



# **The Investment Climate in Philippines**

**Arvind Gupta**

**World Bank, Manila**

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# MTDP CONTEXT: Ambitious But Achievable Targets

	<b>2004</b>	<b>2010</b>
GDP Growth (%)	6.1	8
Investment/GDP (%)	19.9	27.7
New Jobs ('000)	1234	2000
Poverty (families %)	26	19.8

*Source: DOF and NEDA*



# The Investment Climate Agenda

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- **How is Philippines Performing?**
- **What Are the Concerns of Firms?**
- **What are the Key Issues?**
- **What are some Practical Solutions?**

**WE SEEK YOUR VIEWS, INSIGHTS and SOLUTIONS**



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# How Has Philippines Done?



# Declining Relative Competitiveness and FDI Attractiveness

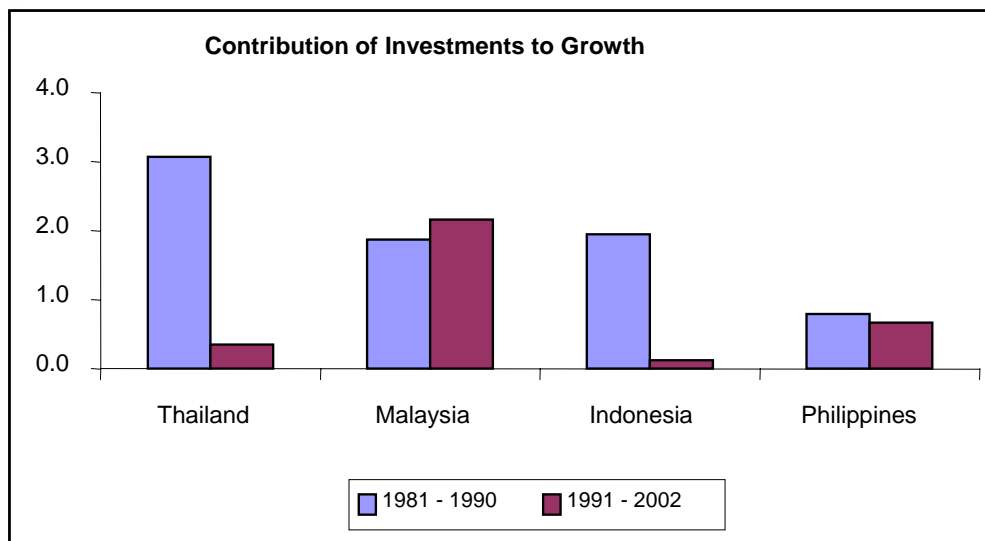
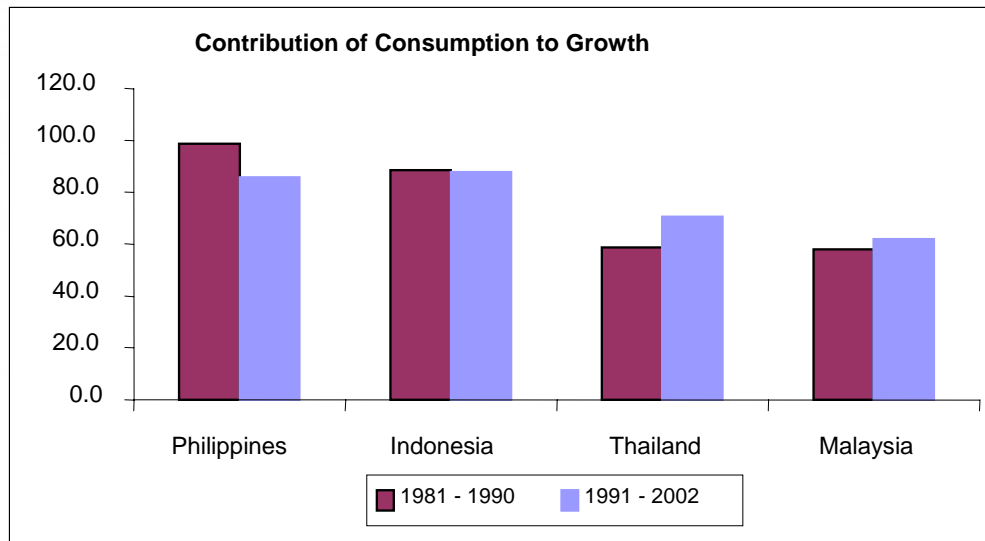
	<b>00</b>	<b>01</b>	<b>02</b>	<b>03</b>	<b>04</b>
<b>SGP</b>	2	3	8	4	2
<b>MYS</b>	26	28	24	21	16
<b>THA</b>	31	34	31	30	29
<b>CHN</b>	24	26	28	29	24
<b>PHIL</b>	35	39	40	49	52
<b>INDO</b>	43	46	47	57	58

**In an AT Kearney Survey of Investment Intentions of 1000 leading MNCs Philippines did not figure in the top 20 locations. SGP, MYS, CHN, THA did.**



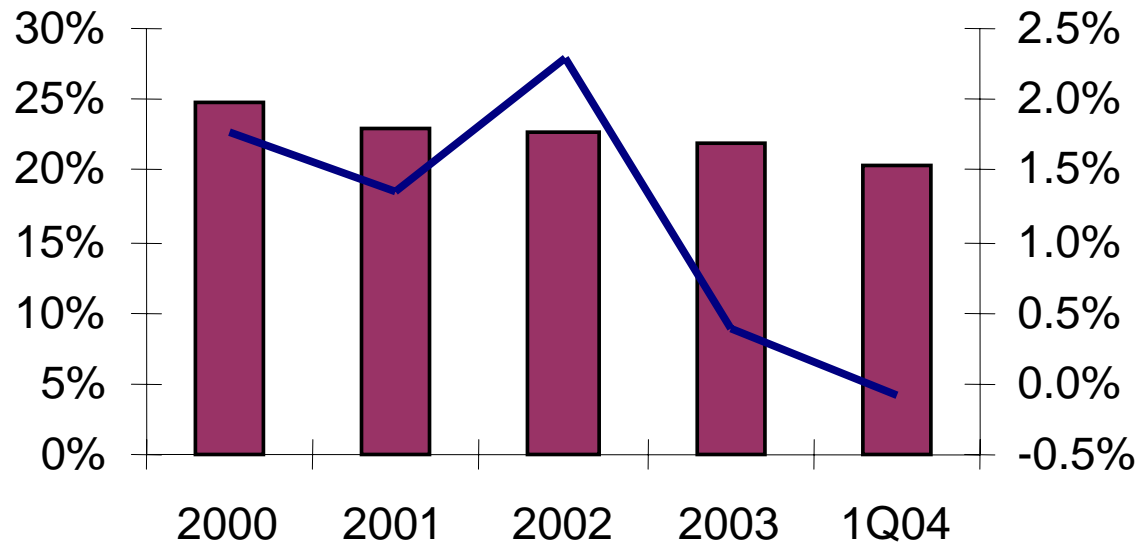
# Consumption and Not Investment Drives Growth

Is this  
cause for  
concern?  
Very  
different  
from other  
Asian  
Countries





# Investments as % of GDP have been declining

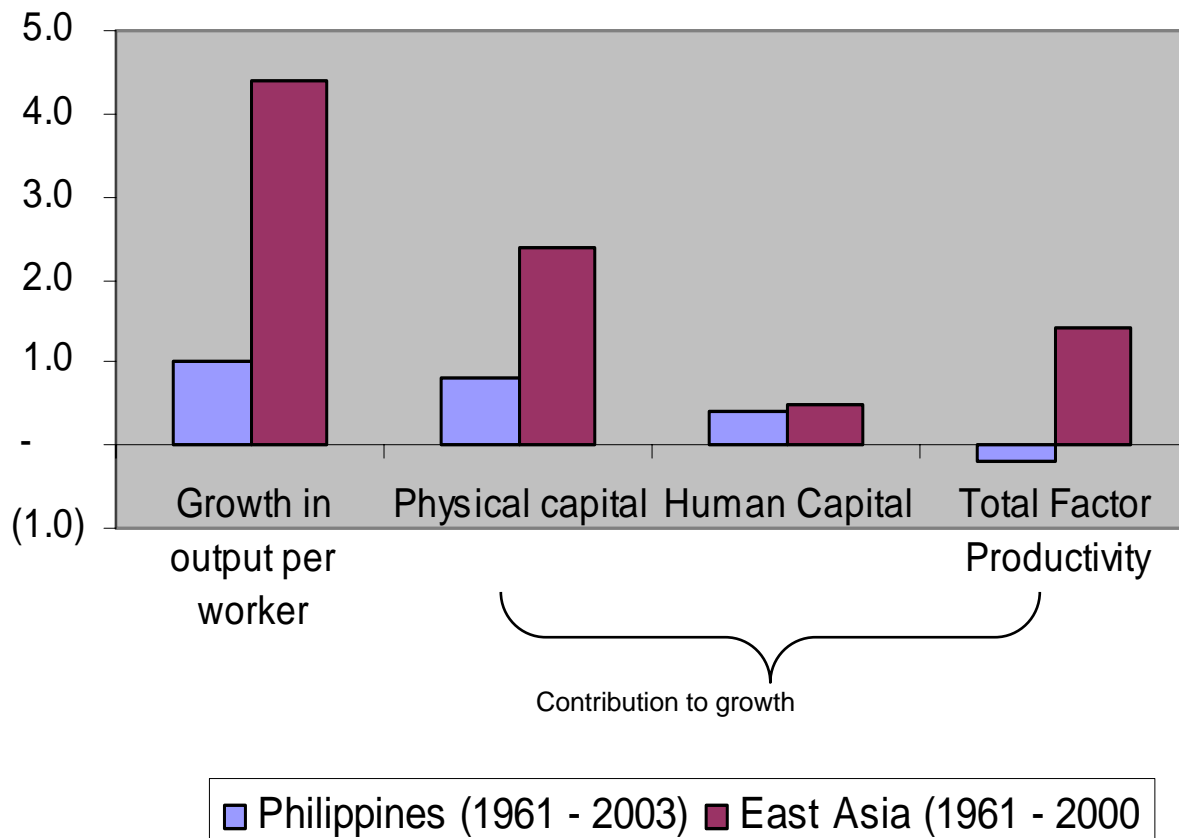


Source: NSCB

■ Fixed capital formation, lhs  
— Foreign direct investments, rhs



# And Productivity Has Been Low



**Productivity growth requires long-term planning and investment horizons.**

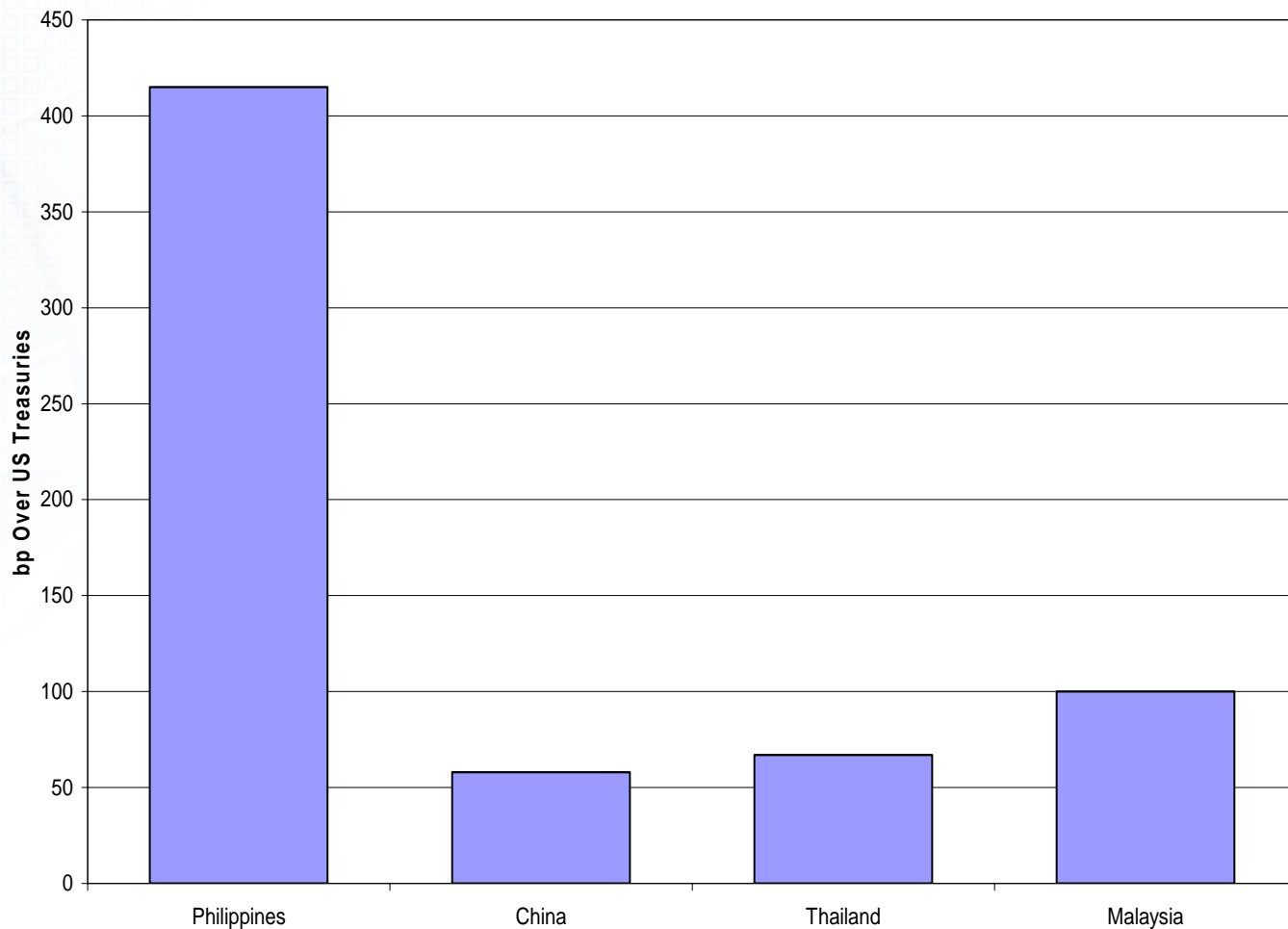
*Source: Bosworth and Collins (2003) & WB staff estimates*





# Country Credit Risk is High

EMBI Yield Spreads (end 2004)



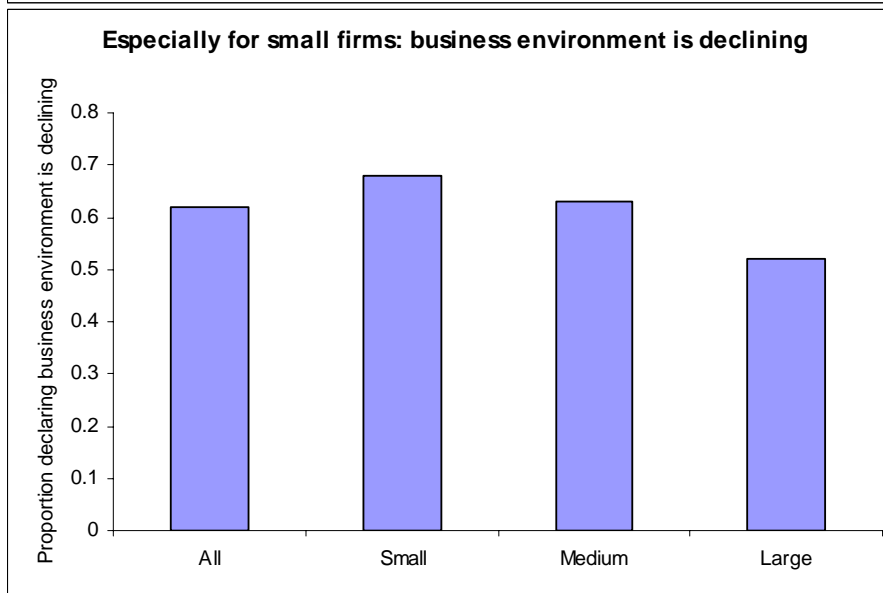
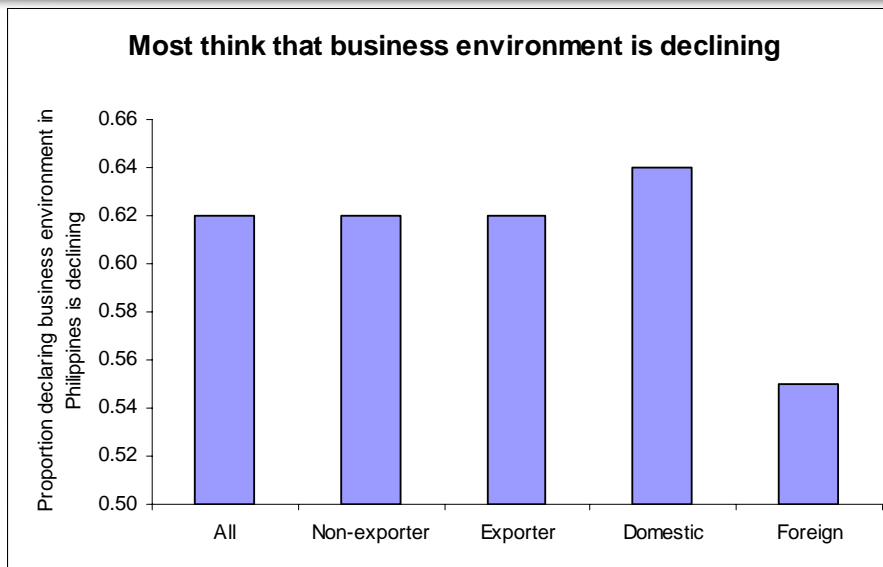


# **What Are The Firms Saying?**

**(ADB-WB Joint Survey of Firms)**



# Firms Worried About The Investment Climate

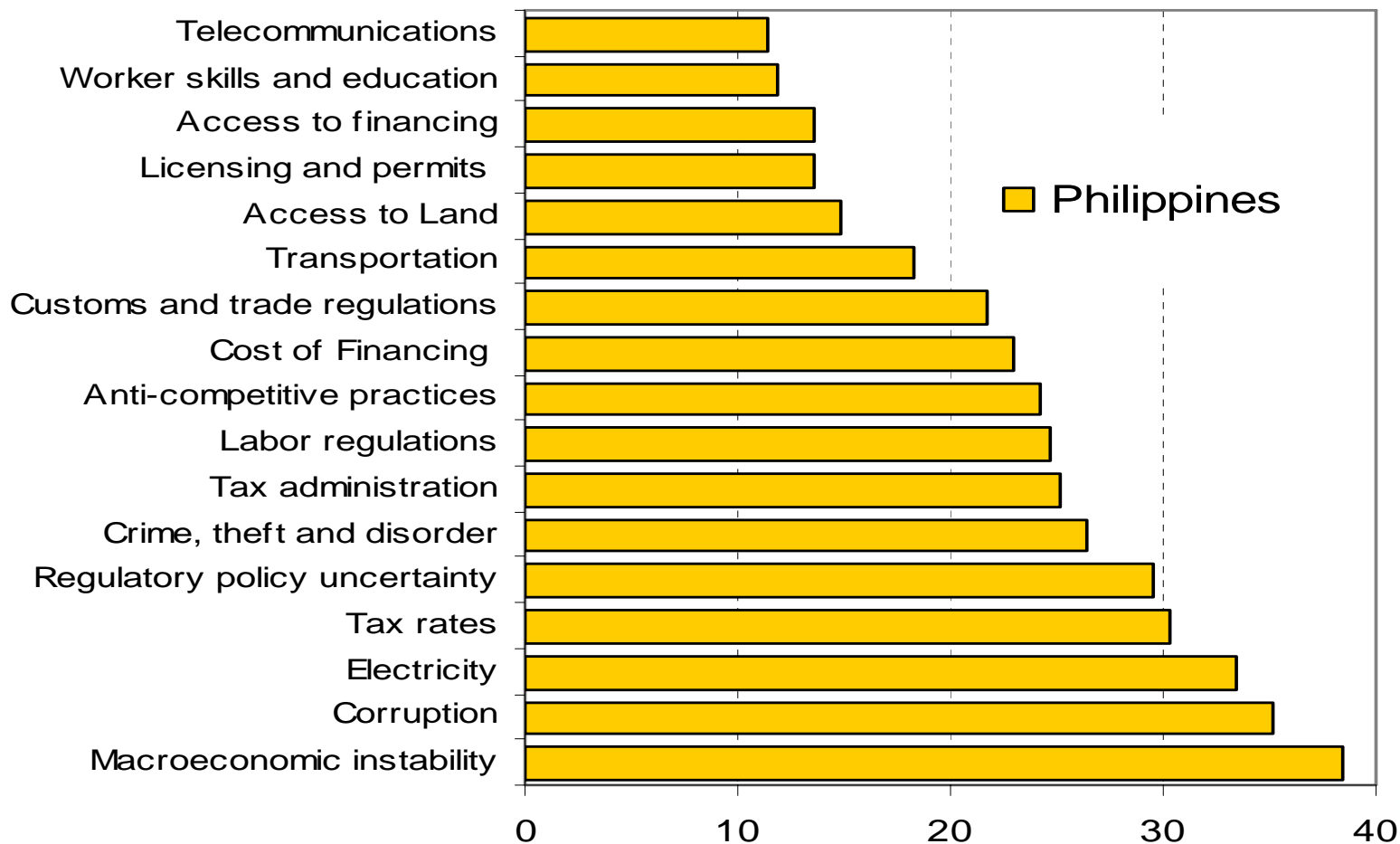




# Main Constraints: Macro & Governance Related

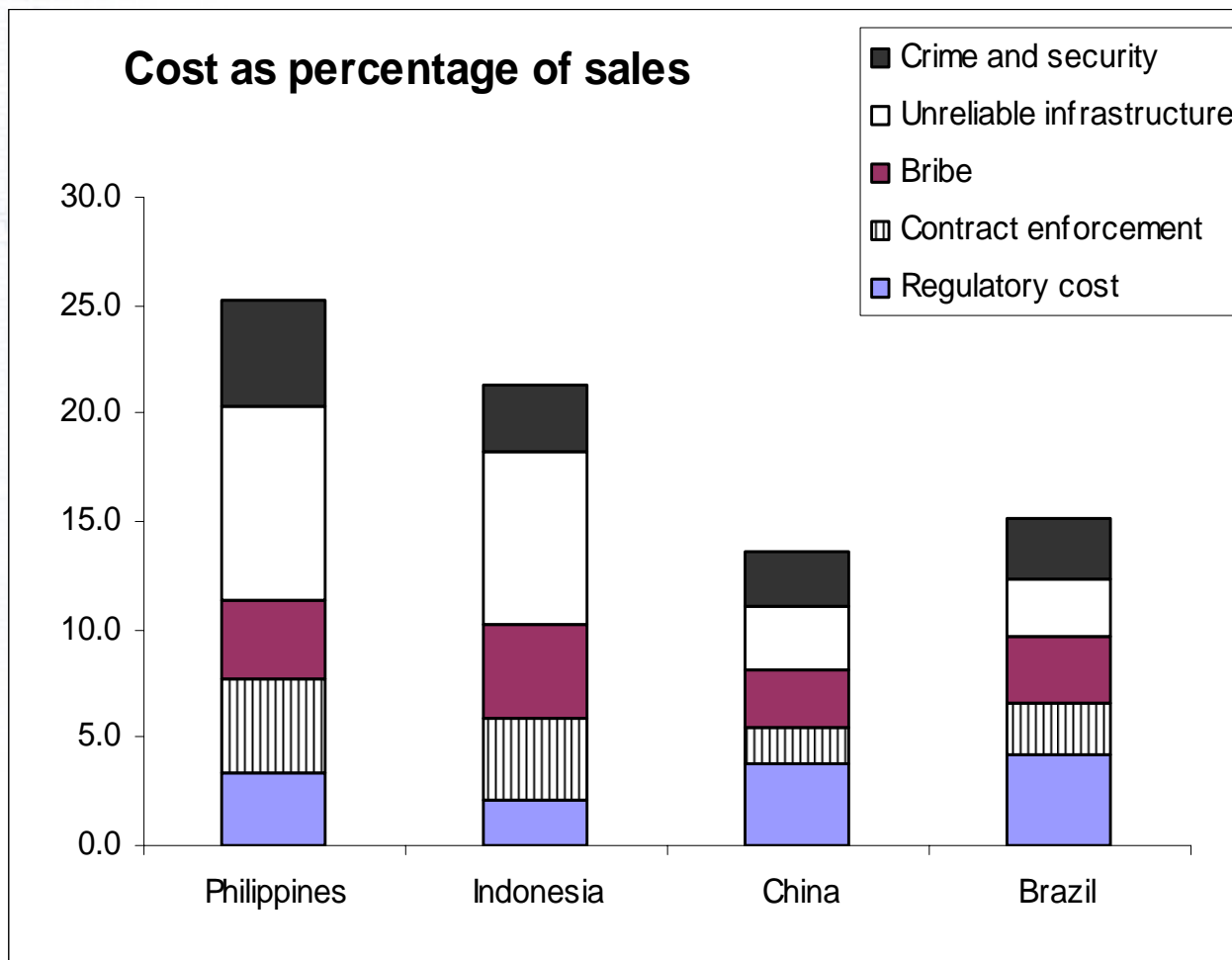
## Firm Perceptions Of Severe Constraints

(% of firms finding issue a major or severe constraint)





# Unproductive Expenses Could be Lowered

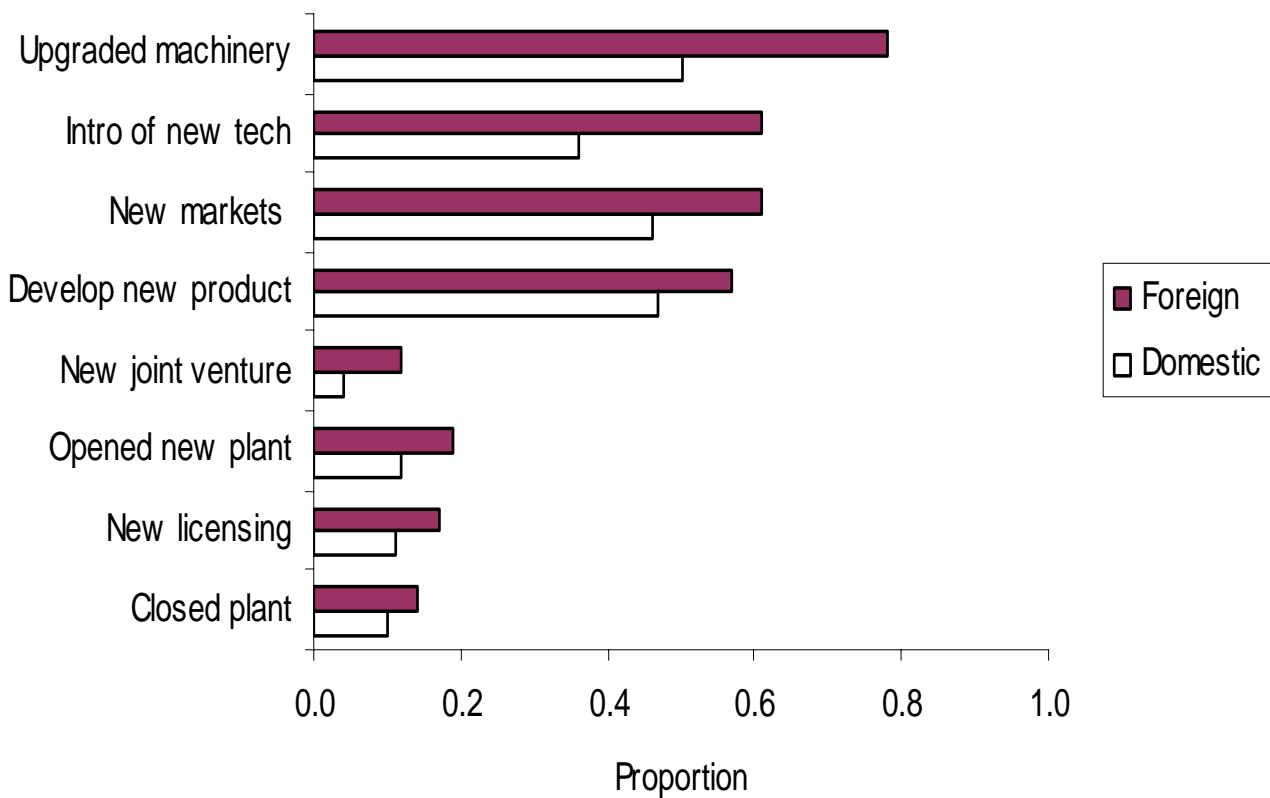


Source: *Investment Climate Surveys*



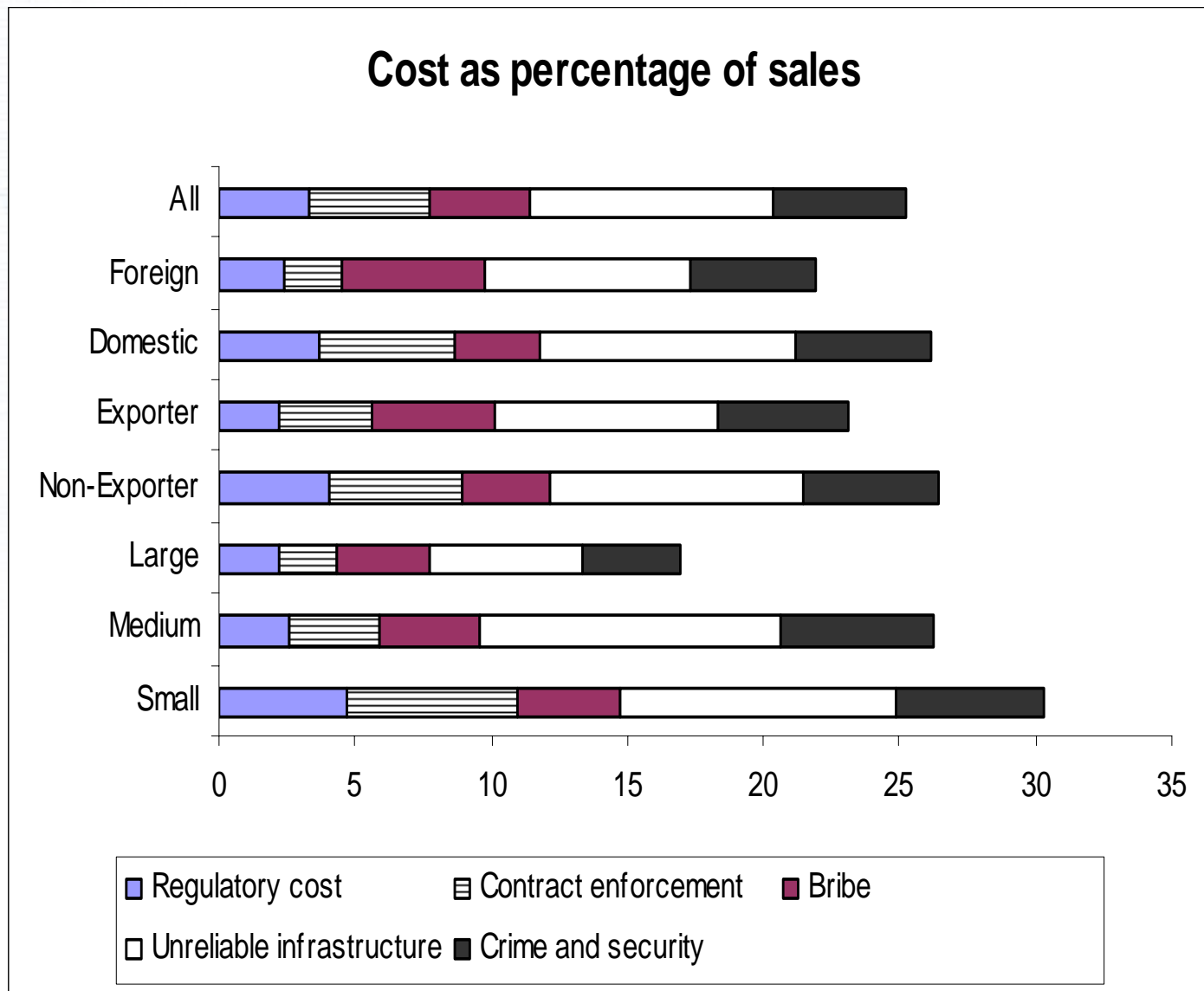
# Domestic Firms Need a Better Investment Climate

Foreign firms are more active: initiatives taken by firms since 1998





# And SMEs Will Benefit Most





# What Explains Relatively Poor Performance?

- Trade and Investment Regimes are Liberal
- Managerial and Entrepreneurial Talent Plentiful
- Exchange and Interest Rate Policy Prudent
- Mainly Private Outward Oriented Economy

**These Are Strong Positives**



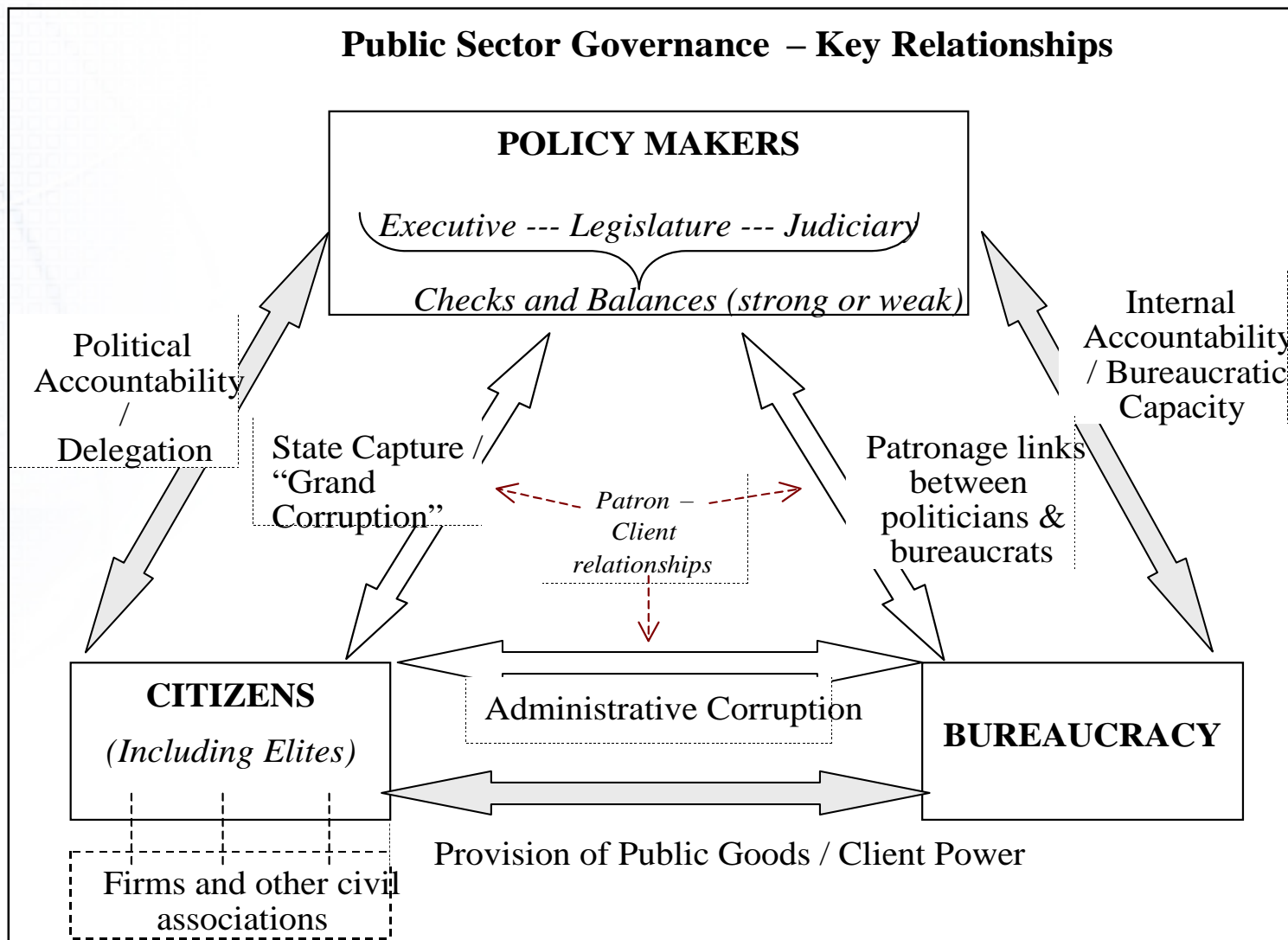


# But Governance, Infrastructure and Financial Sector Could Be Improved

- Strong State Delivering Essential Services
  - Political Risks and Political Cohesion
  - Administrative Capacity
- Infrastructure Services Are Reliable
- Financial Sector Selects and Finances Most Profitable Investments

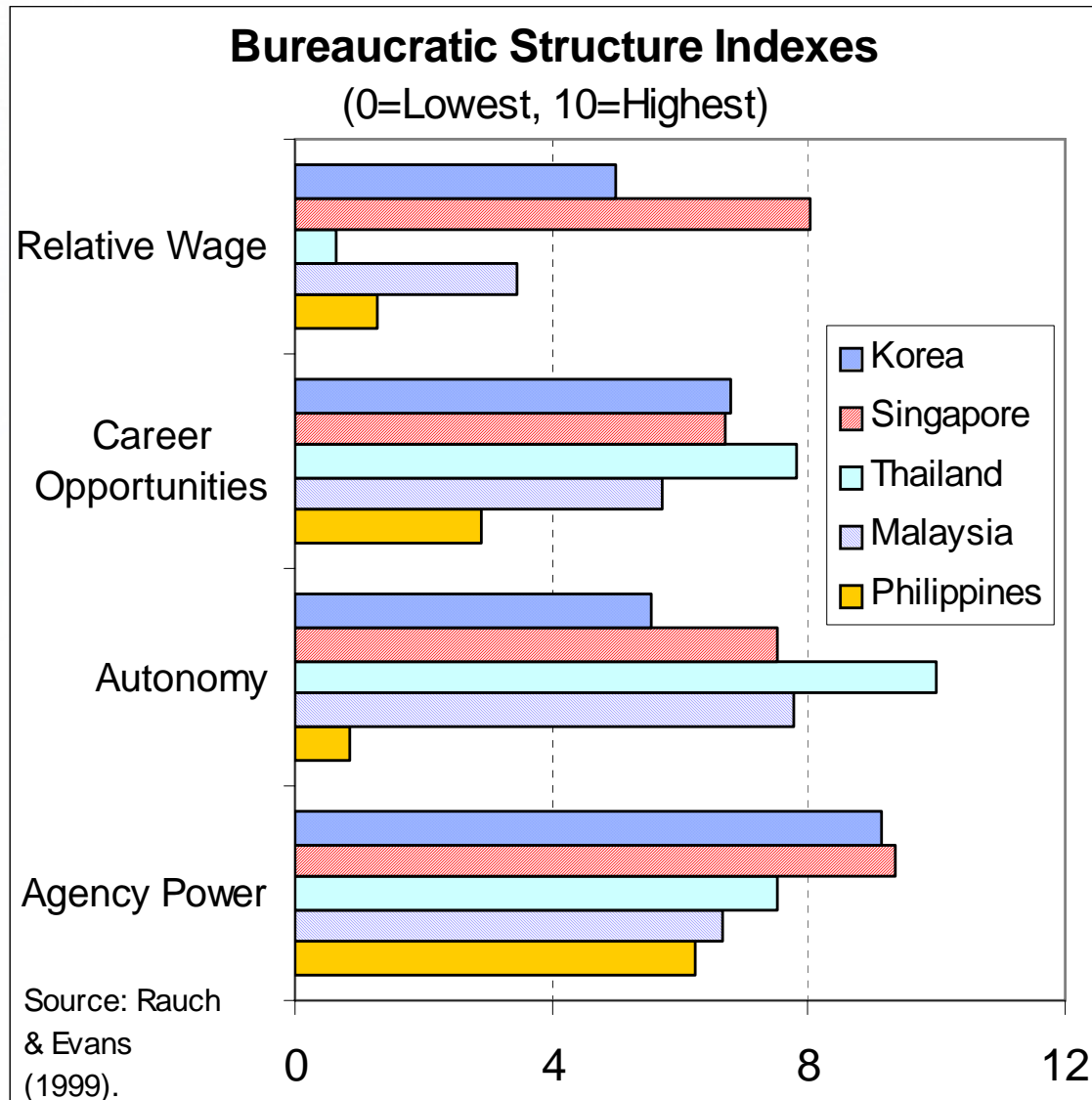


# Good Governance Matters



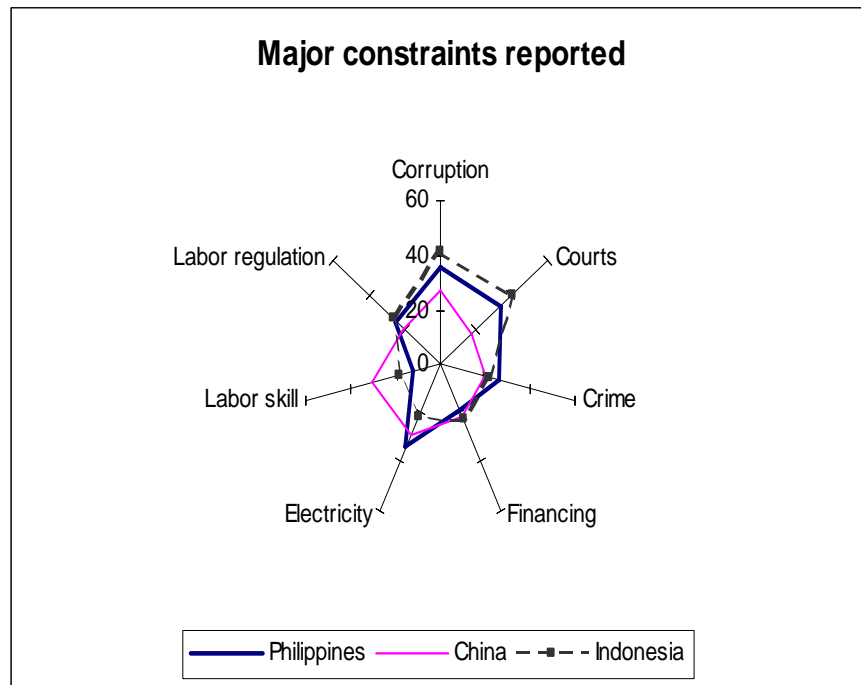
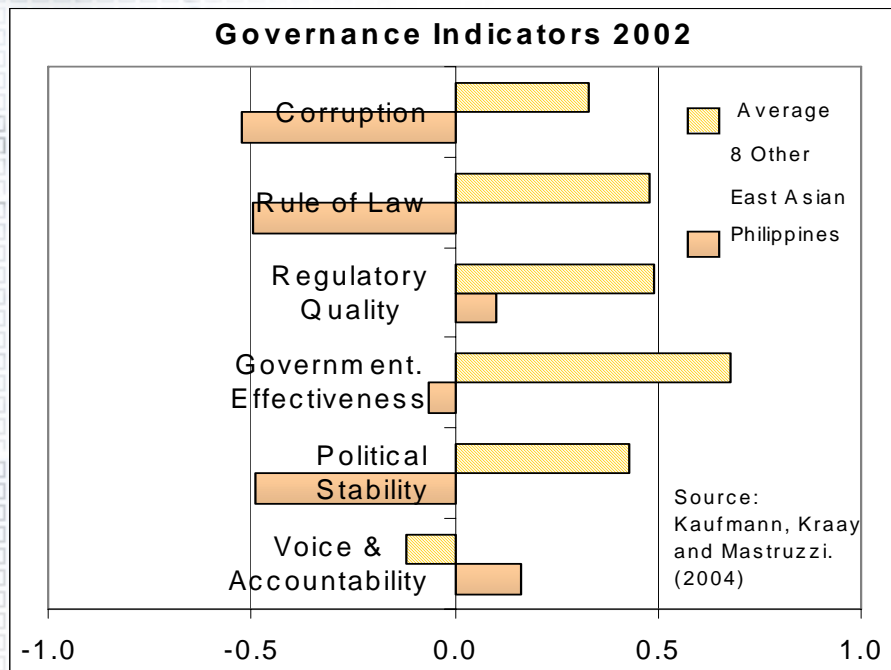


# Administrative Capacity Could Be Improved



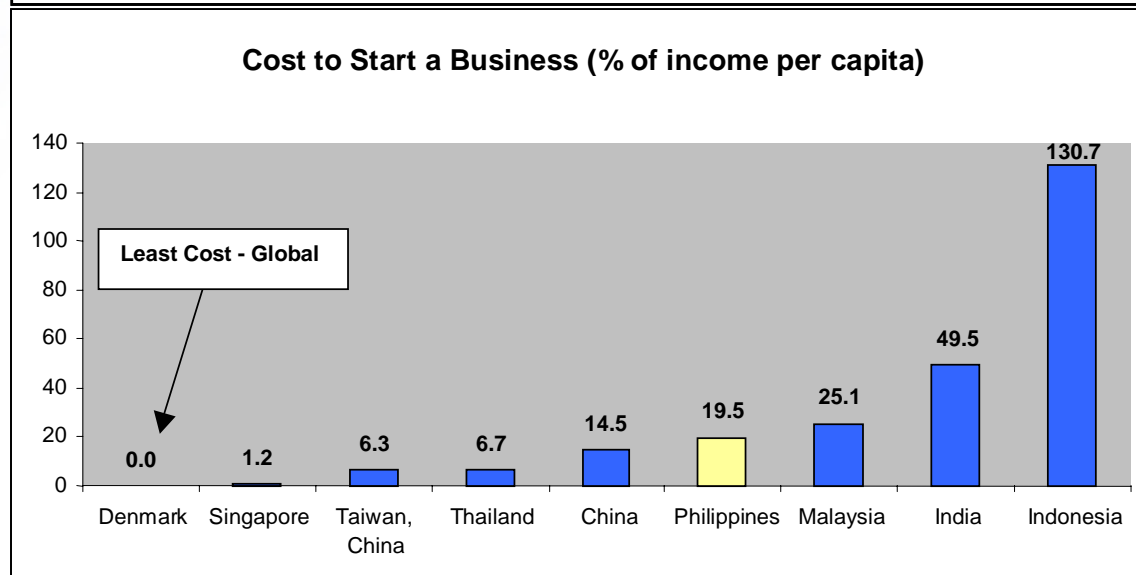
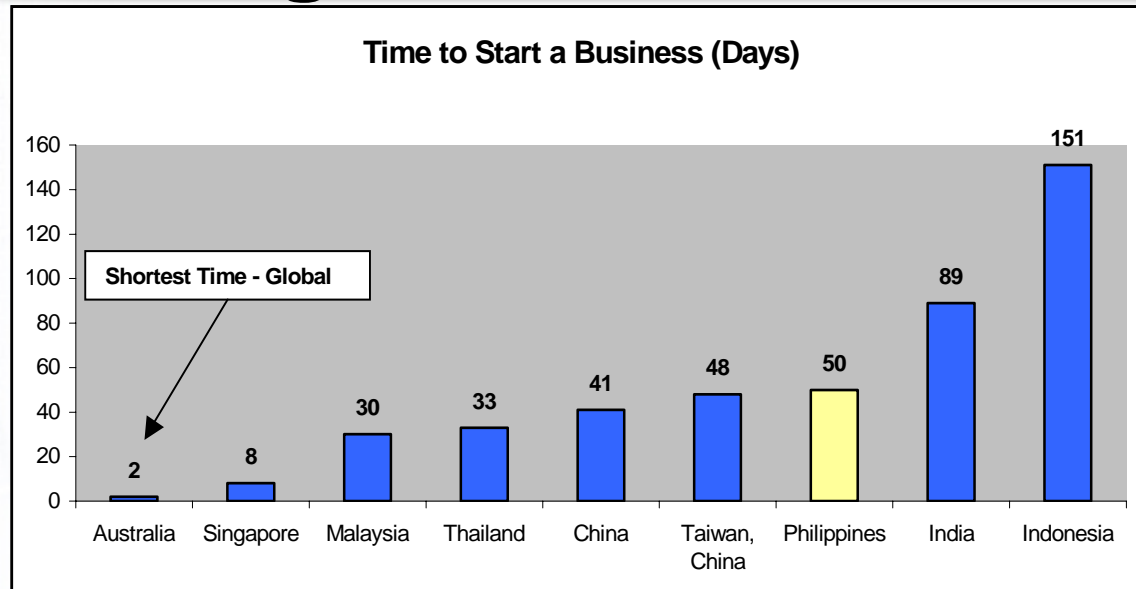


# Good Governance Could Make a Difference



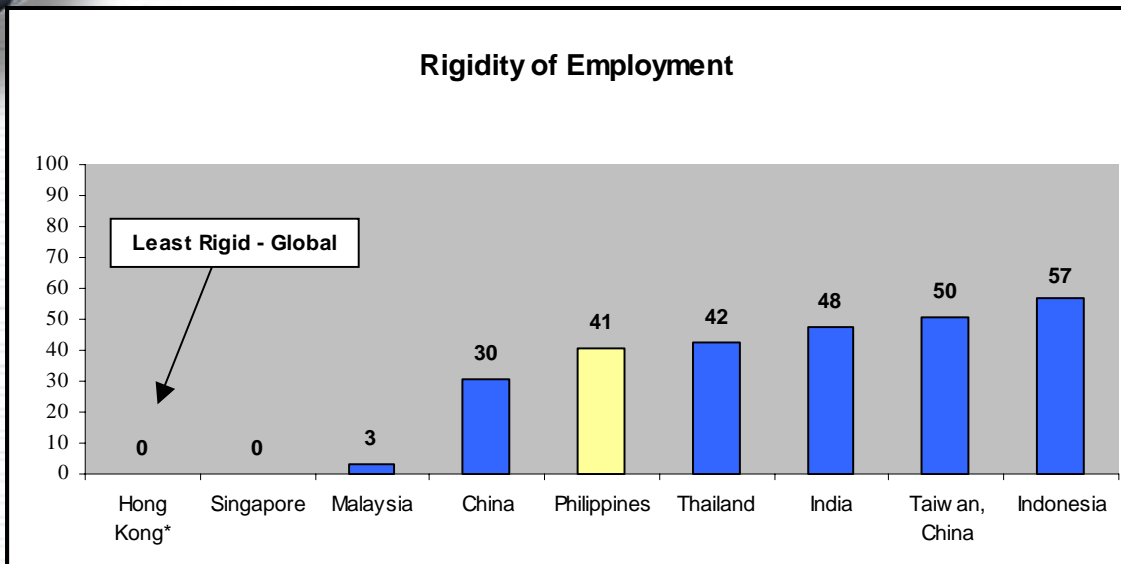


# And Costs of Doing Business can be brought down



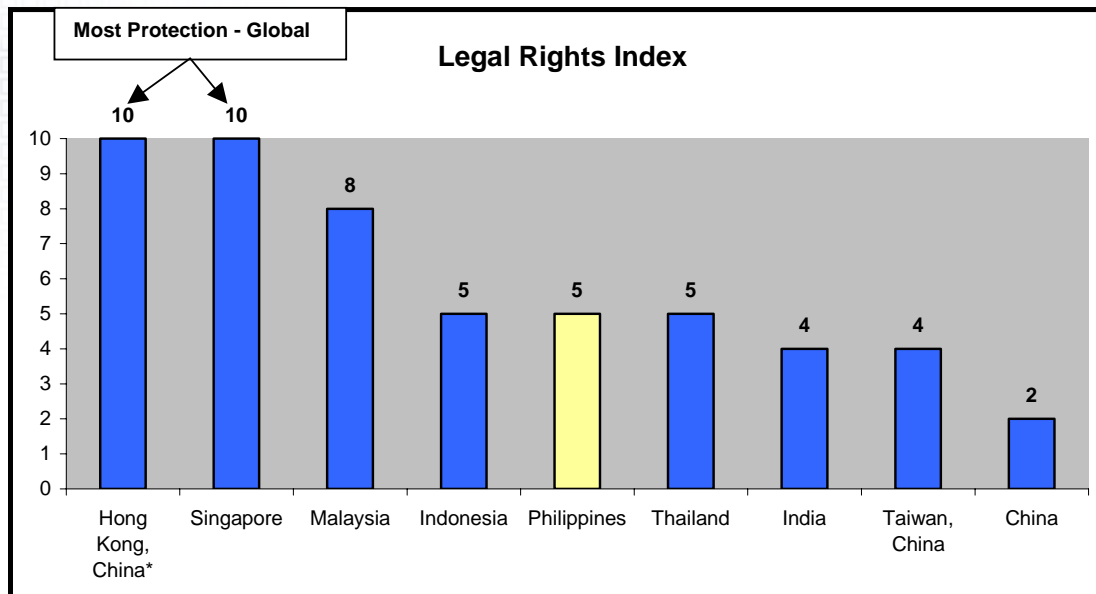


# Costs of Doing Business



What can be done to improve labor market flexibility?

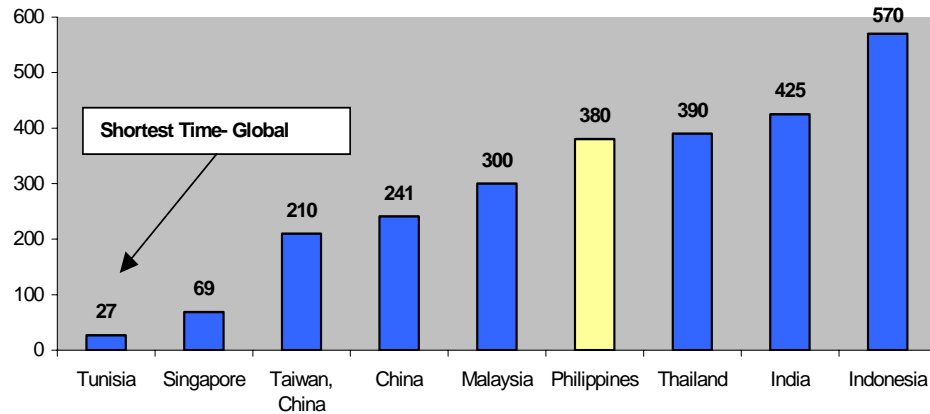
How can the legal system be made more transparent and predictable?





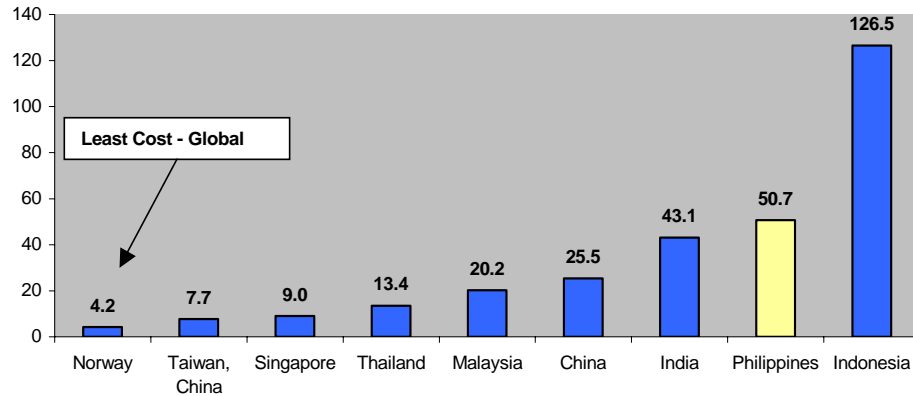
# Costs of Doing Business

Time to Enforce a Contract (Days)

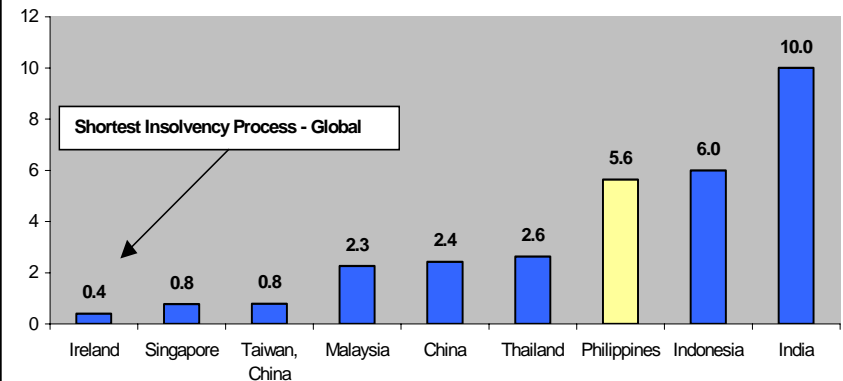


These add to the add risk premiums demanded by investors and lenders.

Cost to Enforce a Contract (% of debt value)

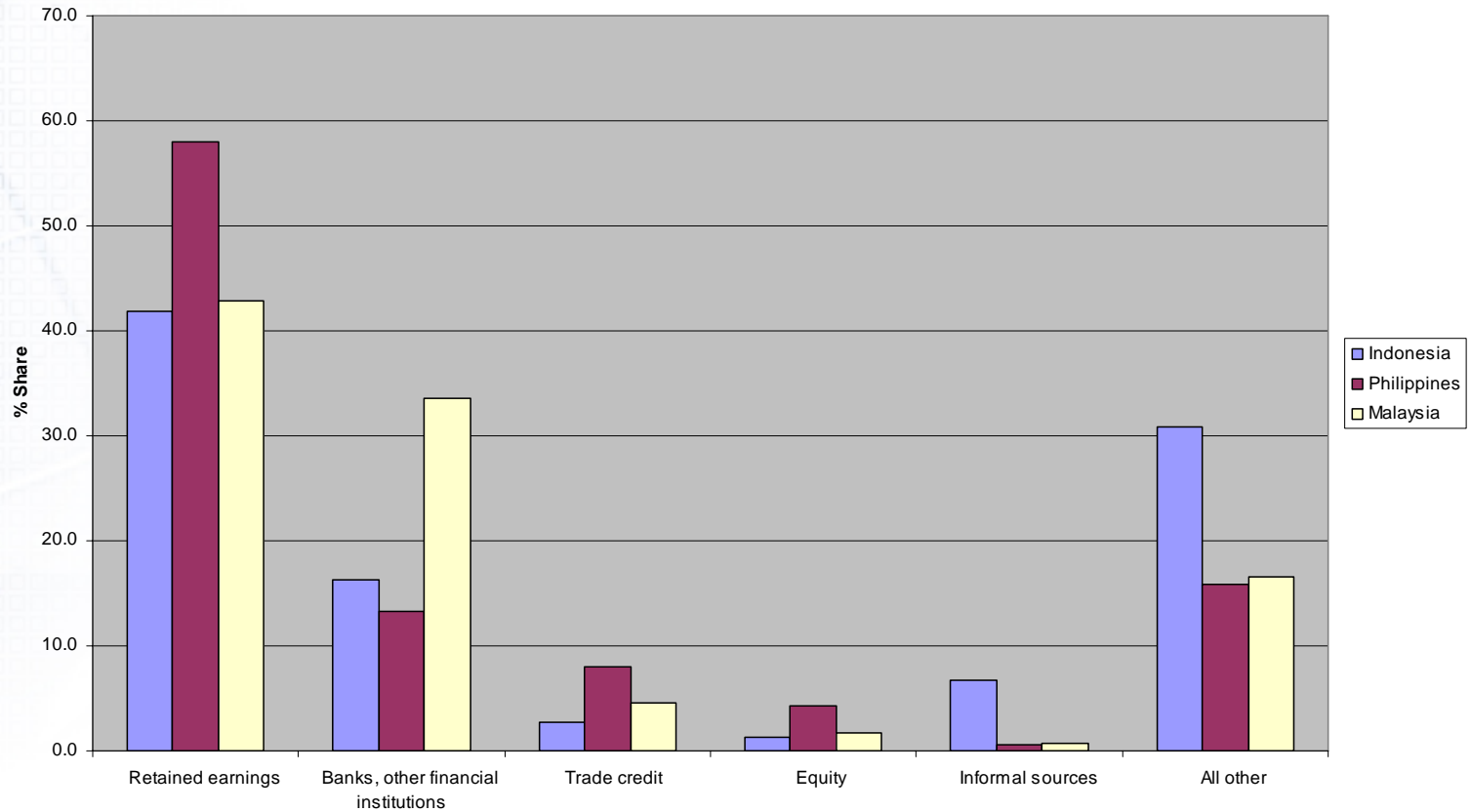


Time to go through Insolvency (Years)





# Financial Sector Has Not Been A Supplier of Funds

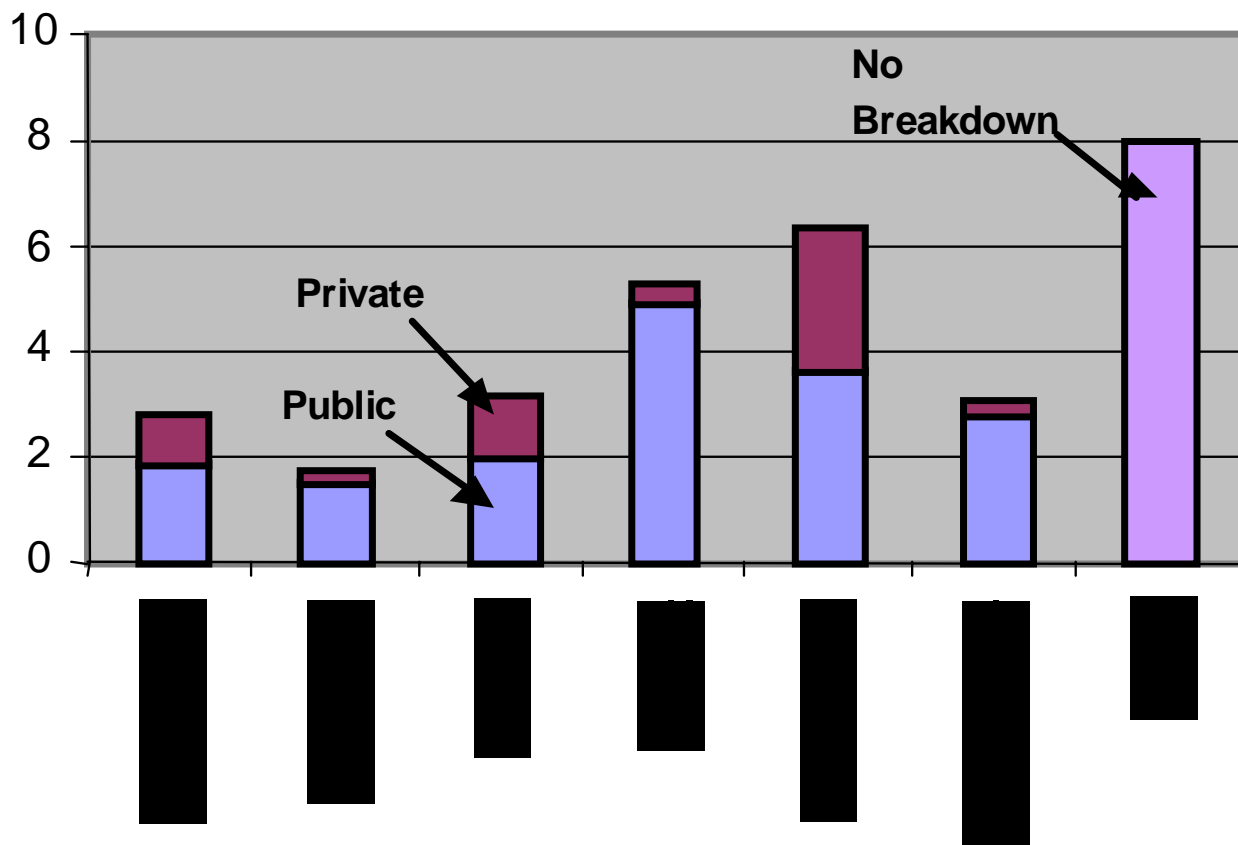


**Government has pre-empted financial sector resources.**  
**Corporate Bond Markets are underdeveloped.**  
**Equity Markets are moribund**  
**Banking sector has high NPLs and ROPOAs**  
**Non-bank sector is fragile and small**





# Therefore, infrastructure investments have lagged



Note: No breakdown for China, figures are 1991-2000 average. Latest available- Philippines and Indonesia (2002), Albania and Russia (2000), Cambodia (2001)  
Sources: World Bank PPI Database, World Bank Public Expenditure Reports



# The Bottom Line

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- Philippines is becoming marginal to investors
- Investment horizons are very short-term
- Investors invest when at least either one of two conditions exist: good domestic demand or good supply side resources for use as export platforms --- Philippines seems to be weak in both.
- Risk premiums are increasing
- Fiscal fragility is becoming a very urgent short-term concern.
- Philippines cannot leverage on a liberal trade and investment regime.



# Possible Factors

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- Political divisions and political turbulence --- political economy of reform.
- Concentration of corporate and banking power and insufficient market competition.
- A few dominant business families, missing middle, deprived small scale sector.
- High incidence of political patronage in civil service
- Reforms do not stick because there are no reform champions.
- No group is willing to make sacrifices for the greater good.



# What do we do?

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- Problems known, solutions available but implementation weak.
- How do we create sustained pressure for reform?  
Role of media.
- What should the private sector do on its own?
- Instead of big bang reforms should we start with supporting existing islands of excellence?
- Should we first focus on reforming a few sectors?
- Focus on reforms at the local level?
- Governance a high priority?



# Some Outcomes

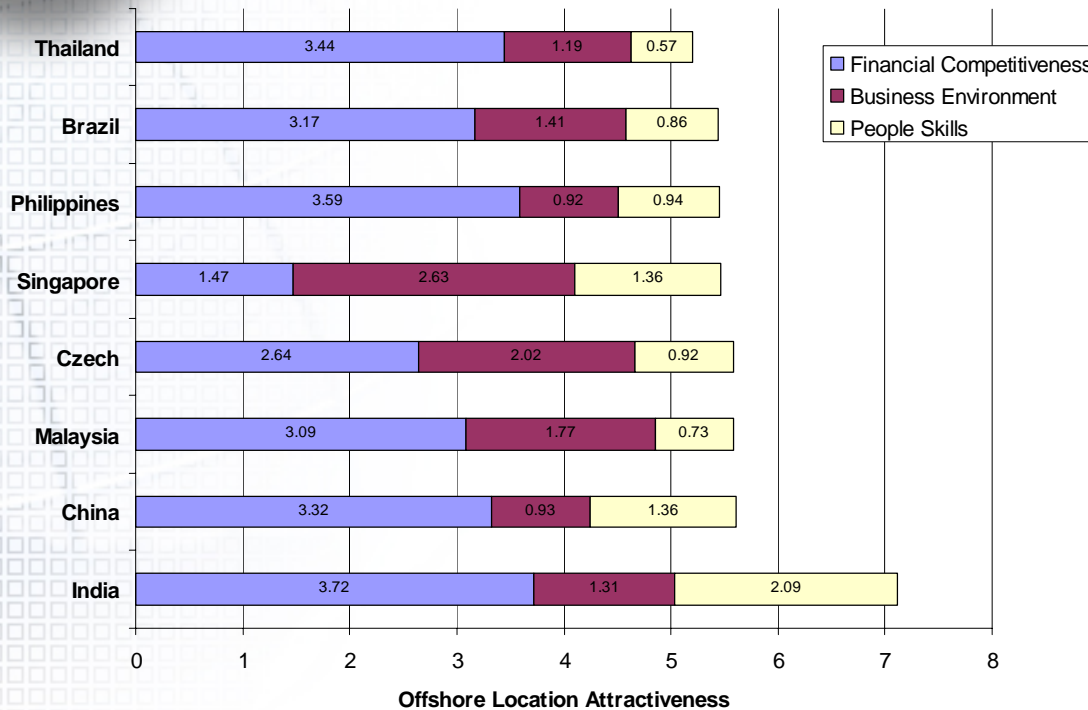
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## Main Messages

- Philippines stuck in the middle
- Investment performance is sluggish
- Fiscal fragility: increased economic risk, higher cost of capital, lower FDI
- Poor infrastructure: lowers productivity, increases operating costs, lowers FDI
- Poor governance: increases business costs
- No USP to offer to investors --- either a large market or good supply side endowments.
- Solutions known but not implemented.



# Philippines as offshore location in IT Sector



**A Good Business Environment Could Give Philippines a Competitive Advantage**

Financial Competitiveness: Wages and Taxes (40% weight)

Business Environment: Country Risk, Intellectual Property (30% weight)

People: Experience, Skills Availability, Education and Language (30% weight)

Source: AT Kearney



**Thank you for your time**