
All non-agricultural tradables	12.9	11.0	9.9	8.6	7.3
Agriculture RRA (agriculture relative to non-agriculture) ^b	-14.9	4.3	6.1	24.9	19.1

^aNRA_s including product-specific input subsidies and non-product-specific assistance. Total of assistance to primary factors and intermediate inputs divided to total value of primary agriculture production at undistorted prices (percent).

^bThe relative rate of assistance (RRA) is defined as $100 * [(100 + NRA_{ag}) / (100 + NRA_{nonag}) - 1]$, where NRA_{ag} and NRA_{nonag} are the percentage NRAs for the tradables parts of the agricultural and non-agricultural sectors, respectively.

Source: David, Intal, and Balisacan in World Bank (2009).

diffusion of the Green Revolution in the 1970s (when rice production benefited from significant investments in technology development, irrigation and extension, along with a favorable trade policy regime and adequate conditions in transport and education), production has always fallen short of consumption in the Philippines. In recent years, the government intensified its intervention in the rice sector to prop up local production. Nominal assistance rates for rice increased from about 15 percent in the second half of the 1980s to about 50 percent in the second half of the 1990s and early 2000s (Table 13). Despite agricultural tariff declines associated with World Trade Organization (WTO) tariff reduction commitments in this period, marketing interventions and other non-tariff barriers (especially in cereals, sugar, poultry, and livestock) have raised the nominal assistance rates in agriculture relative to those in other sectors. Nominal assistance rates for agriculture rose almost two-fold, from an average of only 14 percent in the second half of the 1980s to about 26 percent in the early 2000s, and peaking at much higher rates in the case of certain import-competing agricultural commodities (especially rice, corn, and sugar).

71. The elasticity of poverty reduction to agricultural sector growth has been fairly low in the Philippines, and decreasing over the past two decades. An analysis of FIES income data shows that agriculture's role in poverty reduction is more limited than that of non-agriculture: a one percent increase in non-agricultural incomes generates a larger impact on poverty reduction than does the same increase in agricultural incomes. One explanation for the fairly low elasticity between agricultural growth and poverty reduction is that the key drivers of total factor productivity (TFP) growth for the sector—namely, investment in public

infrastructure and technological change—reduce the sector's labor-to-capital intensity and thereby reduce its employment generation impact.³⁸

72. Although agricultural growth has long been assumed to be the main pathway out of poverty for rural households, the nonfarm sector has become just as important and is continuing to grow in importance as a stepping stone out of poverty.³⁹ A longitudinal study of four villages for the period 1985-04 found that households with a higher share of non-farm income at the start had a higher prevalence of transition out of poverty. At the same time, engaging in non-farm activities reduced the probability of falling into poverty for rural households (Fuwa, 2009). In all four villages studied, employment in tertiary sector activities was the dominant source of poverty escape. For areas near Manila, the services sector was most important, while in other areas, self-employment and transport played the biggest role. Fuwa (2009) also found that international remittances are the second most important source of escape from poverty.

73. The relative importance of the agricultural and non-agricultural sectors in poverty reduction depends on the geography of economic growth. Rural areas that are distant from growing urban areas and markets but

³⁸ An analysis by Teruel and Kuroda (2005) indicates that the elasticities of factor share (pertaining to labor, intermediate inputs, and capita) in total cost with respect to investment in public infrastructure reveal a labor-saving bias in favor of greater capital utilization. This finding is also consistent with the analysis of Mundlak, et al. (2004).

³⁹ Using a long-term panel study from a village in Pangasinan province, which is a highly productive agricultural area, Fuwa and Anderson (2006) and Fuwa (1999) document a striking decline in the relative share of households escaping poverty via the "agricultural ladder" over the three decades between 1962 and 1994. These findings suggest that the potential for agriculture's direct contribution to poverty reduction is relatively limited.



Table 14: Agricultural Resource Endowment and Urbanization

		Urbanization (level of commercialization)		
		Low (highly rural)	Mid (Peri-urban)	High (urban)
Geo-physical endowments (Irrigation potential)	Low	# of provinces: 11	3	1
		Population share: 3.9%	0.9%	1.0%
		Poverty incidence: 23.5%	18.5%	11.5%
		Share to total poverty: 3.6%	0.6%	0.4%
		Share of non-Ag income: 75.1%	70.2%	92.1%
	Mid	25	17	3
		22.3%	29.1%	9.3%
		32.4%	25.2%	22.9%
		28.3%	28.7%	8.3%
	76.0%	80.3%	95.2%	
High	8	6	5	
	10.2%	11.0%	12.4%	
	41.0%	24.6%	6.6%	
	16.3%	10.6%	3.2%	
	72.8%	82.4%	94.5%	

Notes: The provincial composition of the regions has changed over the years. For comparability over time, the provinces are grouped consistently according to the 2000 regional classification.

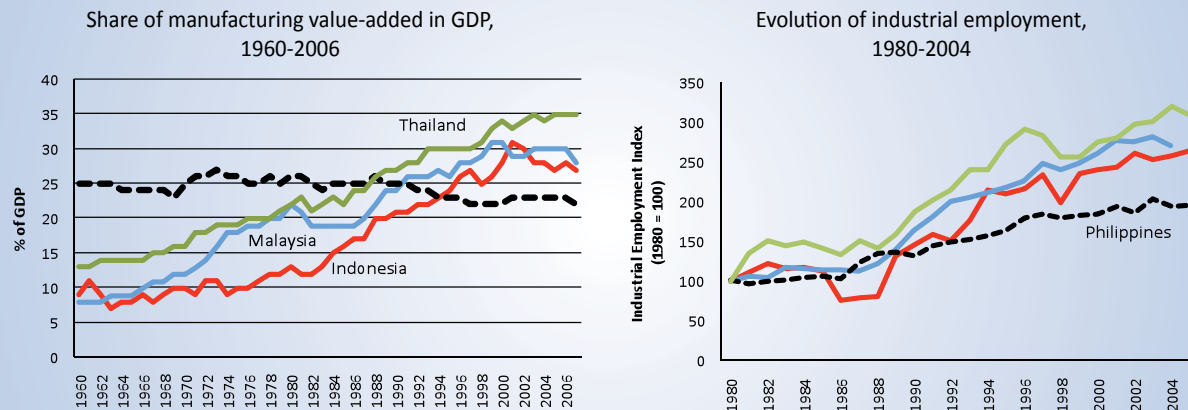
Source: World Bank staff estimates based on data from FIES.

have high land quality tend to be more dependent on agricultural incomes. For these areas, agricultural growth will continue to play a significant role, especially if land ownership patterns favor a broadly based distribution of the benefits of such growth. In contrast, rural areas that are well-connected to rapidly industrializing growth centers are less likely to depend on agricultural incomes. In these cases, non-agricultural employment and enterprise development become the main pathway out of poverty. (Table 14) summarizes the clustering of the country's 79 provinces in terms of geophysical characteristics associated with potential for agricultural growth—in particular, the potential for irrigation development—and access to markets and development opportunities. For the 35 provinces characterized by medium to high levels of urbanization, non-farm development may be a more powerful stimulus for poverty reduction than agricultural development, while the opposite may be true for the 44 highly rural provinces. Of these highly rural provinces, 11 have low potential for agricultural development due to poor quality of agricultural land endowment. For these provinces, pathways out of rural poverty also will center on the diversification of economic activities away from farming and on outmigration.

74. Non-farm employment includes both the rural non-agricultural sector as well as the urban sector. Aside from off-farm employment in rural areas, many of the poor are also turning to informal employment in urban areas, particularly in the services sector. Even though proximity to dynamic urban labor markets made employment in factories an important option for job migration in the communities sampled by Fuwa (2009), this path was dominated by services. Some of the poor who migrate from rural areas work in the informal services sector while others remain unemployed, either waiting for a job locally or abroad, contributing to the higher unemployment rates in urban areas. Fostering employment opportunities in these other sectors then becomes as important as in agriculture and more promising than seeking to generate agriculture growth in areas with poor conditions for farming. It is for that reason important that the policies to generate productive employment remain sector and spatially blind.

75. Even though agriculture has lost its leading role as an engine of poverty reduction at the national level, it can still play a role in some lagging areas. Agriculture retains its importance in lagging areas where it has good

Figure 18: Sector Contribution to GDP and Employment Generation



Source: World Bank, World Development Indicators 2008.

potential for growth and can contribute to diversification of the local economy. To realize its full potential, however, it will be critical to push the horizon beyond the farm, for example by developing a consolidated agribusiness sector in which primary and post-harvest activities are part of a continuum. Moreover, agriculture can also play an important indirect role in poverty reduction through its linkages to other sectors. For example, the food processing sector, which comprises about half of the manufacturing sector, represents a significant source of employment for rural unskilled labor. For the food processing sector to thrive, however, TFP growth in agriculture and the development of modern institutions with regulatory and supervisory functions will be critical. By providing primary products at lower cost, agriculture can help support the development of the manufacturing sector, thereby generating greater domestic value-added and possibly more employment.

Strengthening the contribution of manufacturing to growth and employment

76. The manufacturing sector has not lived up to its full potential as a source of growth and employment in the Philippines. Even though manufacturing has been among the most important contributors to GDP growth since the Asian financial crisis in the late 1990s, it continues to be less dynamic than in neighboring countries and has only been a modest source of employment generation. The comparatively weak performance of manufacturing in the Philippines is not a recent phenomenon and appears to reflect deeper structural weaknesses. The Philippines

began to industrialize much earlier than its regional neighbors,⁴⁰ but its GDP-share of manufacturing has been declining gradually in the Philippines since the mid-1970s, while it continued to grow in the other ASEAN countries (Figure 18).

77. Total Factor Productivity (TFP) growth has accounted for only a small part of the growth in manufacturing output in the Philippines. Although growth in manufacturing value-added is positively associated with TFP increases, the relationship has been very weak. This finding mirrors the overall pattern of economic growth in the Philippines, which had been characterized by negative TFP in the 1990s and early 2000s (Table 9).

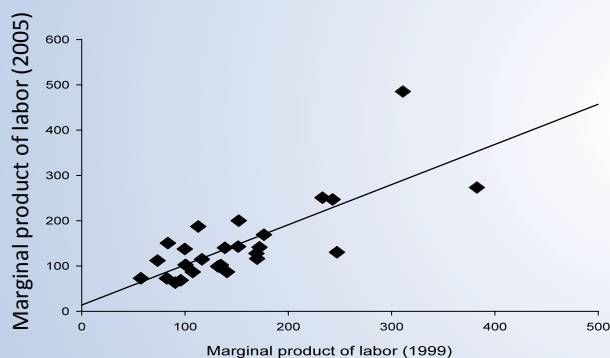
78. The biggest increases in TFP levels have occurred in subsectors with greater competition. Competition is one of the most important factors influencing the productivity of firms, and one good measure of the degree of competition in a sector is the markup of prices over costs. The sectors that had lower markups—or faced greater competition—in 1999 had greater increases in TFP levels during 1999-05. Although it has increased in recent years, the overall degree of competition in the manufacturing sector remains fairly low. Accordingly, the relationship between TFP growth and markups is not very strong.

⁴⁰In the early 1960s, manufacturing output accounted for 25 percent of GDP in the Philippines but less than 15 percent in the other ASEAN member countries.

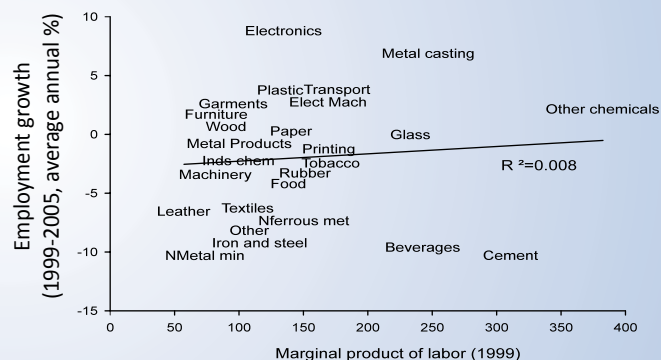


Figure 19: Marginal Products of Labor in Manufacturing

The marginal products of labor vary widely and have not converged over the period 1999-2005



Employment growth has not been faster in sectors with a high marginal labor product



Source: World Bank calculations based on NSCB, Philippines Statistical Yearbook, various years.

79. TFP and investment in manufacturing are also affected by other investment climate factors. The analysis of firm-level data in the Philippines found that both TFP levels and investment are significantly affected by governance-related factors, infrastructure quality, and labor issues (Asian Development Bank (ADB) and World Bank, 2005). An investment climate survey completed in 2005 reveals that macroeconomic stability and weak governance—in particular, corruption, regulatory uncertainty, and insecurity—are perceived as major business obstacles by a large number of firms. Compared to firms in China and Indonesia, those in the Philippines are also more concerned about infrastructure and labor regulations, and they suffer higher losses as a share of sales from various unproductive expenses related to these factors.

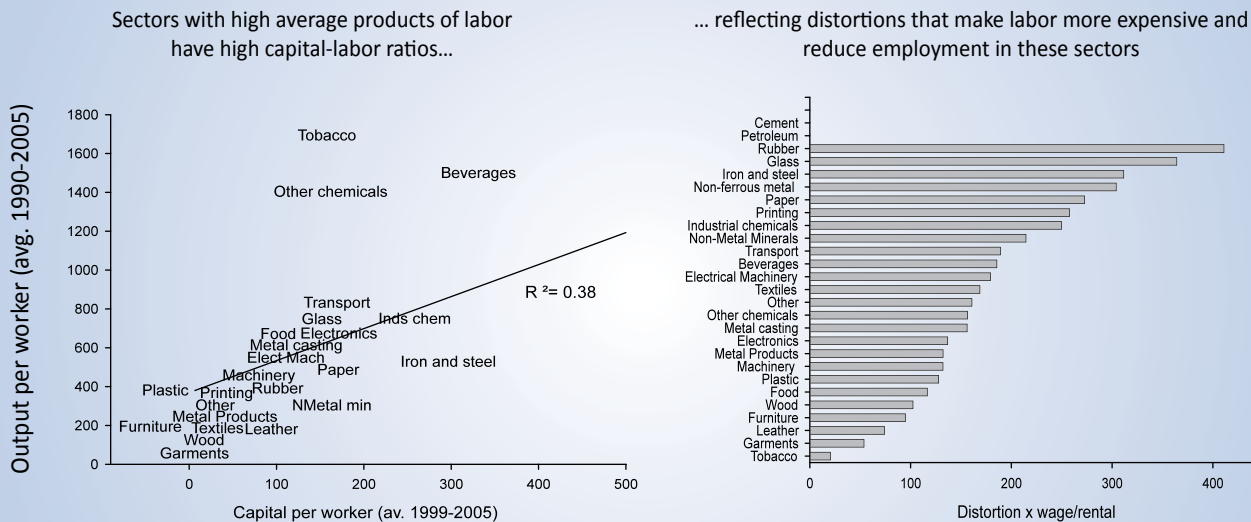
80. Employment generation is adversely affected by the same investment climate factors that undermine TFP. In particular, infrastructure problems and labor regulation have adverse impacts on employment growth. There is also evidence of distortions that constrain labor movement and employment growth in the manufacturing sectors. One indication of these constraints is that the marginal product of labor, or the output produced per additional worker, varies widely across manufacturing sub-sectors and does not appear to converge over time. If labor could move freely, workers would move to sectors where marginal labor productivity is relatively higher. However, employment growth has not been faster in the sectors with higher marginal products of labor (Figure 19). Moreover,

the differences in the marginal product of labor across manufacturing sectors mainly appear to reflect differences in the capital-labor ratios across those sectors.

81. High capital-labor ratios also may be indicative of policy distortions that adversely affect productivity and employment growth. In many manufacturing sub-sectors, capital-labor ratios are far higher than what would be expected after accounting for differences in technology.⁴¹ This is indicative of the existence of policy distortions that affect the relative price of labor and keep employment artificially low. The right-hand side of Figure 20 shows the level of factor market distortions calculated for each manufacturing sector as a proportion of the economy-wide

⁴¹ Assuming that output in each manufacturing sector is determined by a production function with constant returns to scale and two homogenous factors of production, Capital (K) and Labor (L), profit-maximizing firms in each sector will employ labor and capital up to the point where the capital-labor ratio multiplied by the inverse of their respective factor shares in each sector is equal to the economy-wide wage-rental ratio multiplied by sector specific factor distortions; or $[K_s/L_s] * [\alpha_L/\alpha_K] = [w/r] * \phi_s$, where ϕ_s refers to the factor distortion in sector s. In the absence of factor market distortions (meaning that $\phi_s = 1$) and assuming that the wage-rental ratio is the same across sectors, the variations in K/L across sectors would only reflect variations in the relative factor shares (α_L/α_K). Any variation in K/L across sectors in excess of that associated with variations in (α_L/α_K) constitutes prima facie evidence that ϕ_s is not the same for all sectors. A high K/L ratio in a particular sector, therefore, suggests the presence of large factor market distortions, ϕ_s , that raise the relative cost of labor in that sector. See Chapter III Appendix in the Background Papers for further details.

Figure 20: Capital-Labor Ratios and Factor Market Distortions



Note: The horizontal bars on cement and petroleum have been omitted from the figure so as to make the differences between the bars of the other sectors visible.

Source: World Bank calculations based on NSCB, Philippines Statistical Yearbook, various years.

wage-rental ratio. This calculation reveals large variations across sectors, at least part of which can be attributed to differences in the magnitude of the sector-specific factor price distortions.⁴² Ranking the sectors according to the calculated size of the factor market distortions indicates that cement and petroleum products are by far the most distorted sectors, followed by rubber, glass, iron and steel, and non-ferrous metals. A separate qualitative analysis of the cement, petroleum, and glass sectors reveals that these sectors have been operating in a very protected environment.

82. The elimination of barriers to factor mobility may play an important role in accelerating the structural transition from agriculture to manufacturing, and thereby raise overall economic growth. Barriers to financial capital mobility do not appear to constitute a critical bottleneck at this time, except for small and medium enterprises. Although the amount of domestic

credit to the private sector as a share of GDP has continued to decline gradually since the late 1990s, the share of liquid reserves in the total assets of the banking system has been rising since 2005, and real interest rates have been reasonably low. This suggests that the decline in credit is mainly due to limited demand by borrowers, rather than supply constraints. On the other hand, various elements of the Philippine labor market legislation appear extremely rigid by regional and world standards, as discussed in the next section. Questions remain about the extent to which these elements are binding, but policy reforms in this area deserve further study and may need to be complemented with additional reforms in social safety net legislation to compensate for any declines in social protection that could ensue from the relaxation of certain labor market restrictions.

83. Another area that deserves particular attention is the barriers to competition in Philippine manufacturing or modern technology sectors more generally. While the level of protection provided through trade policies has gone down since the time that Krugman, et al. (1992) prepared their report, there are still signs of significant market distortions (e.g., the non-convergence of marginal labor productivity across manufacturing sub-sectors) that contribute, among other things, to the adoption of overly capital-intensive production techniques. As judged

⁴² Even in the absence of factor market distortions (i.e., $\phi_s = 1$, for all s), we may find variations in the wage-rental ratio across sectors if labor is not a homogenous factor of production. That is, if the quality of labor varies significantly across sectors (e.g., with some sectors employing a higher proportion of skilled versus unskilled labor), the more skill-intensive sectors should exhibit a higher average wage-rental ratio.



Table 15: Labor Transition Rates between Sectors, 2003-2006

		2006			
		Agriculture	Industry	Services	Total
2003	Agriculture	85.68	4.64	9.68	100
	Industry	10.32	70.38	19.30	100
	Services	6.22	5.89	87.89	100
	Total	35.16	16.00	48.84	100

Note: figures refer to percent of workers employed in both periods; panel observations only.
Source: Matched LFS-FIES data 2003-2006.

by the latest Most Favoured Nation (MFN) Tariff Trade Restrictiveness Index for overall trade, the Philippines remains a relatively open economy and compares well to the averages for East Asia and the Pacific and lower-middle-income countries. However, the Philippines continues to exhibit significant domestic constraints that protect existing businesses: it ranks 141st out of 181 countries in the Ease of Doing Business index for 2009, reflecting a cumbersome business environment.⁴³ These “behind the border constraints” to doing business are most effective in protecting businesses engaged in non-tradables production, since competing tradables are produced abroad and not subject to those constraints.⁴⁴ The removal of domestic barriers to competition, whether through the introduction of a more modern legal framework or application of a more effective competition policy and strengthened regulatory framework, deserves careful consideration.

⁴³ One domestic barrier to competition that appears particularly onerous when coupled with a weak judiciary is the limitation on foreign ownership of Philippine assets to a maximum share of 40 percent. This minority ownership provision effectively bars many multinationals and banks from entering the Philippine market and competing. Another important barrier to competition is regulatory capture, which appears to prevail in various regulated activities. Though potentially open to all bidders, domestically owned firms tend to be more adept at exploiting this option, being more familiar with the domestic political environment and legal terrain and less constrained by sanctions on corrupt practices introduced by many governments in developed countries in the last decade.

⁴⁴ The shift in relative importance of these barriers to competition, away from import barriers toward domestic production barriers, may explain why many large domestically-owned companies have recently begun restructuring their businesses away from tradable, export-oriented activities into non-tradables; see World Bank Philippines Quarterly Update, October 2009, paragraph 16.

D. Ensuring Adequate Labor Mobility

84. Beyond creating opportunities, it is critical to ensure that workers can move to those opportunities. To maximize the opportunities that are available, workers must have the ability to move to better jobs, more productive sectors, and even other geographic areas that can offer them better income-earning opportunities. Transitions across sectors, for example, are significantly correlated with changes in income over time. The distribution of changes in incomes due to transitions across sectors is particularly favorable for workers moving out of agriculture and for those moving into industry. The ability to move geographically is also important since it is generally not possible to spread economic activity equally across space. Especially for workers in lagging areas that are near or connected to rapidly industrializing growth centers, being able to move and take advantage of opportunities in those centers may be their pathway out of poverty.

85. Labor flows are responding to sector wage differentials, albeit slowly. In a flexible labor market, high dispersion in the distribution of wages should lead to transitions across sectors, with workers adjusting their skills to take advantage of potential income gains. A disaggregation of earnings distributions by sector and employment type shows a significant degree of variation in average salaries, and the panel analysis in Table 15 shows a certain amount of labor mobility across sectors during 2003-06: 15.8 percent of workers who were employed in 2003 and 2006 changed their sector of employment, while 25.4 percent of workers reported a change in employment category. It is important to note that transitions into the manufacturing sector, which was shown earlier to display signs of factor market distortions, are less frequent than transitions into other sectors.

86. Significant differences in wages across different geographic areas suggest a regional segmentation in the labor market. Individuals employed in the NCR earn the highest wages, while the wage in Visayas is 40 percent lower than in the NCR, all other things being equal. Rather than declining, wage gaps have actually widened over time. Even within regions, wages vary widely across sectors. For example, in Luzon, workers in the industry sector and services sector earn daily wages that are 46 percent and 24 percent higher, respectively, than those in the agricultural sector.

87. Another sign of possible labor market segmentation is the increase in the unemployment rate of skilled labor over 2003-07. This suggests that there is an excess supply of skilled labor, especially for younger cohorts, which should depress their wages. At the same time, however, the skill premium in the wages paid to younger workers has increased, as well. This points toward the existence of labor market frictions that result in the rationing of jobs in growing sectors and prevent wages from falling to their market level. However, it could also be reflecting an increase in the reservation wages of younger, skilled workers.

88. The mobility of labor may be hindered in part by labor market rigidities stemming from employment protection legislation. At least on paper, labor market regulations are among the most rigid in the region, and minimum wages are particularly high. The average level of minimum wages in 2007 was set at US\$494 (PPP). Higher minimum wages have been registered only in two other, more developed countries in the region, Taiwan (China), and Korea (Table 16). The Philippines figure is particularly striking considering that only 20 percent of countries worldwide have monthly minimum wages exceeding US\$500 PPP. The Philippines also ranks first regionally in terms of its minimum wage as a proportion of GDP per capita (151 percent) or of the average wage of salaried workers (91 percent). The objective of minimum wage policies is usually to improve the welfare of low earners. In a competitive labor market, however, minimum wages can contribute to job rationing and unemployment if set above the market-clearing wage level. Moreover, minimum wages will price out workers whose marginal productivity falls below the wage floor—typically younger and unskilled workers—inducing firms to substitute unskilled labor with relatively more

Table 16: Minimum Wage (MW) Levels in East Asia

	Level of the minimum wage (2007 or latest)		
	PPP (US\$)	MW/ GDP per capita (%)	MW / average wages (%)
Philippines	424	150.6	90.8
Nepal	133	132.4	
Cambodia	156	103.8	
Bangladesh	69	63.6	
Vietnam	120	55.7	58.5
India	113	50.9	22.8
China	204	46.3	37.5
Thailand	304	46.2	56.0
Indonesia	142	45.8	64.0
Korea	815	39.4	28.9
Lao	65	38.0	
Taiwan	955	38.0	36.7
Sri Lanka	122	36.0	

Source: International Labor Organization (ILO 2008).

productive skilled labor.⁴⁵ Preliminary evidence regarding the employment impact of minimum wages suggests a negative relationship.⁴⁶

89. Compared to other countries in the region, the conditions placed on the use of fixed-term contracts are among the most restrictive in the Philippines. As shown in Table 17, the Philippines, along with Indonesia and Vietnam, has the least flexibility in contractual arrangements. According to the Philippines Labor Force Survey, 80 percent of workers were employed under a permanent contract in 2007. Furthermore, the distribution of workers across different contract arrangements—permanent, temporary, and working for multiple customers or employers—has remained fairly stable over the past decade: the share of permanent workers has changed by less than 2 percentage points in 10 years.

⁴⁵ One way to mitigate this adverse effect on unskilled workers is through the implementation of capacity-building programs. An example of such a program is the Self-Employment Assistance Kaunlaran (SEA-K), being implemented by DSWD in coordination with local government units.

⁴⁶ The high minimum wages may be preventing a more fluid transition of labor from agriculture to other higher-value activities, and contributing to the segmentation of the labor market into a formal and an informal sector. By raising labor costs in the formal sector, such segmentation would be encouraging more capital-intensive production processes in that sector. Further analysis is required to ascertain the magnitude of these effects in the Philippines.


Table 17: Fixed-term Contract Regulations in selected East Asian Countries

	Country	Regulation
Most flexible	Japan	Limited duration (3 years; 5 years for highly specialized employees) several renewals are possible; exemptions exist for specified projects.
	Korea	Limited duration (2 years); exceptions exist for specified projects or tasks.
	Malaysia	No limit on duration; contract must be in writing if longer than 1 month.
	Thailand	No restrictions; regulations cover every establishment employing at least 20 employees.
Moderate	Singapore	Specified work or specified period of time.
	China	Overwhelming majority of employment relationships is permanent; contract for defined tasks must be in writing.
Most restrictive	Cambodia	Limited duration (2 years); defined tasks; contract must be in writing.
	Indonesia	Limited duration (3 years); no renewals; temporary work.
	Philippines	Specified projects; limited duration depending on the defined categories; no renewals.
	Vietnam	Limited duration (1-3 years); 36-month extension; specific/seasonal work

Source: ILO-LABORSTAT, 2008.

E. Policy Implications

90. To generate better income opportunities in lagging regions and sectors of the economy it is best to integrate them with the leading ones. In the Philippines, the poor mostly reside in rural areas and work in agriculture, which has been stagnant for years. Rather than targeting productive investments directly to rural areas and the agricultural sector, however, the 2009 WDR argues in favor of hitching this lagging, rural-based sector to the more dynamic urban-based manufacturing and services sectors through the application of ‘spatially blind’ policies. Such policies primarily involve the elimination of market distortions that inhibit sector development and interfere with the functioning of markets, coupled with investments in spatially connective infrastructure and human capital and the maintenance of sound macroeconomic policies.

91. In agriculture, the application of this approach points to a need to review and revise the existing sector policy framework, with particular attention to the strategy to achieve self-sufficiency in the production of rice and other basic commodities, and with respect to the agrarian reform. The ongoing agrarian reform policies have contributed to a decline in farm size, while the policy of self-sufficiency has led to high trade barriers that limit competition. Both have lowered productivity in agriculture. The stimulation of faster TFP growth will

also require greater investments in public infrastructure, despite its labor-saving bias. Even with such reforms, however, agriculture will not become the main pathway out of poverty in the Philippines except perhaps in rural provinces with strong geo-physical endowments.

92. In manufacturing, this approach argues for enhancing competition, removing key investment constraints, and eliminating distortions in factor markets as key priorities for improving productivity and employment generation. While manufacturing has been one of the most dynamic sectors of the economy, it is not living up to its full potential in terms of its contribution to overall growth and job creation. Despite improved performance over the last decade, the manufacturing sector has been exhibiting modest growth in comparison with the performance in neighboring countries. Three sets of factors have been identified that may have contributed to the manufacturing sector’s comparatively modest growth performance, namely the lack of competition, shortcomings in the investment climate, and factor market distortions that have tended to promote greater capital-intensity of production, resulting in limited labor absorption.

93. In services, this approach argues in favor of building on some of the revealed comparative advantages exhibited by the Philippines. Certain leading sectors, notably the Business Process Outsourcing (BPO) industry,



have grown rapidly in recent years, taking advantage of the country's English language skills and improved informational connectivity from earlier telecom reforms. The main challenge for policymakers is to facilitate further growth in these sectors through appropriate investments in public infrastructure and expansion of complementary education services. In these cases, the private market has 'picked the winners,' while the public sector would be playing a facilitating role. Another sector with apparent comparative advantages that have not yet been revealed is tourism. It also has the potential to become a major source of employment for low-skill labor and contribute directly to poverty reduction. To realize that potential, however, it will be necessary to address various key constraints discussed earlier, including inadequate transport and energy infrastructure, which currently render the sector uncompetitive vis-à-vis other providers in the region.⁴⁷

94. To foster greater competition, the government could consider introducing new competition legislation and the establishment of an anti-monopoly authority. The Philippines had made considerable progress since the mid-1980s in opening up the economy to competition by removing tariff and non-tariff barriers in the manufacturing and other sectors, and by reducing impediments to foreign investment. However, the elimination of trade barriers, though a powerful instrument, does not automatically guarantee a more competitive environment. Sometimes foreign competitors that enter the market end up asking for protection (as in the cement industry), and in other cases, the existing firms are so strongly entrenched that they are able to ward off competitors through other means (i.e. petroleum industry). Efforts to enhance competition therefore call for additional measures, including the strengthening of regulatory and consumer protection agencies and the facilitation of better access to financing for small and medium sized enterprises (SMEs). SMEs are more labor-intensive than larger firms, and the growth of this sub-sector could play an important role in employment generation, including in rural areas as people move out of agriculture.

95. Among the factors that contribute to a good investment climate, the firm-based Investment Climate Assessment in 2005 put most emphasis on the quality of governance and the quality of public infrastructure. In particular, the Investment Climate Assessment found that both total factor productivity and the propensity to invest are particularly sensitive to the prevalence of bribes and administrative corruption, as well as to shortcomings in the power sector. Improvements in governance, including the elimination of corruption, should therefore rank high on the agenda of any action plan designed to stimulate growth. Efforts to improve the quality of public infrastructure, in turn, need to focus on both devoting a greater share of the public sector budget to investment spending, while leveraging the higher amount of public investment spending by continuing to rely on public-private partnership arrangements.

96. The factors that limit mobility between jobs and between different areas need to be studied further with the aim of removing distortions that prevent the labor market from functioning more efficiently. On paper, the Philippines' labor market regulations are among the most rigid in the region. It is not clear, however, to what extent these labor market regulations are binding. There is empirical evidence (reported in World Bank, 2005a) indicating that labor market regulations are a significant determinant of employment growth in the Philippines, and a significant number of firms (25 percent) cite labor regulations as a severe constraint on their operations. However, further analysis is needed to understand better the causes of labor market segmentation and rigidities and their impacts on mobility and employment generation. The recent debate in OECD countries about the optimal configuration of flexible labor legislation and secure social protection also provides useful insights for potential new approaches to tackling the problems of the Filipino labor market. The international evidence suggests that efficiency gains might be achieved by strengthening social protection—i.e. unemployment insurance, wage subsidies, safety nets—in a way that is inclusive and mobility-friendly. Measures to strengthen social protection are discussed in Part III.

⁴⁷ Here, too, the prospects of climate change present important challenges for the tourism industry, in particular, considering the rising frequency of typhoons and its implications for coastal development.



Jun Pinzon



Dave Llorito

“To address the disparities in access to health services, increased public spending for properly targeted interventions is needed.”

Assisting Households to Participate in Markets

97. To take full advantage of the income-earning opportunities available to them, workers must be healthy, well-educated, and sufficiently protected from shocks. Evidence from the Philippines and elsewhere shows how critical good health is to poverty reduction. For example, decreasing fertility can reduce demographic pressures and contribute to improved growth in per capita incomes, while better nutrition improves cognitive function and productivity and reduces loss of income from morbidity and mortality. Education also plays a critical role: daily wages increase monotonically with education level, with university graduates earning P354 a day, while workers with no elementary education earning only P106 a day.⁴⁸ At the same time, having adequate protection from shocks helps minimize disruptions to income as well as prevent adverse coping behaviors—including reduced spending on education and health—which can lead to greater destitution in the long run. Therefore, building human capital through health and education and providing adequate social protection are crucial for making growth more inclusive.

98. Although the Philippines has made some progress in all three areas in recent years, major challenges remain in ensuring equity and access to quality basic services across the country. Given the importance of human capital in enabling households to escape from poverty, the wide dispersion in the distribution of human capital in the Philippines could explain why recent economic growth has not translated into greater progress in poverty reduction.⁴⁹ To realize the gains mentioned above, health and education services and social protection must themselves be inclusive—that is, they must be equally accessible to the poor and rich in all regions of the country, with the same level of high quality. Providing such universal access requires sufficient financing and the efficient use of resources. Successful implementation also depends on effective management and measures to ensure accountability. The following sections explore these issues in health, education, and social protection in more detail.

A. Improving Health Service Delivery

Key indicators and recent developments

99. Progress in key health indicators has been mixed, both at the national level and across different regions. As shown in Table 18, the Philippines has performed relatively well in reducing infant and child mortality and is on track to achieving these MDG goals by 2015. However, the Philippines is currently not on track to reach the MDG goals for maternal mortality and reproductive health. The current estimated maternal mortality rate is 162 deaths per 100,000 live births, which is high given the country's level of development. The latest health surveys reveal that only 66 percent of mothers

⁴⁸ See World Bank (2009c).

⁴⁹ In this context, it is useful to distinguish between an unequal distribution of human capital and a deterioration of the distribution in human capital or access to social services. The former will likely manifest itself in a reduced income elasticity of poverty reduction: as income increases, a more unequal distribution of human capital means that the earnings from that capital tend to be less equally distributed, with a smaller proportion of increased earnings accruing to the poor. A deterioration in the distribution of human capital, on the other hand, can lead to an increase in poverty independent of any change in aggregate income. In the sections that follow, this report will pay special attention to the distribution of human capital and public expenditures, as well as to changes in both of these variables, as possible factors contributing to the increase in poverty observed in the Philippines since 2003.

Table 18: Progress toward Health, Nutrition, and Population MDGs

MDG	Baseline 1990 or year closest to 1990	Level 2002/2003	Current Level 2008	Target by 2015
Eradicate extreme poverty and hunger				
Prevalence of malnutrition among 0-5 year-old children (underweight)	34.5	27.6	26.2	17.3
Reduce child mortality				
Under 5 mortality rate (per 1,000 children)	80.0	40.1	34.0	26.7
Infant mortality rate (per 1,000 live births)	57.0	29.0	25.0	19.0
Improve maternal health				
Maternal mortality rate	209.0	172.0	162*	52.2
Increase access to reproductive health services				
Prevalence of men and women/couples practicing responsible parenthood	40.0	48.9	50.7	70.0
HIV prevalence	< 1	< 1	< 1	< 1
Halt and begin to reverse the incidence of malaria and other diseases				
Malaria morbidity rate (per 100,000 population)	123.0	48.0	n.a.	24.0
Provide basic amenities				
Proportion of families with access to safe drinking water	73.7	80.0		86.8

* 2006 Family Planning Survey.

Sources: National Demographic and Health Surveys (NDHS 1998, 2003, 2008)

receive postnatal care, and only a few obtain complete care. As noted in Part I, the Philippines also has a high rate of child malnutrition, with the poor carrying most of the burden. Among 6-10 year olds, the prevalence of underweight children and of stunting was 25.6 percent and 35.8 percent, respectively—among the highest rates in the region.

100. The lack of progress in addressing high fertility rates is particularly worrisome. Using alternative population projections, Racelis (2008) found that if intensive family planning efforts and changes in fertility preferences were to result in replacement fertility being reached by 2020, the population would stabilize at around 127 million by 2050—a 43 percent increase from 88.6 million in 2007. If, however, replacement fertility is not reached until 2050, the population could grow to 160 million, or almost twice as high as in 2007.

101. These population growth scenarios have major implications not only for health but also for future public expenditure requirements, employment, human capital investment, and environmental management. As noted earlier, a larger population puts pressure on the economy to generate more jobs. It also requires that the government build more schools and hire more teachers. Increased public and private expenditures for health care are also necessary, and as the population ages, the burden of health expenditures increases further. For health, the growth scenarios above suggest that health expenditure will need to at least double, with an even higher burden for the high-growth scenario (Racelis, 2008). Population pressures can also increase environmental degradation and may push more people into areas that are more prone to natural disasters.



102. However, use of family planning has stagnated in the past decade, with persistent unmet needs for family planning and inadequate access to family planning services for poor women. The percentage of married women using family planning has remained static at around 50 percent since 1995, although the use of modern methods has increased to over 35 percent of married women (NDHS 2008). In 2003, only 24 percent of women in the poorest quintile were using family planning, compared to 58 percent in Vietnam and 49 percent in Indonesia. Over half of pregnancies in the Philippines are unintended. While poorer women typically want more children than wealthier women, women in the poorest 40 percent of the population have between 1.5-2.1 more children than they desire (Guttmacher Institute, 2009). Moreover, poor households bear the heaviest financial burden for family planning, with the lowest income quintile spending 5.6 percent of household health expenditures on contraceptives compared to less than one percent for the highest income quintile (FIES 2006).

Equity and access

103. The progress in some health indicators masks significant differences among the rich and poor and among different regions. Health outcomes vary significantly by income level and geographic location. For example, although infant mortality rates have improved at the national level, infant mortality was more than twice as high among the poorest quintile compared to the richest quintile in 2003. Child mortality (ages 0-5) was more than three times higher among the poorest quintile—an increase compared to 1997 (Table 19).

104. These disparities in health outcomes are unsurprising given the wide disparities in access to health services. Variation in immunization rates among different income groups and geographic areas is particularly revealing. Measles immunization coverage in 2003 exceeded 90 percent among the richest quintile, compared to just under 70 percent among the poorest quintile. Large geographic disparities can be seen in the coverage of DPT3—three doses of vaccine against (diphtheria, pertussis, and tetanus), commonly used as a measure of health service availability—with 89 percent coverage in

the NCR compared to 41 percent in the ARMM. Similar disparities are apparent in maternal health: 87 percent of birth deliveries in the NCR were attended by a health professional compared to only 19 percent in ARMM, and 68 percent of deliveries in the NCR were health facility deliveries compared to 15 percent in the ARMM (NDHS 2008). Figure 21 illustrates the degree of regional variation in the percentage of facility deliveries across the country.

Expenditure issues

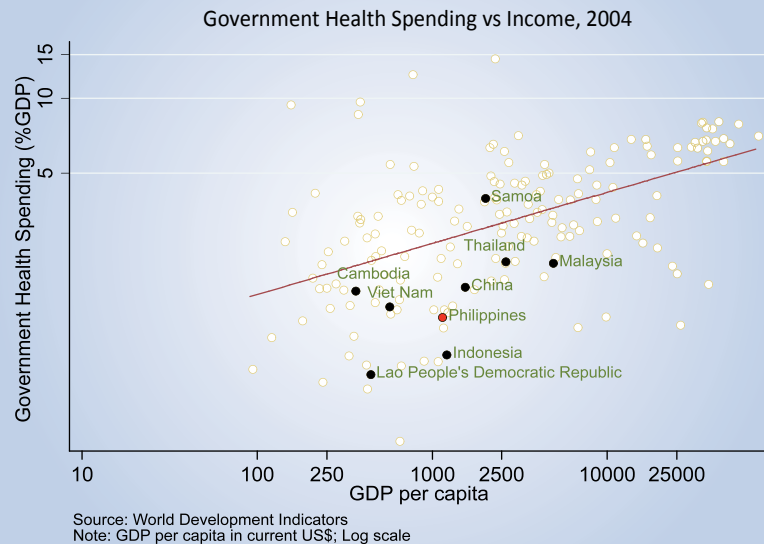
105. Total health spending in the Philippines has increased in recent years, but remains low compared to similar countries in the region. Preliminary estimates by the World Health Organization (WHO) of the country’s National Health Accounts show that for most of the decade up to 2005, total health expenditures as a percentage of GDP remained relatively unchanged at about 3.4 percent. Expenditures then increased in the next two years to reach

Table 19: Equity in Maternal and Child Health Outcomes and Services: Comparing Lowest and Highest Income Quintiles in Philippines and East Asia

Indicators	Philippines 1998		Philippines 2003		Vietnam 2002		Indonesia 2002/3		Cambodia 2000	
	Low	High	Low	High	Low	High	Low	High	Low	High
Child illness and mortality										
Infant mortality rate	48.8	20.9	42.0	19.5	39.3	13.8	60.6	17.1	109.7	50.3
Under-five mortality rate	79.8	29.2	66.3	20.6	52.9	15.8	76.8	21.9	154.8	63.6
Prevalence of fever (%)	26.4	19.4	28.0	17.8	30.9	18.4	24.6	20.5	33.9	36.3
Prevalence of diarrhea (%)	8.8	4.9	13.1	9.4	18.2	3.8	10.0	8.2	19.5	16.0
Prevalence of acute respiratory infection (%)	15.3	9.1	14.6	5.8	23.7	14.0	8.3	5.2	18.3	19.4
Full basic coverage (BCG, measles, DPT)	59.8	86.5	55.5	83.0	44.3	92.3	37.1	64.7	28.6	67.7
Measles coverage	67.6	92.2	69.7	89.4	64.4	97.8	59.5	84.9	43.9	81.8
Maternal and reproductive Health										
Total fertility Rate	6.5	2.1	5.9	2.0	2.2	1.4	3.0	2.2	4.7	2.2
Antenatal visits to medically-trained personnel	73.1	97.8	72.3	96.6	67.7	99.5	77.6	99.1	21.9	79.6
Delivery by medically trained personnel	21.2	91.9	25.1	92.3	58.1	99.7	39.9	93.6	14.7	81.2
Delivery by a doctor	7.1	75.8	8.6	73.2	29.2	91.4	0.7	0.8	0.4	8.8
Delivery in a public facility	7.1	26.3	9.2	31.6	43.2	94.8	3.6	14.7	1.7	36.0
Delivery in a private facility	1.6	52.5	1.2	45.5	4.7	3.9	7.3	66.6	0.1	11.0
Delivery at home	91	21.2	88.7	22.6	51.8	1.1	87.5	17.9	97.1	52.2
Contraceptive prevalence among women	19.6	29.4	23.8	35.2	57.9	51.6	48.6	58.1	12.5	25.4
Treatment of childhood illness in public facility (%)										
Fever	25.6	5.4	38.7	11.6	30.6	19.3	32.0	22.8	10.8	18.1
Acute respiratory infection	37.4	11.9	42.8	14.6	50.5	23.1	39.8	19.6	12.1	22.3
Treatment of childhood illness in private facility (%)										
Fever	6.5	36.0	6.2	43.8	11.5	43.1	7.1	48.1	18.1	27.3
Acute respiratory infection	9.4	60.8	7.4	60.7	13.1	54.60	8.5	54.2	19.6	29.4

Note: “Low” corresponds to the lowest income quintile, while “high” represents the highest income quintile.
Source: Gwatkin, et al, 2008.

Figure 22: Country Comparison of Government Health Spending, 2004



an estimated 3.9 percent of GDP in 2007, representing a per capita increase from about US\$39 in 2005 to US\$63 in 2007. Nonetheless, the Philippines still spends less on health as a share of its GDP and less on health per capita than other countries in the region with comparable income levels. The low overall level of health spending in the Philippines is largely due to the low level of central government spending on health (Figure 22).

106. Although it has increased in recent years, government spending on health remains low. After declining in real terms for almost a decade, the DOH budget has increased from P11.3 billion to P23.7 billion over the past three years. General government expenditures on health increased from 6.0 percent in 2002 to 6.8 percent in 2007, which is comparable to the levels in Cambodia, Indonesia, and Vietnam. However, countries such as China and Thailand spent more than 10 percent of general government expenditures on health.

107. Local government spending has stagnated in real terms over the past decade, which has important equity implications since the poor are especially dependent on health services provided by local governments. Local governments spent a total of P19.9 billion for health, nutrition, and population control in 2007. Although this represents a modest nominal increase from P16.5 billion in 2002, it was a stagnant contribution in real terms. As a share of total local government unit (LGU) spending, the contribution for health declined from 12 percent in 2002 to 9.5 percent in 2007. Cities and towns have been

spending even less, with only 7.5 percent and 7.7 percent, respectively, of their total 2006 expenditures going to health. Notably, salary expenditures consume most of local government spending, while pharmaceutical and medical supplies, capital investments, and other operating expenses are systematically underfinanced.

108. Access to health services for the poor may also be compromised by the high and rising share of out-of-pocket (OOP) payments for health. Out-of-pocket payments for health have been increasing steadily for all income categories since 2000, and the share of OOP expenditure comprised at least half of total health spending over the past decade. Preliminary data indicate that this percentage has increased despite the reported expansion of social health insurance coverage (FIES 2006;

WHO, 2009), which suggests that health insurance has only made a limited contribution to improving access to services for the poor. Indeed, social health insurance has not reduced the percentage of medical spending as a share of total household spending, as it is roughly similar at 2.8 percent and 2.7 percent for households with and without membership in the Philippines Health Insurance Corporation (PhilHealth), respectively (Annual Poverty Indicators Survey, (APIS) 2004).

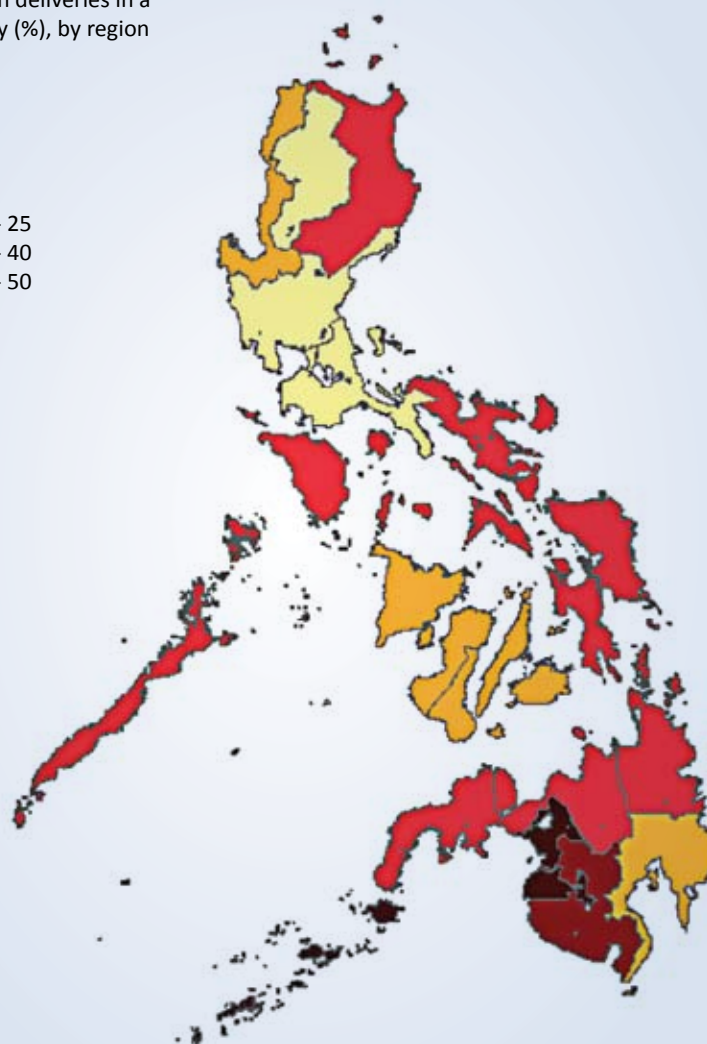
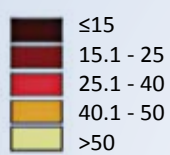
Accountability issues

109. The poor rely predominantly on the public sector for health services, but the quality of care in public hospitals has been problematic due in part to lack of clear performance benchmarks. The DOH used to allocate 60 percent or more of its budget to hospitals, but this share decreased to 35 percent in 2008 as budget increases were allocated to public health measures (Lavado, 2009). Despite the traditionally large share in the budget allocation, public hospitals continue to suffer from inefficiencies, uneven quality, and inadequate funding for medicine and maintenance. To address the funding shortfall, public hospitals have formal user fees, including revolving drug funds. A major issue is that clear performance benchmarks have not been established between the Department of Health and the DOH-managed and LGU-run hospitals, resulting in ambiguity over what services the hospitals are accountable for, which in turn affects public health service delivery.



Figure 21: Birth Deliveries in a Health Facility by Region, 2008

Share of birth deliveries in a health facility (%), by region



Source: WB staff, based on data from NDHS 2008



110. Insufficient monitoring and evaluation of service provision have also weakened accountability in public health service provision, although the current reform agenda attempts to address this problem. The health sector reform agenda calls for the use of performance-based financing to support local service delivery and improved performance of public hospitals. The government is also strengthening its regulatory capacity to ensure that the poor have access to quality medicines and other health goods and services.

Policy Implications

111. Given the implications for inclusive growth and health outcomes for the poor, a key priority is to strengthen the focus on family planning. For the middle and upper classes, private sector and social marketing could help encourage better family planning practices. For the poor, enhanced public service provision will be critical.

112. To address the disparities in access to health services, increased public spending for properly targeted interventions is needed. In particular, greater investment in vaccination coverage, access to health professionals and facilities for deliveries, nutritional status of children, and water supply and sanitation will be needed for poorer areas. On the demand side, conditional cash transfers to poor households (Section C below) should improve access and utilization of health care services by the poor. Financing and appropriate incentives should be provided to local governments to increase expenditures on health and to upgrade the quality of, and access to, essential maternal and child health services.

113. Access to health services could be improved by expanding coverage of the National Health Insurance Program. Membership coverage of the program could be expanded by reviewing the voluntary component and expanding government-subsidized enrollment of the poor with improved targeting of the poor by utilization of the National Household Targeting System for Poverty Reduction (Section C below). In addition, deeper risk protection, another priority area for the national insurance program, could be achieved by improving the benefit package—in particular, through revising the current inpatient benefit and provider payment schemes, and by introducing primary care and outpatient drug benefits.

114. To ensure better quality service provision, greater efforts are needed on a number of fronts to improve accountability in the health system. First, the services provided by public hospitals and LGU-provided services could be improved by introducing performance benchmarks, holding hospital management accountable through explicit contracts, and scaling up performance-based financing. Second, access to essential drugs and quality medicines could be increased by strengthening regulation, increasing procurement transparency, expanding government subsidies, and promoting further competition. Finally, the overall stewardship of the health sector could be enhanced by improving the monitoring and evaluation of the sector and the regulation of the private health care sector.

B. Improving Education and Skills

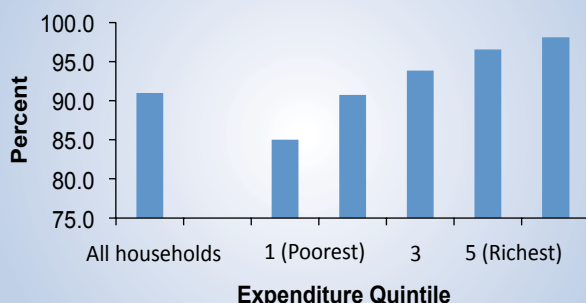
Key indicators and recent developments

115. Educational attainment has increased dramatically over the past two decades, but completion rates for basic education remain very low, particularly among the poor. The number of workers with primary education has stayed roughly constant, while those with secondary and tertiary education have doubled. In fact, secondary and tertiary enrollment rates in the Philippines are higher than the averages in East Asia. However, less than half of children in the three lowest expenditure quintiles graduated from elementary school, and even in the richest quintile, only 54.9 percent of children graduated from elementary school. At the secondary school level, a 15-17 year old teenager in the richest quintile is 4.4 times more likely to have graduated from high school than his peer in the poorest quintile.

116. Tertiary and vocational education outcomes are also low. Although college and university enrollments have risen dramatically since the 1970s, the rate of increase has slowed more recently. Enrollment increases since school year 1998-99 have declined to 1.23 percent per year, a pace that is 0.67 percentage points slower than the growth rate of the 15-24 year old population. The quality of tertiary institutions is also problematic, as evidenced by uniformly low but highly variable passing rates in professional licensure exams. Technical and vocational education and training (TVET) has also expanded rapidly, with enrollment rising by 9.96 percent and the number of graduates rising by 6.85 percent between 2002 and 2006. However, relative to the size of the TVET constituency as estimated by the unemployed labor force, the number of individuals served is not yet very significant.



Figure 23: Percentage of Children in School, 2004



Source: Basic data from APIS 2004.

117. Emerging skills gaps in the service and manufacturing sectors point to problems with the quality and relevance of education.

The problem of a skills mismatch is particularly evident in growth sectors that require more skilled workers. This skills mismatch is exacerbated by migration, with about one-quarter of the labor force being employed abroad, as well as falling labor force participation rates among the most educated workers. In the services sector, vacancy analysis shows difficulties in filling skilled vacancies, particularly for managers, professionals, and sales workers. These difficulties appear to stem from the quality of graduates, relevance of higher education skills, and low levels of certification in fields relevant to growing subsectors. In the manufacturing sector, evidence points to problems of staff turnover for managers and professionals and the insufficient quality and relevance of post-secondary TVET. The main issues include poor perceptions of TVET graduates among manufacturing employers and a lack of certified TVET graduates in some technologically advanced fields.

Equity and access

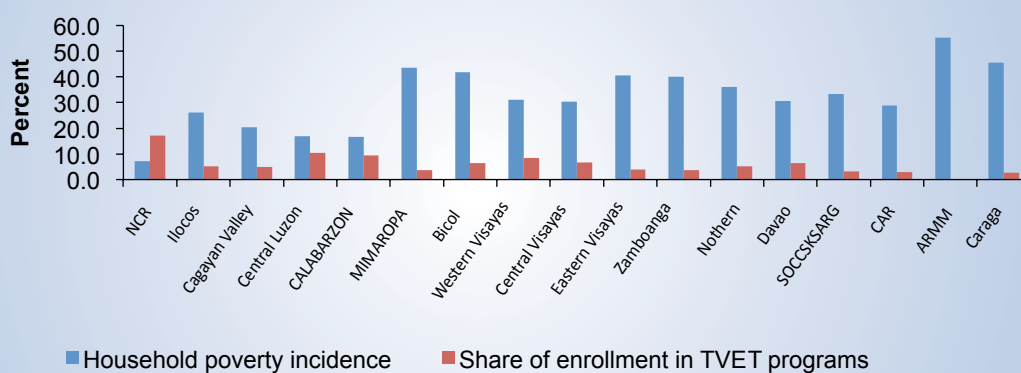
118. Gaps in access to basic education persist between poor and non-poor households, contributing to greater inequality.

Data from the 2004 APIS shows that the proportion of children 16 years or younger who were in school increased—at a decreasing rate—by expenditure quintile, from 85.0 percent in the poorest quintile to 98.1 percent in the richest. As shown in Figure 23, the largest adjacent quintile difference was between the lowest two quintiles, indicating that the drop-off in schooling opportunities was most severe for children in the poorest quintile.

119. Higher education and TVET, which are important for economic growth, also appear to be less accessible to the poor.

Data merged from the LFS and FIES in 2006 show that the attendance rate in tertiary institutions was only 24 percent among the poorest income decile, compared to 46 percent in the richest decile. College education has remained out of reach for the poor due to the high indirect costs of schooling and credit constraints. The coverage of financial assistance programs for students from low-income families such as the Private Education Student Financial Assistance (PESFA) program and the Study Now Pay Later Plan (SNPLP) is quite limited. While the accessibility of TVET programs for the poor is difficult to determine given the heterogeneity of the target clientele, an analysis of regional poverty incidence and regional share in total enrollment in TVET programs shows a negative correlation. In other words, regions that need them more are allocated a smaller share of TVET resources (Figure 24).

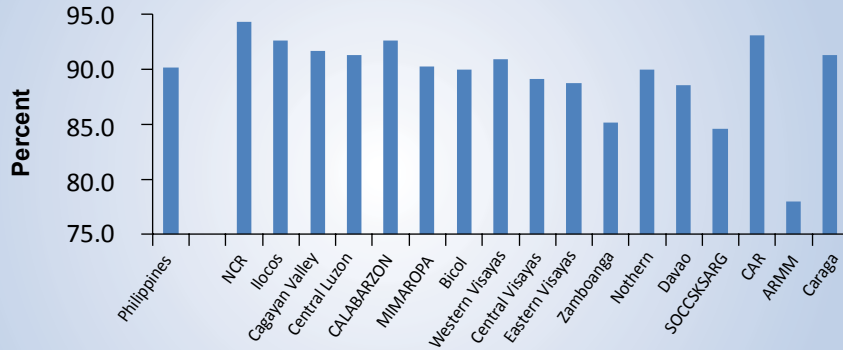
Figure 24: Poverty Incidence and Share in Total Enrollment in TVET Programs, by Region, 2006



Source: Lanzona (2008), based on data from TESDA and 2006 FIES.



Figure 25: Percentage of Children in School by Region, 2004



Note: Children are defined as 16 years of age or under.
Source: APIS 2004.

120. Disparities in education access are also evident across geographic regions. Figure 25 reveals significant geographic disparities, with children in the Mindanao regions of Zamboanga, Davao, SOCCSKSARGEN, and ARMM having relatively less access to schooling. In the ARMM, only 78 percent of children 16 years or younger attended school, compared to the national average of 90.2 percent and to 94.3 percent in the NCR.

Expenditure issues

121. Overall, total government education expenditures as a proportion of GDP have fallen in recent years. Total government expenditures on education declined from 3.4 percent of GDP in 2002 to 2.4 percent in 2008. The Philippines' level of public spending has been relatively low compared to its Asian neighbors, with the exception of Indonesia (Table 20). Although the budget share of public spending on basic education has risen, the real amount spent on basic education and per pupil real spending were lower in 2008 than in 2002.



Dave Llorito

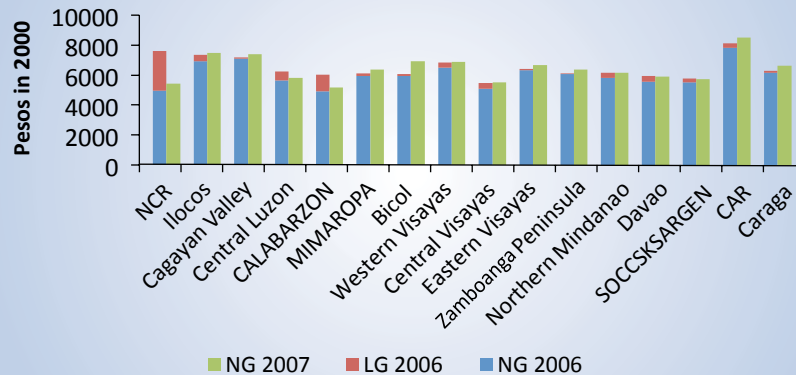
Table 20: National Government Expenditures on Education as a Percent of GNP, 1985-2003

	1985	1990	1995	2000	2003
Philippines	1.35	2.90	3.15	3.28	2.77
Indonesia	n.a.	1.04	n.a.	1.01	1.28
Malaysia	6.61	5.45	5.00	6.38	7.91
Singapore	4.40	3.01	2.98	3.98	4.23
Thailand	3.79	3.59	3.59	4.55	4.13

Source: Manasan and Cuenca (2007).



Figure 26: National Government (NG) Expenditures per Student and Local Government (LG) Expenditures per Student, by Region



Source: DepEd.

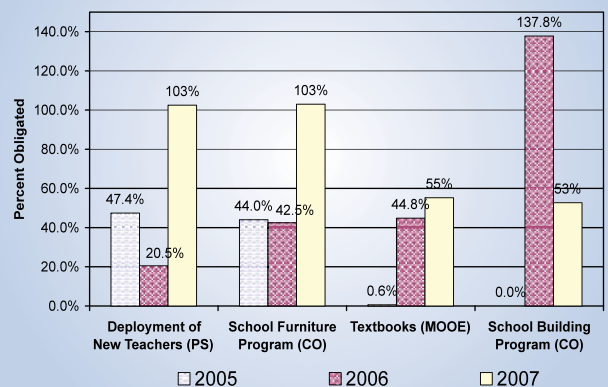
122. Large regional variations in national government per pupil spending have persisted, while local government spending comprises a small proportion of basic education expenditures. Even at the peak of national government spending on basic education in 2007, estimates of this spending ranged from P5,517 and P5,405 in Central Visayas and NCR, respectively, to P7,403, P7,495, and P8,511 in Cagayan Valley, Ilocos, and CAR, respectively (Figure 26). In the NCR, LGU spending in education usually compensates for the national government shortfall, as indicated by the data for 2006. Other regions are not as fortunate, since their LGUs are unable to generate revenues as large as those of the NCR. Local governments fund a very small proportion of basic education expenditures—between 7-8 percent over the years, with a peak of 8.4 percent in 2006.

123. Persistent inefficiencies in resource management and utilization make it difficult for the Department of Education to deliver quality education services efficiently. The DepED has increased its budget allocation for recurrent expenditures over the past two years, enabling it to implement interventions for improved teaching and learning. Nonetheless, resource management and utilization continue to be inefficient. A World Bank Budget Execution Study of large items in the 2007 DepED budget found that slow execution of some priority programs hampers the Department’s ability to deliver quality education services efficiently. Figure 27 shows an erratic pattern of budget execution in four priority program/activity/ project (PAP) items. Analyses conducted to date indicate that much of this erratic pattern is due to institutional and managerial weaknesses.

Accountability issues

124. In the past, weak governance greatly hampered the performance of the basic education sector in the Philippines. There was limited provision for disadvantaged communities, little empowerment of local school communities, and favorable treatment of selected communities that received strong political support. With the slow implementation of decentralization, decision-making on education remained largely regulated by central prescriptions, and no clear accountability structure was in place. Moreover, resource management was inefficient, and schools were unable to respond flexibly to local needs.

Figure 27: Utilization Rate for Selected Department of Education Programs, 2005-2007



Source: DepEd Budget Division.



125. Recognizing these shortcomings, successive DepEd administrations have progressively refined a set of reform strategies that have culminated in the school-based management initiative. By 2005, there was widespread consensus on the nature of reforms that would empower local communities to improve schools and monitor results. Efforts were initiated to decentralize the administration of education to the grassroots level through school-based management (SBM), which was piloted and implemented in public elementary and secondary schools in 2000 and is now being rolled out on a phased basis nationwide through the government's Basic Education Sector Reform Agenda. The SBM model has forged partnerships between schools and communities to improve learning outcomes and school performance, mobilize resources for reforms, and foster a culture of ownership and responsibility among local stakeholders, thus enhancing accountability.

126. A crucial component for fostering accountability in SBM is the system of checks and balances. In the SBM system, decisions for a School Improvement Plan are made collaboratively among all stakeholders then affirmed by the school and community in a public assembly. At the end of the school year, a School Report Card, which assesses plan implementation and the performance of the school and students, is made at a public assembly, after which a review of the School Improvement Plan is made as a basis for the next year's plan. The SBM system also includes the preparation of a School Operating Budget, and the inflows and outflows of Funds are reported at the same public assembly where the School Report Card is presented.

127. Involving local stakeholders in addressing local problems in basic education appears to have had positive results. SBM has empowered communities by giving local stakeholders the opportunity to participate in setting priorities for school improvement and to monitor outcomes. As a result, education has become more responsive to the needs of the poor and disadvantaged, such as indigenous peoples. Using an administrative dataset of SMB pilot schools in the 23 poorest public school divisions in the country, an initial World Bank assessment of the effects of SBM on student performance found that SBM has had a statistically significant, albeit small, overall positive impact on average school-level test scores. It has also had positive spillover effects—for example, the collective responsibility developed among local stakeholders has extended to providing for health, nutrition, and early childhood development needs.

Policy implications

128. Expanding demand-side interventions and scholarship programs could help increase educational enrollments, particularly among the poor. Conditional cash transfer programs, which provide transfers to families that fulfill certain criteria such as school enrollment for children, can be an effective demand-side intervention to help improve the human capital of the poor and thereby lower inequality. An effective targeting system is critical to the success of such programs. To help reduce the financial burden of schooling for poor households, effective scholarship programs and student loan programs—especially for the poorest income quintile—should also be expanded.

129. The level and efficiency of education expenditures need to be raised to enable the provision of quality education services around the country. Greater real per capita spending in basic education is needed to help reduce inequality between the poor and non-poor. At the same time, the limited public funding for tertiary education should be used more strategically. In general, new public investments should be better targeted to benefit the poorest. Special attention is needed to ensure that adequate resources reach schools in a timely manner—the continued decentralization of resources to schools, for example for school maintenance and other operating expenses (MOOE), would help in this regard. An equity- and poverty-based formula for MOOE allocation should be applied immediately.

130. Further involvement of local communities and the private sector would also help improve education service delivery. Given the achievements of SBM to date, it should be implemented as quickly as possible, which would require changes in attitudes and actions at all levels, including the need to move away from regulation by central prescriptions. Where available, private sector capacity should also be utilized in cases where it has been shown to be more effective, but under an improved quality assurance framework.

131. To help address the problem of skills gaps, which is critical for raising economic growth, higher education and TVET need to be more responsive to the needs of the labor market. As a starting point, the quantity and quality of information on the labor market needs to be improved, with better and more complete firm and labor force surveys. Close linkages between post-secondary and tertiary education and industries, for example through



greater collaboration in curriculum design, training, and research and development, would also help make education more responsive to the demands of employers. In addition, the skills supply system needs to be better articulated through strengthened skills certification and through an education and training quality assurance and accreditation system.

C. Strengthening Social Protection

Key indicators and recent developments

132. Social protection has been viewed as a way to promote equity and growth by assisting the poor to manage risk and safeguard their human capital. In the face of health, labor, price, and other idiosyncratic and macroeconomic shocks, poor households are bound to adopt coping strategies that can impair households' human capital or hinder further investment, leading them to a vicious cycle of increased destitution. For instance, falling income among poor households leads to increased child malnutrition with long-lasting consequences on child growth, cognitive and learning ability, and schooling attainments (Alderman et al, 2006; Ferreira and Schady, 2008); higher dropout rates with long-term consequences for the children's labor market performance (Ferreira and Schady, 2008); and selling productive assets (livestock and land) which impedes households' recovery from the shock (Fafchamps et al., 1998; Carter et al., 2004).

133. The lack of progress in poverty reduction and the human and social impacts of the recent food, fuel, and financial crises, as well as the typhoon disasters that followed, have underscored the need for social protection to assist the poor and vulnerable. As in other countries in East Asia and the Pacific, the negative effects of the 1997-98 financial crisis drew greater attention to the problem of vulnerability and the need to protect poorer households from shocks. Since then, rising poverty incidence, the adverse impacts of the food and fuel price shock in 2008, the socioeconomic effects of the global economic crisis, and the disaster triggered by two typhoons in September and October 2009 have raised concerns over the effectiveness and efficiency of social protection services.

134. The importance of social protection is underscored by the large proportion of the population living near the poverty line. As discussed in Part I, raising the poverty threshold to an international poverty line of US\$2 per day



reveals that an additional 19.4 percent of the population in 2006 would be classified as poor. The National Anti-Poverty Commission (NAPC) and the NSCB estimated that around 45 percent of Filipinos face the risk of falling into poverty. Shocks that commonly push vulnerable households into poverty in the Philippines are those related to health, employment, natural disasters, civil unrest, and food prices. (World Bank, 2001b)

135. Although the Philippines has numerous social protection programs in place, their effectiveness has been compromised by targeting, financing, and management problems. The largest share of social protection resources is dedicated to programs aimed at addressing price and income shocks, such as price subsidies, food transfers, and cash transfers, including those that support livelihood and other community-based programs. Other major programs focus on protecting households from health shocks, natural disasters, and labor market shocks. Although the attention to social protection is commendable, the lack of a legitimate and functional system for targeting has undermined the effectiveness of programs in helping the poorest and most vulnerable households. These efforts have also been compromised by the limited resources for social protection and by weak policy and institutional coordination.

Targeting issues

136. The development impact of the most significant social protection programs is severely limited by low coverage of the poor and high leakage to non-poor. International experience shows that directing resources toward the poor or vulnerable can increase the benefits

Table 21: Estimated Leakage Rates of Selected Social Protection Programs

Selected Programs	Intended Beneficiaries	Leakage Rate
• Pantawid Kuryente Program	Households with electricity consumption of no more than 100kwh (lifeline power consumption level) in May 2008	72
• Food-for-School Program	Poor households in selected geographic areas with public school children enrolled in accredited day-care centers, pre-school, and Grade I	59-62
• Tulong Para Kay Lolo at Lola Program	Persons 70 years old or older with no income or retirement benefits	61
• PhilHealth Indigent Program	Indigent households	40-50*
• NFA rice price subsidy	Poor households nationwide	41*

Sources: Manasan (2009); * World Bank staff estimates.

that can be achieved within a given budget or can achieve a given impact at the lowest cost (Grosh et al, 2008). However, a number of social protection programs, particularly those that comprise the largest portion of government spending, are characterized by exceptionally high leakage rates—that is, a large proportion of those reached by the programs are classified as non-poor. As shown in Table 21, leakage rates for the major social protection programs range from 40 to 72 percent.

137. The rice subsidy, which consumes the largest share of government spending on social protection, is poorly targeted and undercovers the poor. The National Food Authority (NFA) rice intervention is a universal consumer price subsidy which by design also benefits the non-poor. World Bank estimates using FIES 2006 data show that the poorest income decile consumes only 14 percent of the total NFA rice subsidy. In addition, the geographic distribution of NFA rice is not sensitive to poverty incidence. For instance, the shares of NFA rice in total rice consumption in Western Visayas (5.9 percent), ARMM (7.1 percent), and Cagayan Valley (9.9 percent) in 2006 were low, although the poverty incidence in these regions was high. While various attempts have been made to improve the targeting for poor households, the leakage rate remains very high.

138. The proxy means test targeting methodology underpinning the National Household Targeting System for Poverty Reduction (NHTSPR) used for the 4Ps CCT program appears to have resulted in higher coverage of the poor and potentially higher poverty impact. The *Pantawid Pamilyang Pilipino* Program (4Ps) is a CCT program providing health and education grants to qualified households on the condition that the children

be sent to schools and health centers for regular check-ups and vaccinations. As described in Box 1, the program uses a proxy means test (PMT) targeting mechanism that appears to have performed well in pilot areas. It is estimated that 87 percent of households classified as poor were identified as potential program beneficiaries. The 4Ps is expected to increase the total incomes of poor and eligible households by an average of 23 percent and to reduce poverty incidence in targeted areas by 6.1 percentage points.⁵⁰ Although these estimates are preliminary, they are consistent with the results of impact evaluations of comparable CCT programs in countries such as Mexico and Colombia.

139. To improve the targeting of its social protection programs, the government is putting in place a national household targeting system that uses the PMT methodology. As part of its social protection reform agenda, the government is implementing the National Household Targeting System for Poverty Reduction (NHTS-PR), which uses the PMT methodology in selecting the poor. The NHTS-PR is intended to be used for targeting the beneficiaries of key social protection programs of DSWD as well as other government agencies.

⁵⁰World Bank staff simulations based on the total cash transfer (health plus education component), computed according to the actual demographic composition of potential beneficiary households and per capita income predicted using the PMT.



Box 1: National Household Targeting System for Poverty Reduction

The National Household Targeting System for Poverty Reduction (NHTS-PR) uses a Proxy Means Test (PMT) approach to select poor beneficiaries for program access. It is used by the Pantawid Pamilyang Pilipino Program (4Ps), a conditional cash transfer (CCT) program. During the pre-pilot and initial phase of the roll-out to 360,000 households in 2008, targeting included two steps: (i) selection of poor provinces based on poverty incidence according to the Family Income and Expenditure Survey (FIES) in 2006 and selection of municipalities based on poverty incidence according to Small Area Estimates in 2003 and (ii) assessment of households through the application of PMT, in which household incomes are predicted on the basis of demographic, educational, and socio-economic characteristics. The information for estimating the PMT is gathered in a two-page questionnaire with relevant variables that predict household income. The PMT model was estimated using the FIES and Labor Force Survey.

The information for calculating the PMT is collected using a number of data-collecting strategies such as survey sweeping (i.e. all residents in a given area are surveyed), on-demand application, or a combination of the two methods depending on the poverty incidence and the urban/rural classification of the areas to be surveyed. The information is processed in a standardized way using software developed for that purpose and is routinely validated. A PMT model is then calculated to classify households as poor or non-poor based on the provincial poverty thresholds established by the National Statistical Coordination Board for 2006. This targeting method has been used in other middle-income countries such as Mexico, Colombia, Chile, and Costa Rica, where reported income is hard to verify as a large number of people work in the informal sector and there are few databases available to cross-check incomes or assets.

Source: World Bank (2009).

Expenditure issues

140. Government spending on social protection has increased in response to the food and fuel price crises. When the sharp spike in global rice prices combined with increases in fuel prices hit the Philippines in mid-2008, the government increased its spending on social protection to nearly three times the spending in 2007. The total amount of spending on social protection rose from P28.2 billion in 2007 to P80.4 billion in 2008 (including off-budget spending by NFA), where the latter accounted for 6.6 percent of the national budget and 1.1 percent of GDP (Table 22).

141. Government spending on social protection during non-crisis times is relatively low, however. The “correct” amount of spending on social protection is debatable and depends on numerous factors such as poverty levels, the need for social protection programs, and the ability of the government to meet those needs given overall resource

Table 22: Government Spending on Social Protection Programs, 2007-2008

	2007	2008
Total Social Protection (P, millions)	28,214	80,418
Percent of national budget	2.4	6.6
Percent of GDP	0.4	1.1

Source: Manasan (2009).

constraints. Nevertheless, social protection spending in the Philippines for a relatively stable year—meaning a non-crisis year such as 2007— has been quite low at 0.4 percent of GDP, especially compared to spending in neighboring countries at similar levels of economic development (Figure 28). A cross-country analysis of patterns of government social protection spending from 1972 to 1997 shows that, as a percentage of GDP, Malaysia

Figure 28: Government Spending on Social Protection, 2007



Sources: Besley, et al. (2003) and Manasan (2009).

spends 1.2 percent, Indonesia 0.9 percent, Thailand 0.6 percent, and Singapore 0.5 percent (Besley et al, 2003). Another study covering 87 developing and transition countries during 1996-2006 shows that mean spending on safety nets is 1.9 percent of GDP (Weigand and Grosh, 2008).

142. The allocation of funding across social protection programs is uneven. The social protection system in the Philippines has relied heavily on in-kind or food transfers, with rice and food subsidies accounting for 70-80 percent of social spending in 2007 and 2008 (Table 23). Even though they involve higher implementation costs, food transfers continue to be the main social protection instrument. At the same time, resources for programs protecting the poor from shocks related to health, employment, and natural disasters have been limited, oftentimes leaving the poor to rely on their own devices when such shocks occur. However, the recent shift toward CCT programs, which provide social assistance and encourage formation of human capital as a means of breaking the intergenerational cycle of poverty, is a promising development.

143. Lack of policy coordination in social protection also reduces the efficiency of sector spending. The existing social protection system has a range of subsidy and transfer programs that are administered across multiple agencies and in an ad hoc manner. This fragmentation of programs reduces the overall efficiency of spending on social protection. It also inhibits the adoption of a systematic strategy for addressing the risks and vulnerabilities of the population and makes it difficult to develop a more coherent social protection response to crises.

Accountability issues

144. Limited institutional capacity and other factors pose a constraint to improving accountability in social protection programs. Clear governance structures, robust control, and accountability mechanisms are necessary for the effective and efficient delivery of social protection programs. International best practice shows that to minimize losses in administering social protection programs, adequate systems to prevent, detect, and deter error, fraud, and corruption must be in place. However, in the Philippines as in other developing countries, limited capacity and resources, the lack of accurate computerized systems for auditing, and the large share of the informal economy make it difficult to improve accountability.

Table 23: Estimated Government Spending on Social Protection Programs, 2007 and 2008

Programs by Shock	2007		2008	
	Pesos (millions)	Share to total (%)	Pesos (millions)	Share to total (%)
Price and Income Shocks	23,659	83.9	74,832	93.1
NFA rice price subsidy	16,200	57.4	60,880	75.7
Food transfers	4,098	14.5	4,347	5.4
Cash transfers	50	0.2	6,197	7.7
Livelihood programs	251	0.9	160	0.2
Community-based programs	1,962	7.0	2,348	2.9
Programs for special needs	1,098	3.9	900	1.1
Natural Disasters	1,265	4.5	986	1.2
Disaster relief	263	0.9	326	0.4
Disaster rehabilitation	1,002	3.6	660	0.8
Health Shocks	2,100	7.4	2,200	2.7
Health insurance for indigents	2,100	7.4	2,200	2.7
Labor Market Shocks	1,188	4.2	2,401	3.0
Skills enhancement programs	510	1.8	1,350	1.7
Labor and employment assistance programs	678	2.4	1,051	1.3
Total	28,214	100.0	80,418	100.0

Source: Manasan (2009).



145. The 4Ps CCT program is paving the way for a modernized social protection system that integrates control and accountability measures. The design of the 4Ps draws heavily on international experience that establishes solid structures for ensuring adequate transparency, accountability, and governance in program implementation. For example, an objective and transparent methodology is used to select the geographic areas where the 4Ps will be implemented as well as to select beneficiaries, and the PMT results are subject to community-level verification. The 4Ps has also established a simple and accessible grievance and redress system for program beneficiaries and non-beneficiaries. Moreover, the payment system for 4Ps does not require the services of intermediaries, as cash transfers are paid directly into the designated accounts of beneficiaries through electronic banking. Routine monitoring by the project management office and government and by an independent committee helps ensure strong project oversight.

Policy implications

146. Better targeting is critical for ensuring that social protection programs benefit the poor and vulnerable. Programs should be targeted wherever and whenever possible so that more generous benefits can be provided to the poor and vulnerable who really need the assistance. A standardized and transparent household targeting system can also improve the governance, transparency, and credibility of programs. The PMT methodology is one of the most advanced systems for targeting, and once in place, the NHTS-PR should be used to target various social protection programs. Other targeting methods may also be used, as PMT tends to be unresponsive in the short term to changes in the need for assistance (see Ravallion, 2003 and 2008). Other targeting methods include simpler categorical targeting (e.g., elderly, disabled), geographical targeting (universal coverage in areas with high poverty incidence), and self-targeting, where limited assistance is offered to everybody but at some costs to households, such that only the neediest ones would participate.

147. The delivery of social protection services could also be enhanced through improved coordination in social protection policy. A key step in this direction was the passing of an operational definition of social protection in 2007 to help establish a common framework for designing and implementing a national social protection strategy. Another important development was the creation of the inter-agency National Social Welfare Program in 2008. This

inter-agency body has undertaken an assessment of the existing social protection programs, with a view to scaling up and reallocating resources to the most effective and efficient ones. In 2009, the government adopted a Social Protection Framework that provides an inventory and typology of major programs. Further analysis leading to an overall operational social protection strategy will be critical for taking these efforts forward. An important positive step taken in this direction is the establishment of the Social Protection Sub-Committee under the Social Development Committee of NEDA, chaired by DSWD. Among others, the sub-committee is responsible for coming up with a social protection strategy that is consistent with national development priorities and ensuring that institutional arrangements are in place to implement the strategy.

148. The 4Ps could serve as the potential backbone of a modern and more consolidated social protection system for the Philippines. As noted above, the design of the 4Ps and its PMT targeting system are based on best practice examples from other countries which have proven to have good targeting outcomes. Such CCT programs have also been found to be effective demand-side interventions for building human capital. The 4Ps is therefore a promising backbone for the social protection system and, if successful, could potentially replace other subsidy and transfer programs as a flagship social protection and poverty reduction program for the country. In particular, the government could explore the use of more cost effective and better targeted cash transfers to assist the poor in place of current commodity subsidy programs that have been shown to have high administrative and delivery costs in addition to being poorly targeted.

149. Finally, to help ensure successful implementation, it will be important to enhance the capacity of government agencies involved in social protection. The implementation capacity of key agencies is a key consideration in designing social protection programs. For example, the 4Ps requires significant administrative capacity in the DSWD. To roll out the program successfully, extensive training will be needed on all the operational steps of the program, including on how to operate effective monitoring and evaluation systems, for staff at the central and local levels. Enhancing the capacity of DSWD to implement the 4Ps, as well as the NHTSPR, could lead to the emergence of a strong institutional leader in the social protection sector.

Technical Annex I

The Impact of Sector Structure and Productivity Growth on Overall Growth

Table A1 describes the actual evolution of labor productivity and labor shares from the late 1980s to the early 2000s. It shows that labor productivity increased very little over this period (and was most pronounced in agriculture), and that the decline in the labor share engaged in agriculture was entirely absorbed by the services sector. The first row in the lower half of Table A1 shows the change in average output per worker, calculated as a weighted average over all sectors, which has resulted from the actual evolution of labor productivity and labor shares in the Philippines. It indicates an absolute change of 10.5 percent, which works out to a growth rate of under 0.7 percent per annum over this period.

The second row in the lower half of Table A1 (Scenario B) shows the change in overall output per worker that would have occurred if the entire decline in the labor share of agriculture had been absorbed into the more productive industry sector instead of the Services sector, while labor productivity in each sector continued to evolve as in the Actual case. The third row (Scenario C) shows the change in overall output per worker if labor productivity in each sector had increased across both periods at the average rate observed in Indonesia, Malaysia and Thailand, while sector labor shares evolved as in the Actual case. (The basic parameter assumptions for Scenarios A and B are presented in the last two columns of Table A1.) Finally, the last row of the table presents the joint impact of the two alternative scenarios.

The main finding from this decomposition is that output per worker in the Philippines could have grown by almost 3 percent per annum between 1987 and 2004, instead of just 0.7 percent, if it had succeeded in achieving a faster transformation from agriculture to industry and if labor productivity in each sector had grown as fast as in the other middle-income East Asian economies. These two factors would have brought the overall economic growth rate in the Philippines close to the average growth rate experienced in these other economies.

Table A1: The Growth Impact of Structural Transformation and Sector Productivity Change

	Actual				Scenario B	Scenario C
	Labor Productivity		Labor Shares		Labor shares	Labor Product.
	constant 1985 P ('000)		percentages		percentages	1985 P ('000)
period ave.	1987-90	2002-04	1987-90	2002-04	2002-04	
Agriculture	14	17	47	37	37	21
Services	31	31	38	48	38	38
Industry	66	67	15	15	25	80
Average Output/worker						
	1987-90	2002-04	Change	%	% per annum	
Actual	28.26	31.22	2.96	10.47	0.67	
Scenario B	28.26	34.82	6.56	23.21	1.40	
Scenario C	28.26	38.01	9.75	34.50	2.00	
Scenario B+C	28.26	42.21	13.95	49.36	2.71	

Source: World Bank calculations based on World Bank Development Indicators. Notes: Scenario B assumes that labor productivity evolves as in the Actual case, but that the reduction in agriculture's employment share is entirely absorbed into the industry sector. Scenario C assumes that sector employment shares evolve as in the Actual case, but that labor productivity increases in each sector by the average increase observed in Indonesia, Malaysia and Thailand across both periods.



Technical Annex II

The Link between the Regional Composition of Growth and the Evolution of Poverty

Consider a country with two regions; one rich and the other poor. The poverty headcount ratio in each region is denoted H_i for $i = R$ (rich) or P (poor), and GDP (or Income) per capita is denoted G_i for $i = R, P$. The total GDP (G) and poverty headcount ratio (H) of that country can then be calculated as weighted averages of the regional per capita GDPs and poverty ratios:

$$H = \alpha_R H_R + \alpha_P H_P \text{ and}$$

$$G = \alpha_R G_R + \alpha_P G_P$$

where α_R and α_P represent the shares of total population in regions R and P , such that $\alpha_R + \alpha_P = 1$.

Assume that the poverty headcount ratio in each region is negatively related to per capita GDP in that region, with decreasing marginal impact. That is, for $H_i(G_i) > 0$, $H_i' < 0$ and $H_i'' > 0$, for $i = R$ and P . These second order assumptions simply say that the impact of an increase in per capita GDP on poverty reduction tends to diminish as the region becomes richer. With this simple model, the evolution of a country's GDP and overall poverty headcount ratio are determined by the evolution of the regional per capita GDP levels, as follows:

$$dH = \alpha_R H_R' dG_R + \alpha_P H_P' dG_P$$

$$dG = \alpha_R dG_R + \alpha_P dG_P$$

or, expressed in vector notation: $(dH, dG)' = [A] (dG_R, dG_P)'$. The matrix A in this expression is signed $--++$, and its determinant is given by $\Delta = \alpha_R * \alpha_P (H_R' - H_P') > 0$, since $H_R' > H_P'$ as long as $G_R > G_P$.

By inverting the previous expression, it is possible to determine what the regional growth patterns would have to look like in order for both the overall poverty headcount ratio and the overall per capita GDP level to be increasing. That is, $(dG_R, dG_P)' = [A]^{-1} (dH, dG)'$, where the inverse matrix, $[A]^{-1}$, is now signed $++--$. From this expression, the only way that H and G can both increase (i.e., $dH > 0$ and $dG > 0$) is if the rich region becomes richer and the poor region poorer (i.e., $dG_R > 0$ and $dG_P < 0$). As discussed in the main text, such a pattern seems to have characterized regional growth in the Philippines during 2000-2006.



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