

# How the Philippines Can Join the East Asian Renaissance:

## *The Role of Equity and Credible Institutions*



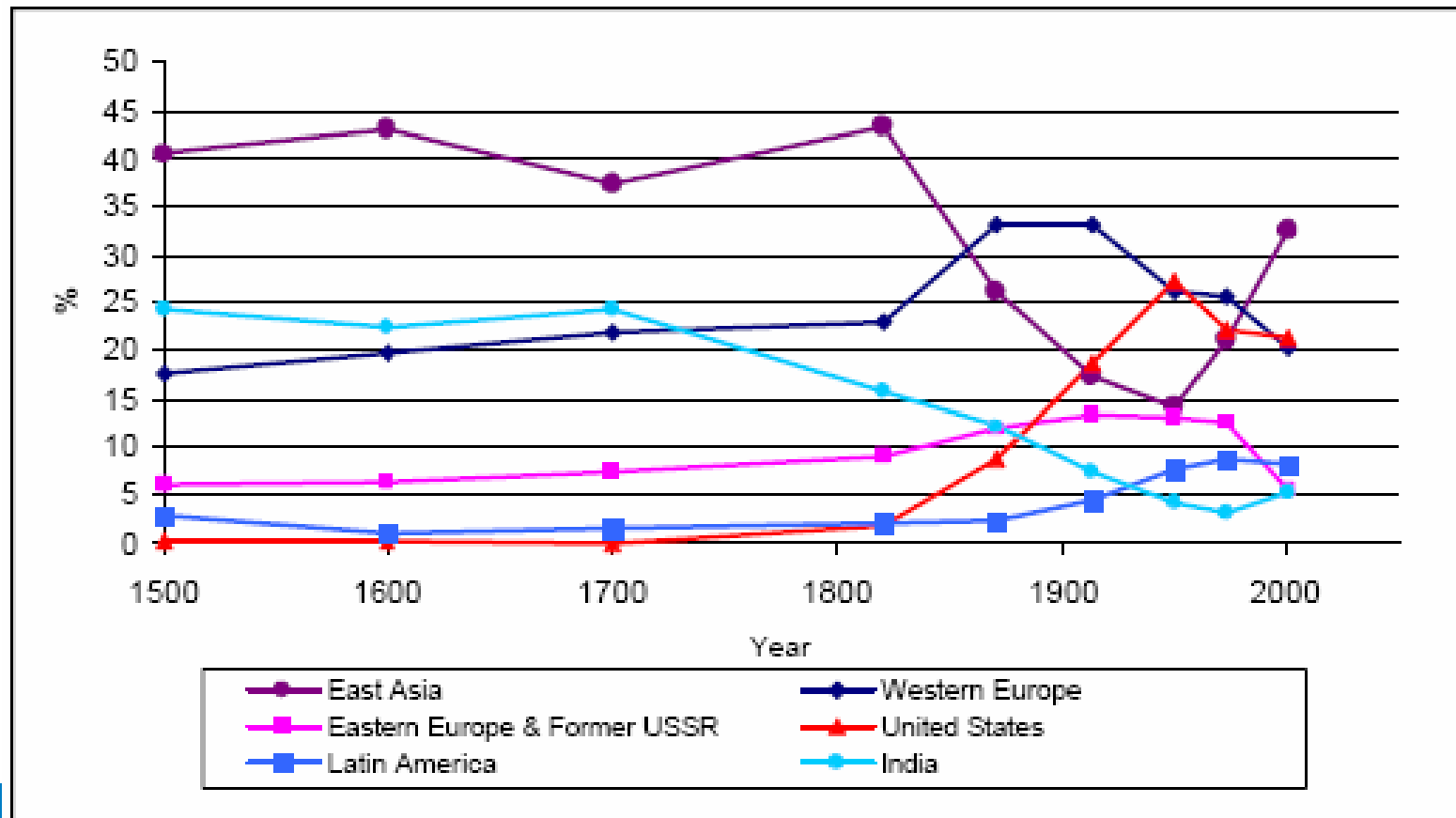
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Country Director, Philippines  
The World Bank  
November 21, 2006



# **An East Asian Renaissance**



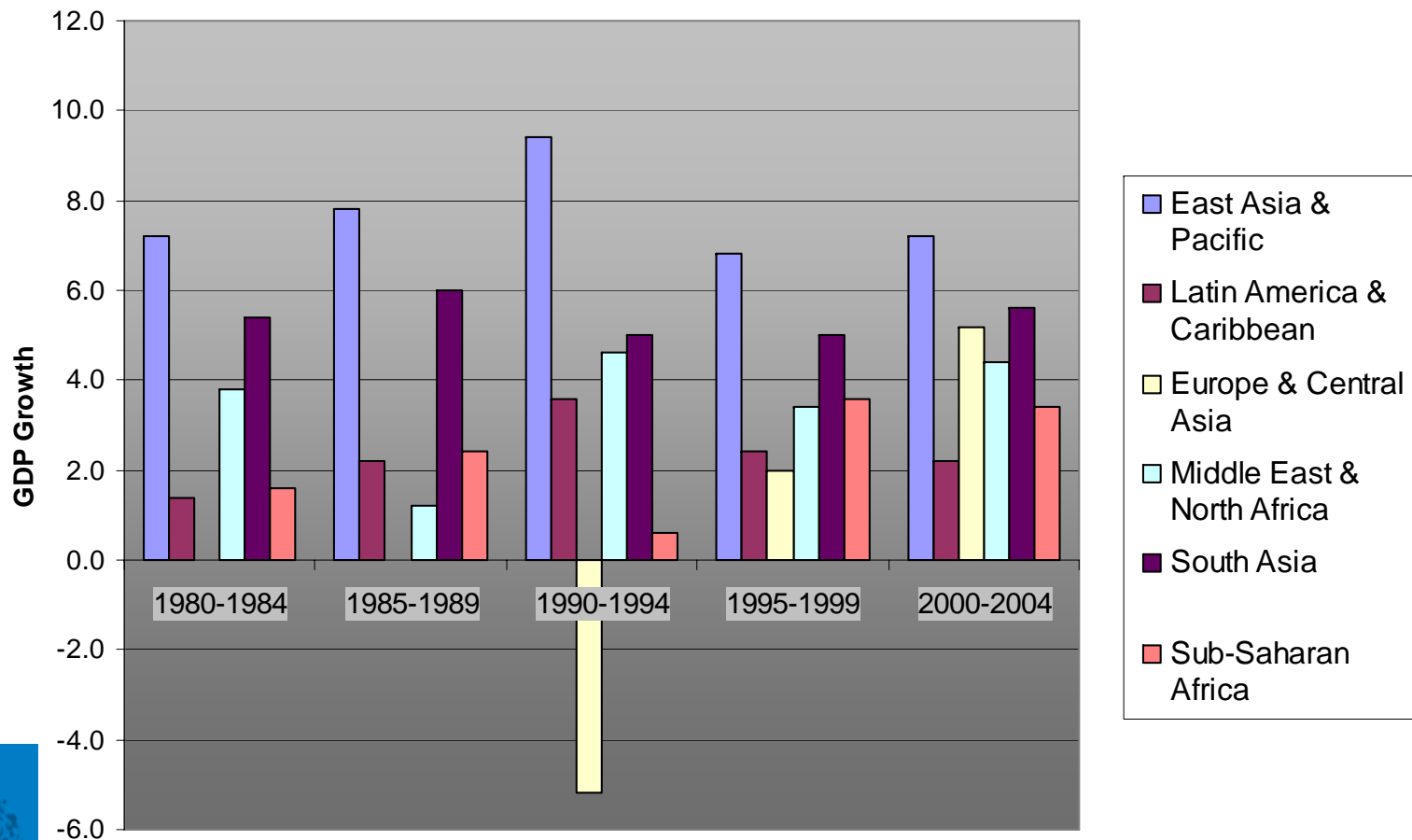
# An East Asian Renaissance





# An East Asian Renaissance

## *East Asia: The Fastest Growing Region*



Source: World Bank WDI and GDF Central Databases (taken from *An East Asian Renaissance: Ideas for Growth*, 2006)



# Drivers of the East Asian Renaissance

1. From Global to Regional Integration
2. Trade and Economies of Scale
3. Ideas and Innovation
4. Finance and Risk



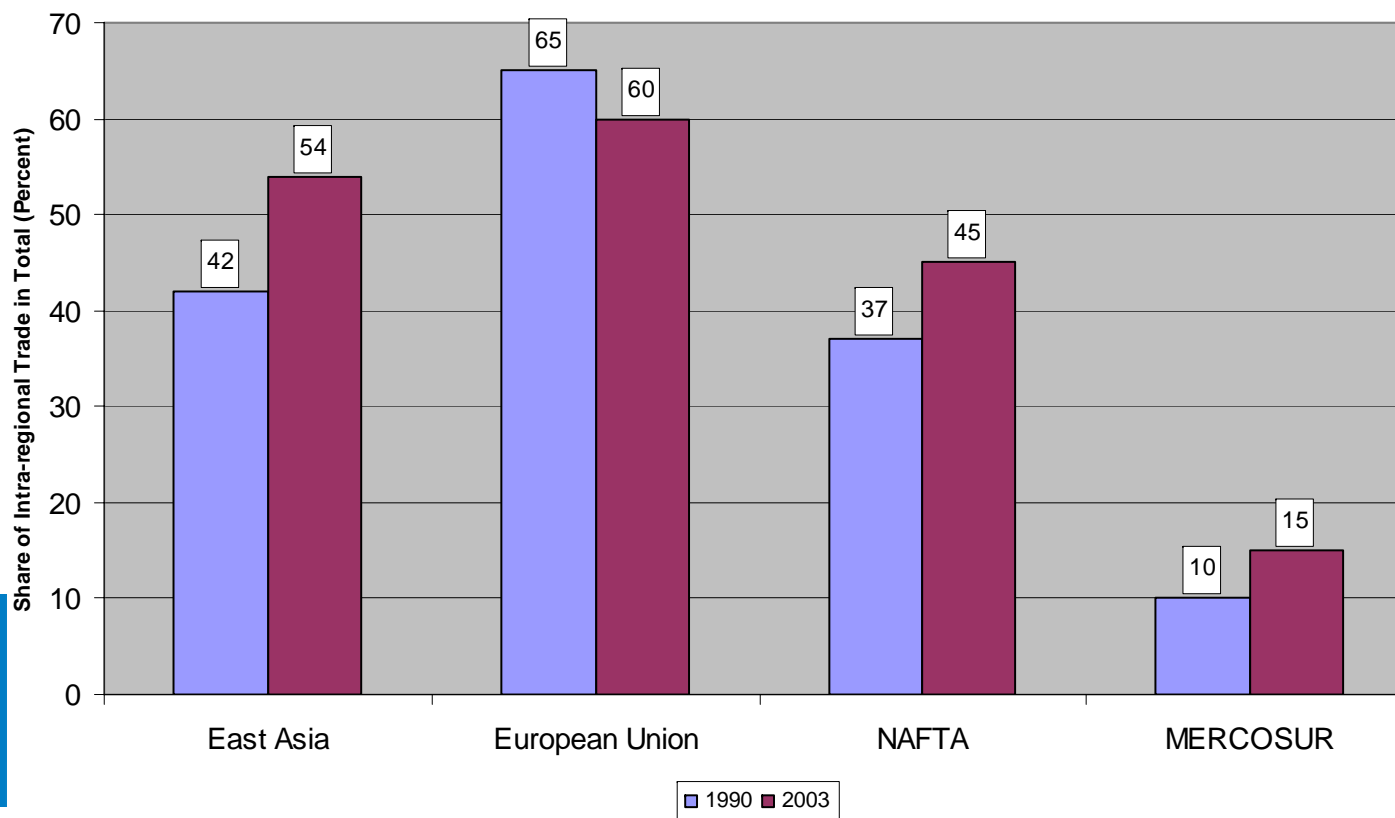
# (1) From Global to Regional Integration

- Rapid regional integration in addition to global integration
- China and Japan are the region's twin engines
- Regional integration driven by China – biggest development story today
- More than half of East Asian trade is within the region

# (1) From Global to Regional Integration

*More than half of East Asian trade is within the region*

Share of intra-regional trade, for selected trading areas



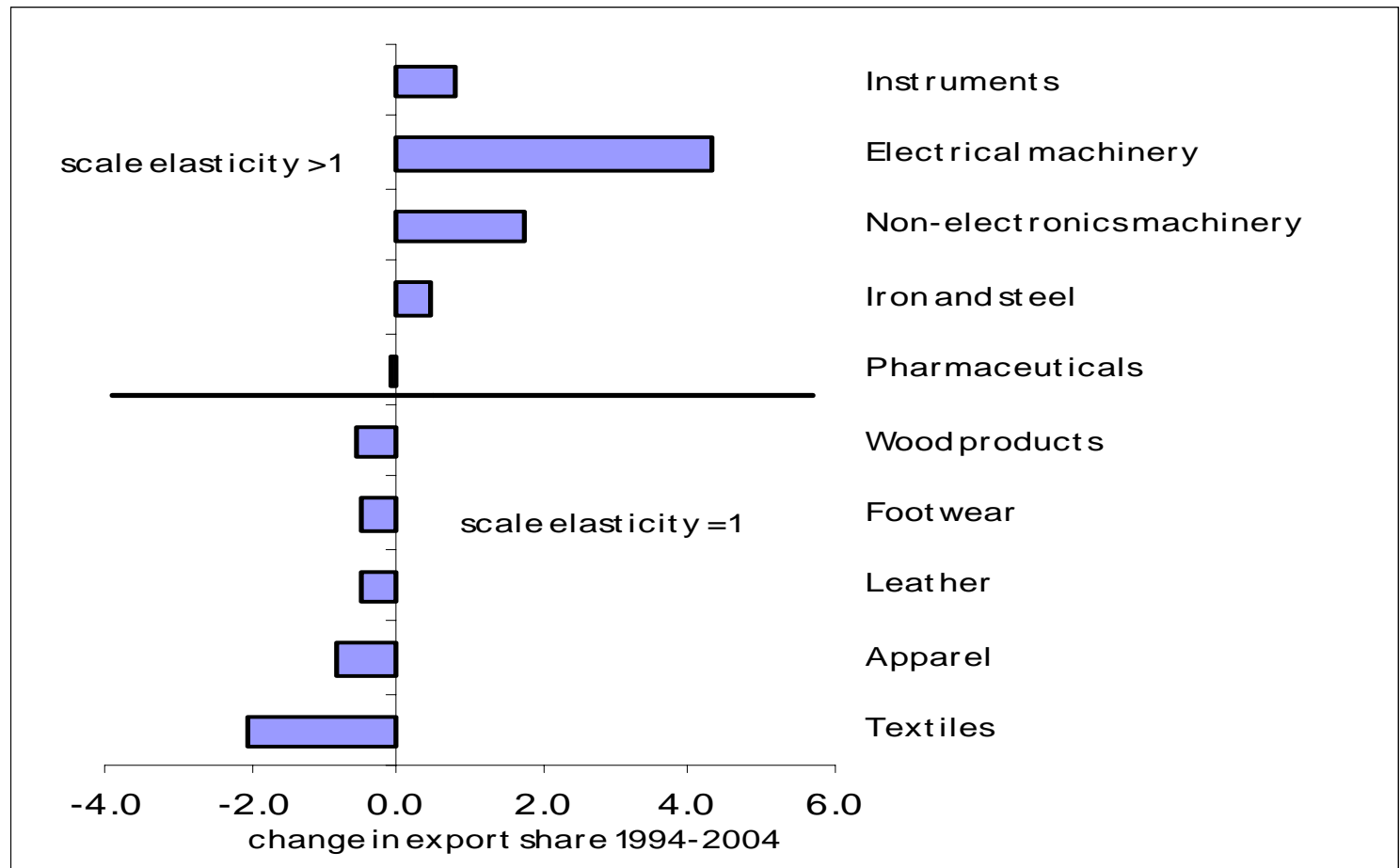


## (2) Trade and Economies of Scale

- East Asia trade increasingly driven by intra-industry trade and vertical specialization
- Components trade and intra-industry trade have grown rapidly – regional production networks
- Export growth in sectors with high economies of scale
  - Vertical specialization becomes critical driver
  - Traditional comparative advantages (low wages) less important
  - Transport/logistics and consistent policy environment (investment climate) more critical
  - Small policy changes can have big impacts on trade

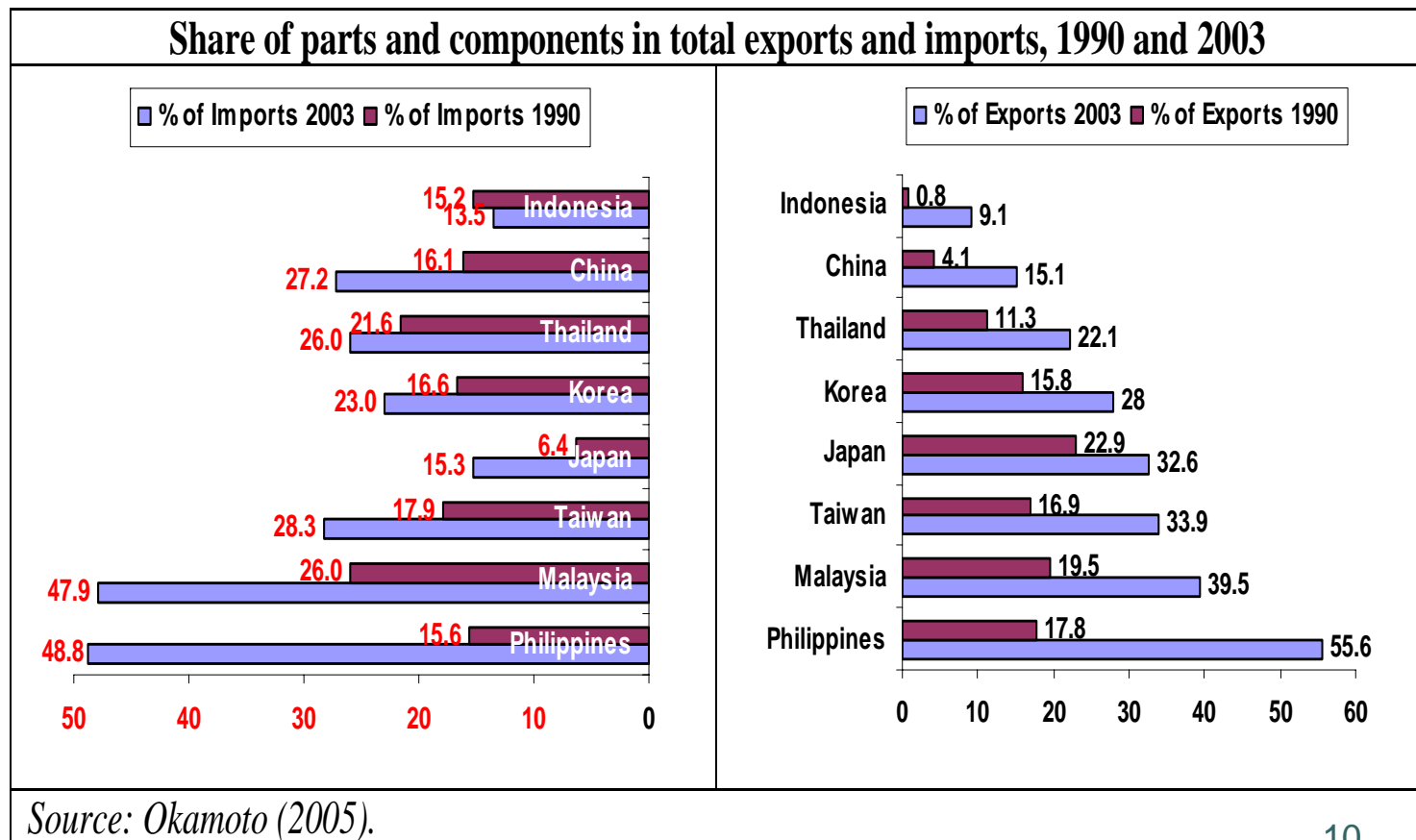
## (2) Trade and Economies of Scale

*East Asian Exports Grow in Sectors with Scale Economies*



## (2) Trade and Economies of Scale

*Intra-industry trade in East Asia has boomed*



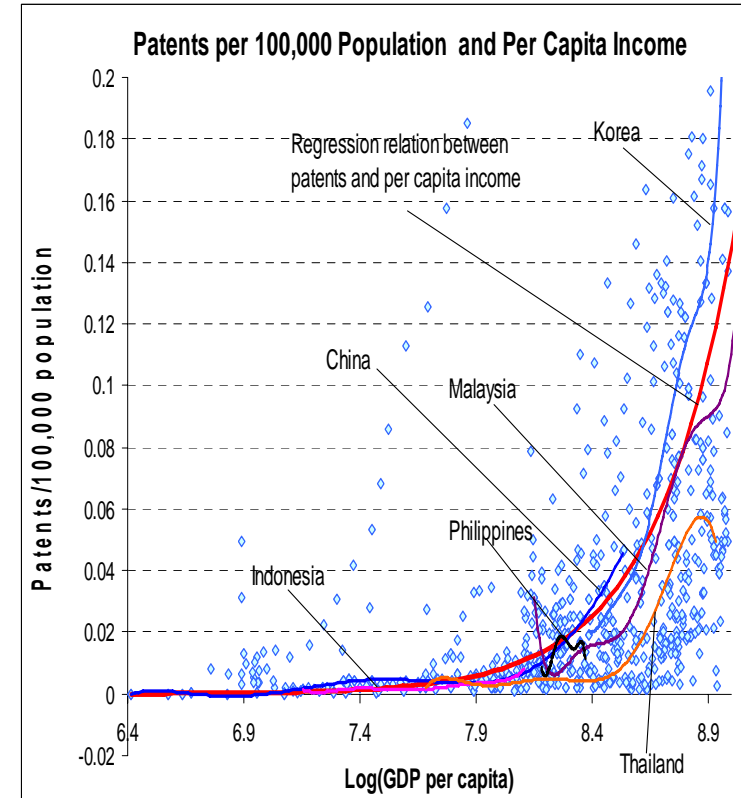
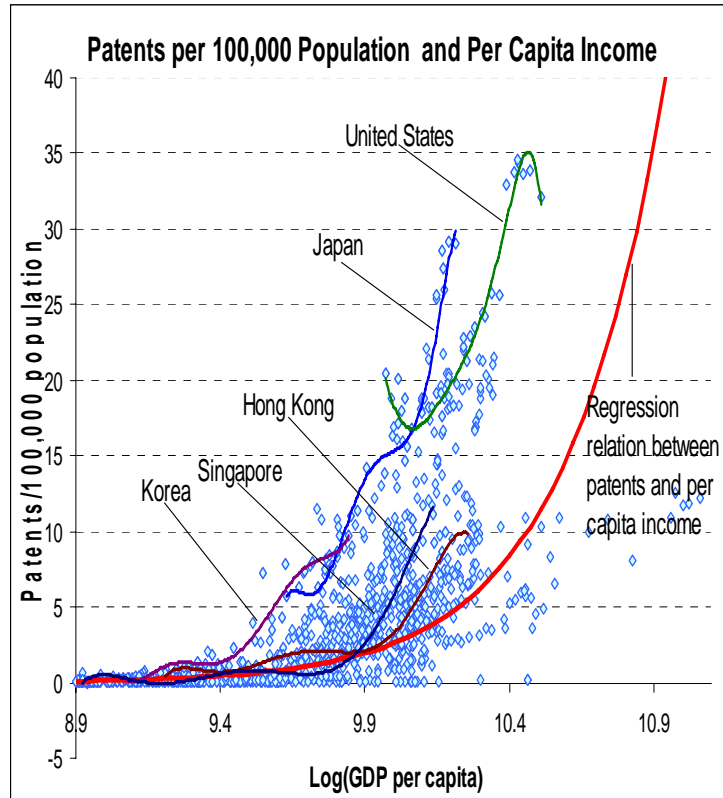


## (3) Ideas and Innovation

- Productivity growth based on ideas and innovation drive economic dynamics
- Key factors and drivers
  - FDI – investment climate
  - Trade - outward orientation and competitiveness should be sustained
  - R&D and technology absorption - education needs to be aggressively upgraded

# (3) Ideas and Innovation

*East Asia's innovation effort has been escalating*





## (4) Finance and Risk

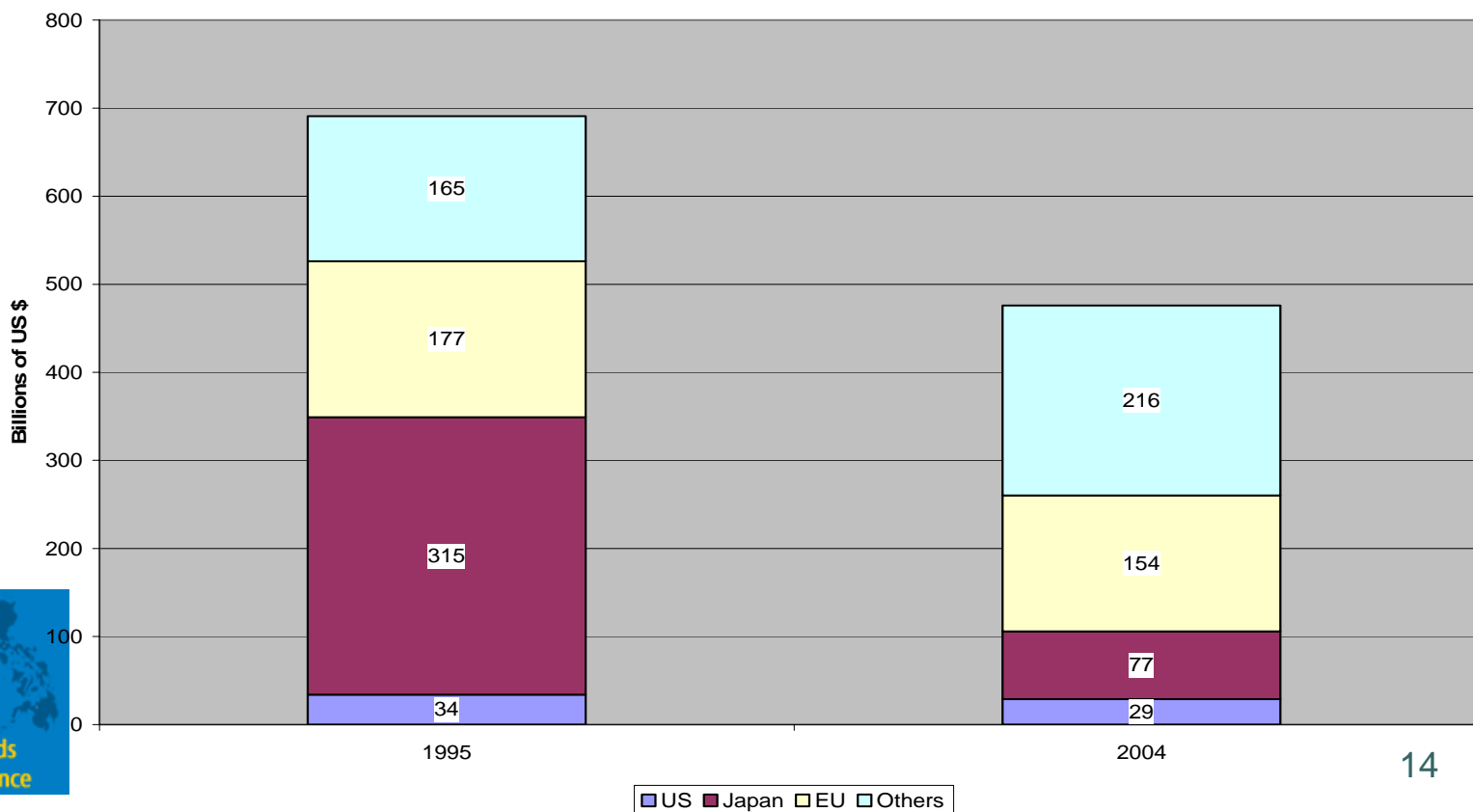
- Financial system/sector key for absorption of shocks
- Failed in 1997-98
- Gradually increasing ability for absorbing shocks
  - More flexible exchange rates
  - Larger FX reserves
  - Bank claims on the corporate sector have fallen
  - Capital market development still lagging
  - Strong corporate bond and equity markets and “patient capital” still needed



## (4) Finance and Risk

*East Asia is less exposed to bank credit since the crisis*

Bank Claims on East Asia, 1995 and 2004





# New Challenges for East Asia

1. Cities and Congestion
2. Inequality and Loss of Cohesion
3. Corruption

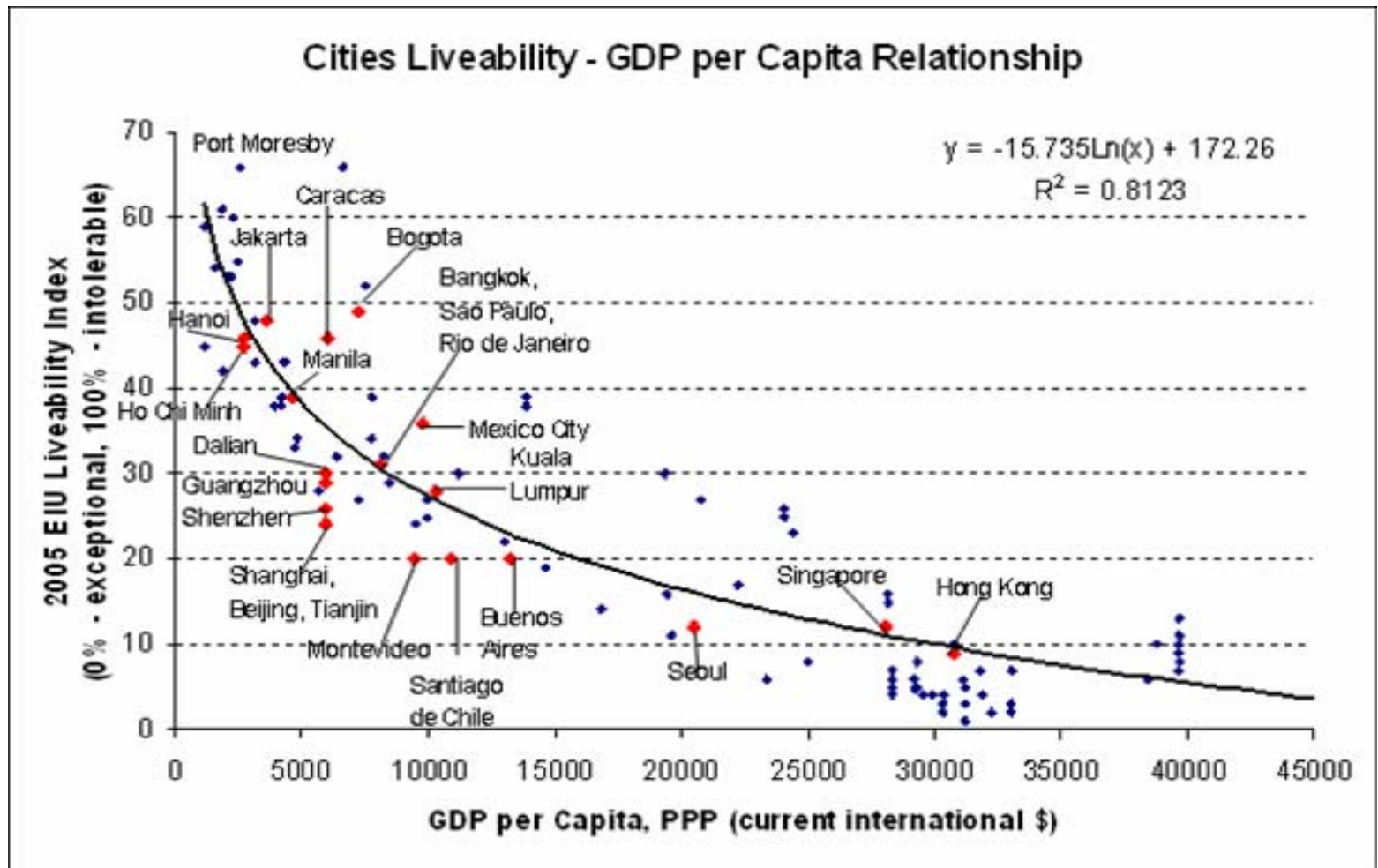


# (1) Cities and Congestion

- Cities have three times the productivity of rural areas, reflecting agglomeration economies
- East Asia is witnessing the largest rural-to-urban shift in human history
- Large cities are coming under stress; secondary cities are growing faster
- Urban growth will drive regional differences
- Livability of cities will be key for future growth
- Connectedness and economic management of smaller cities will be important

# (1) Cities and Congestion

*East Asian Cities are as Livable as those in Latin America*





# (1) Cities and Congestion

*But urbanization still to come for EAP*

**East Asia's urban population will increase by more than 500 million over the next 25 years** (current share and level of urban population and projected growth, 2005-2030)

Country	Share Urban (Percent)		Urban Population (millions)		Annual Growth Rate
	2005	2030	2005	2030	2005-2010
Korea, Rep. of	80.8	86.3	38.6	42.4	0.6
Malaysia	67.3	81.9	17.1	28.4	3.0
Japan	65.8	73.7	84.3	90.4	0.4
Philippines	62.7	76.7	52.1	87.5	2.8
Mongolia	56.7	65.7	1.5	2.2	1.5
Indonesia	48.1	68.9	107.2	186.7	3.6
China	40.4	60.3	531.8	872.6	2.7
Thailand	32.3	45.8	20.7	33.8	1.8
Myanmar	30.6	48.4	15.5	29.3	2.9
Vietnam	26.4	41.8	22.2	45.2	3.0
Lao PDR	20.6	34.0	1.1	3.2	4.0
Cambodia	19.7	37.0	2.8	7.9	4.9
<i>East Asia</i>	44.2	62.0	921.3	1463.0	2.6
<i>World</i>	48.7	59.9	3150.5	4912.5	2.0

Source: World Urbanization Prospects (2005). [Taken from An East Asian Renaissance, 2006]



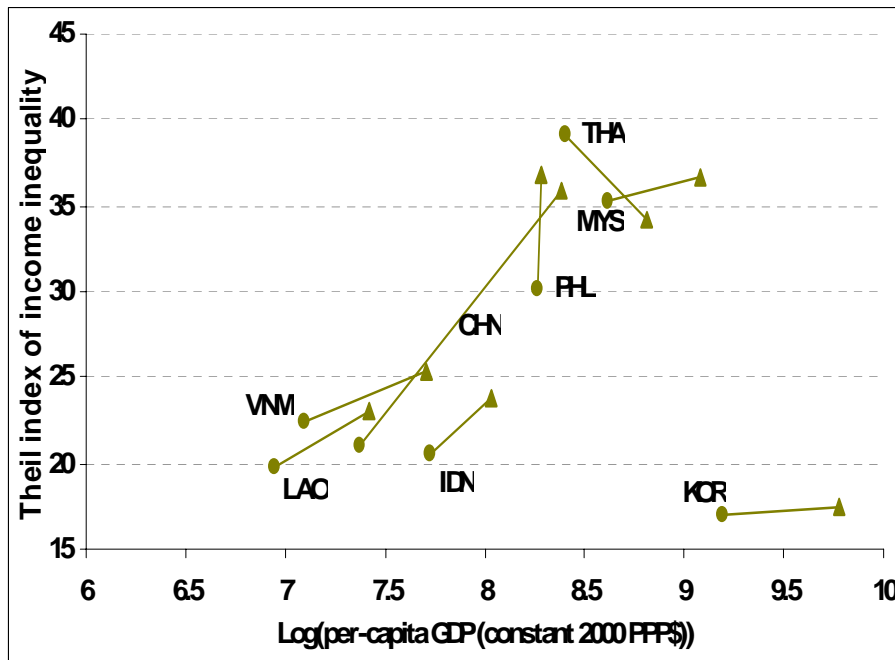


## (2) Inequality and Loss of Cohesion

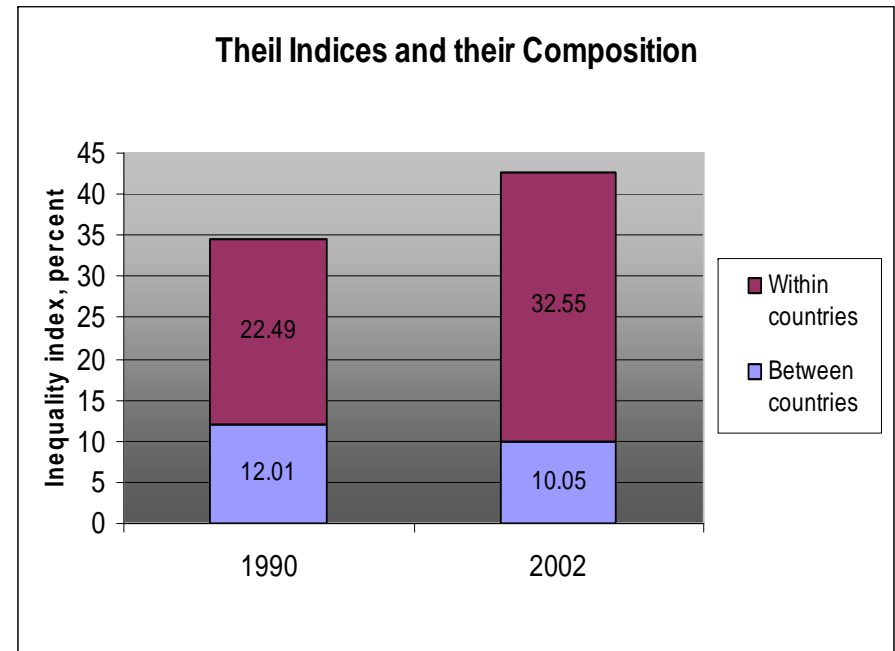
- Poverty rates have been falling rapidly (especially in cities)
- But within-country inequality is high because of urban-rural and coastal-interior gaps
- Within-country inequality is rising because of rising within-urban (and within-rural) inequality
- Implications
  - Need for more proactive social policies
  - Promote access to services, especially education
  - Accelerate skill formation to offset high postsecondary wage premium
  - Reduce segmentation in labor markets

## (2) Inequality and Loss of Cohesion

*Inequality in East Asian countries, 1990 and 2002*



*Inequality: Falling between and rising within countries*





## (3) Corruption

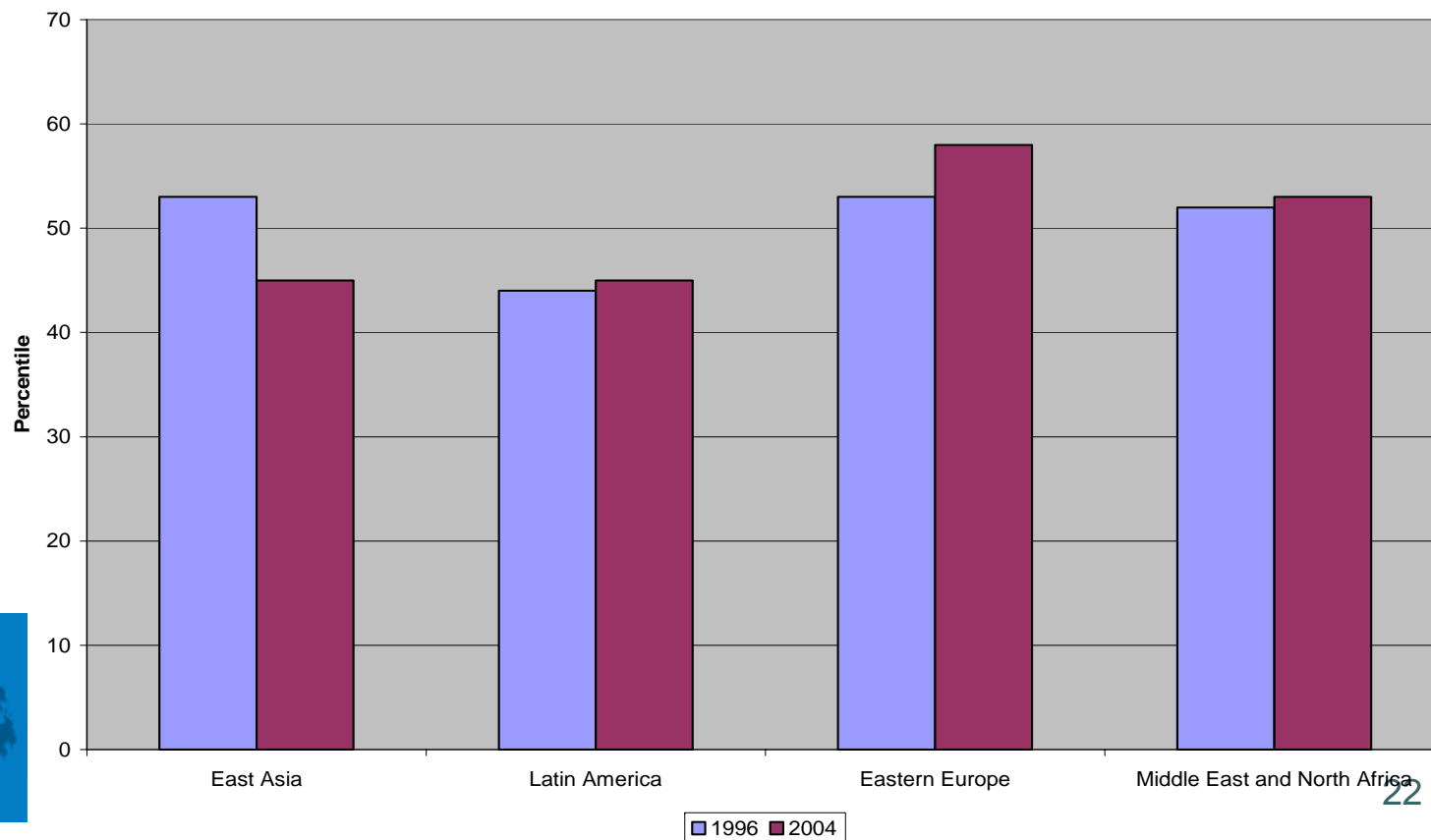
- Corruption in emerging East Asia is high (except Hong Kong and Singapore)
- Corruption is seen as a significant threat to growth and perceptions of corruption are worsening
- “Orderly and organized” corruption in some East Asian countries seems less harmful to growth than elsewhere
- With decentralization, corruption could become a more serious obstacle to growth unless transparency and accountability at local levels develop
- Speed up the transition from “rule of man” to “rule of law”



# (3) Corruption

*East Asia is Falling Behind in the Control of Corruption*

Control of corruption index, ranking in 1996 and 2004





# The East Asian Renaissance

- Global and regional integration have driven rapid development
- Now needs to be followed by national integration to manage urbanization, inequality, and corruption
- Unique opportunity to eliminate poverty and attain high-income status within a generation
- How can the Philippines Join the East Asian Renaissance?



**How the Philippines  
can join the East  
Asian Renaissance**



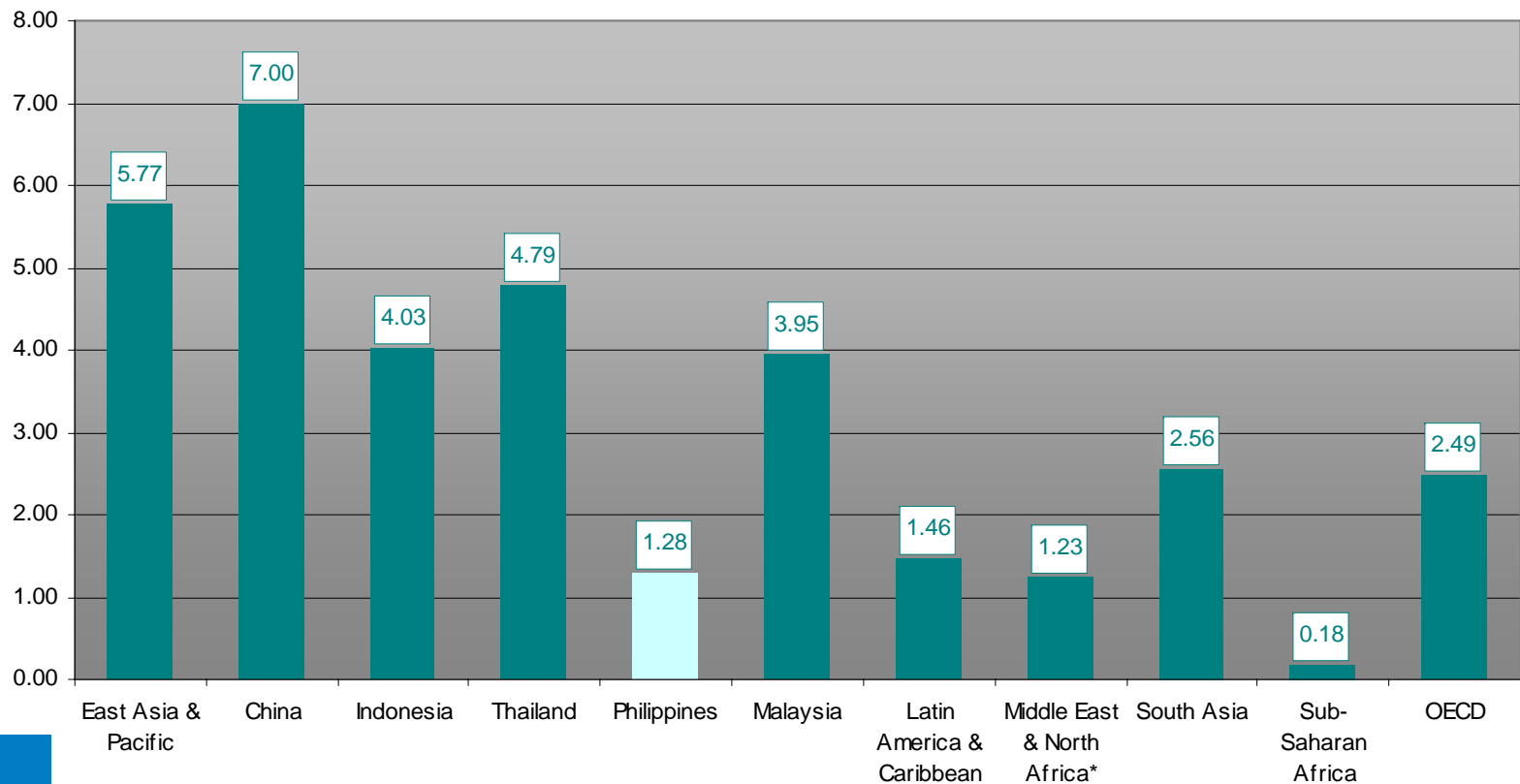
# The Philippines: Strong recent growth

- Strong recent growth performance, aided by marked improvement in fiscal policy stance.
- Longest period of uninterrupted growth in recent decades
- However, medium term performance remains significantly below potential



# The Philippines: Still Falling Short of Potential

Per Capita GDP Growth Rates, 1966-2004

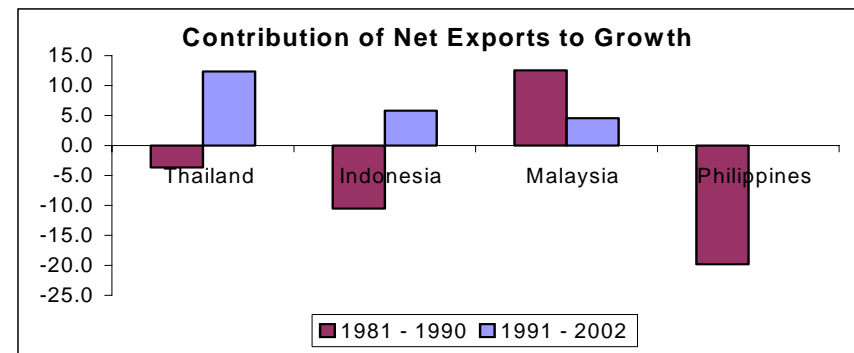
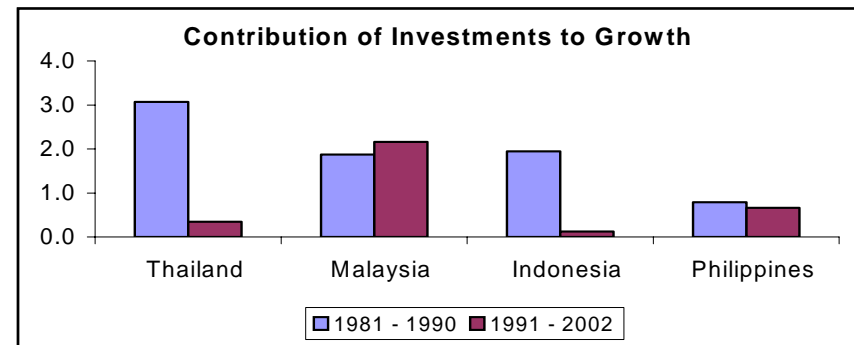
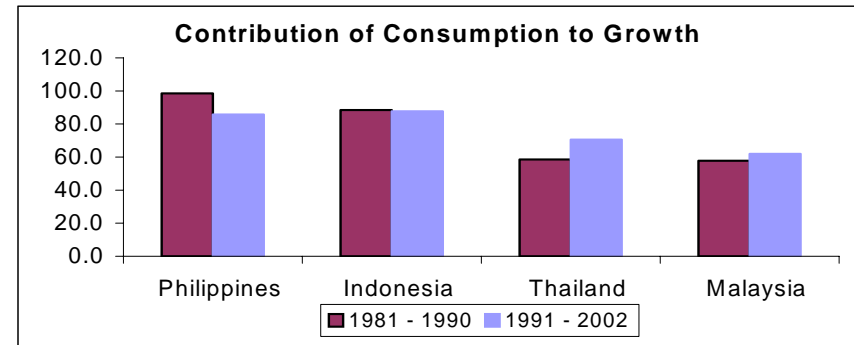


\*Note: Data for the Middle East and North Africa are from 1975 to 2004

Source: World Bank WDI and GDF Central Databases (taken from *An East Asian Renaissance: Ideas for Growth*, 2006)

# Low-level growth path driven by consumption ...

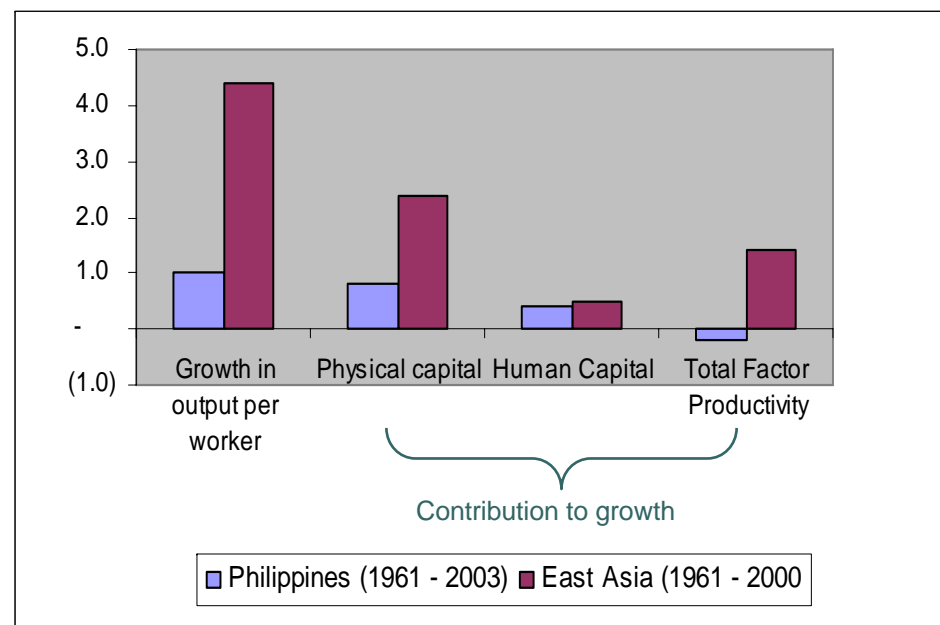
- Contribution of consumption to growth among highest in region, accounting for 86% of average growth in 1991-2003
- By contrast, investment and net exports have made lowest contribution to growth
- With 2/3 of exports in electronics, export base is narrow and value added low





# ...rather than by investment or productivity

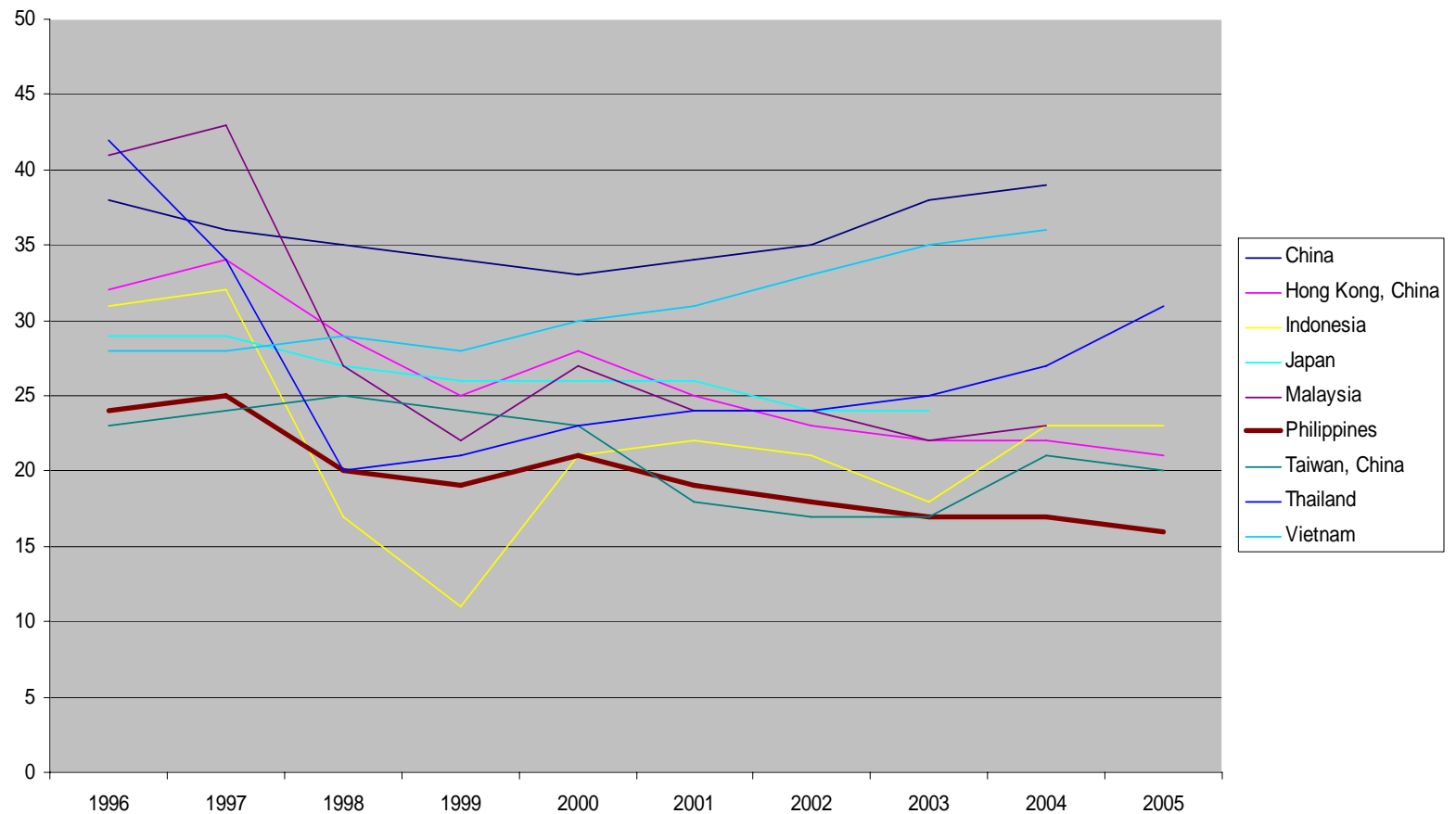
- Output per worker up 50% between 1961-2003, compared to 450% in other E. Asian economies
- Not due to differences in educational attainment or human capital, but to lower physical capital accumulation and productivity growth





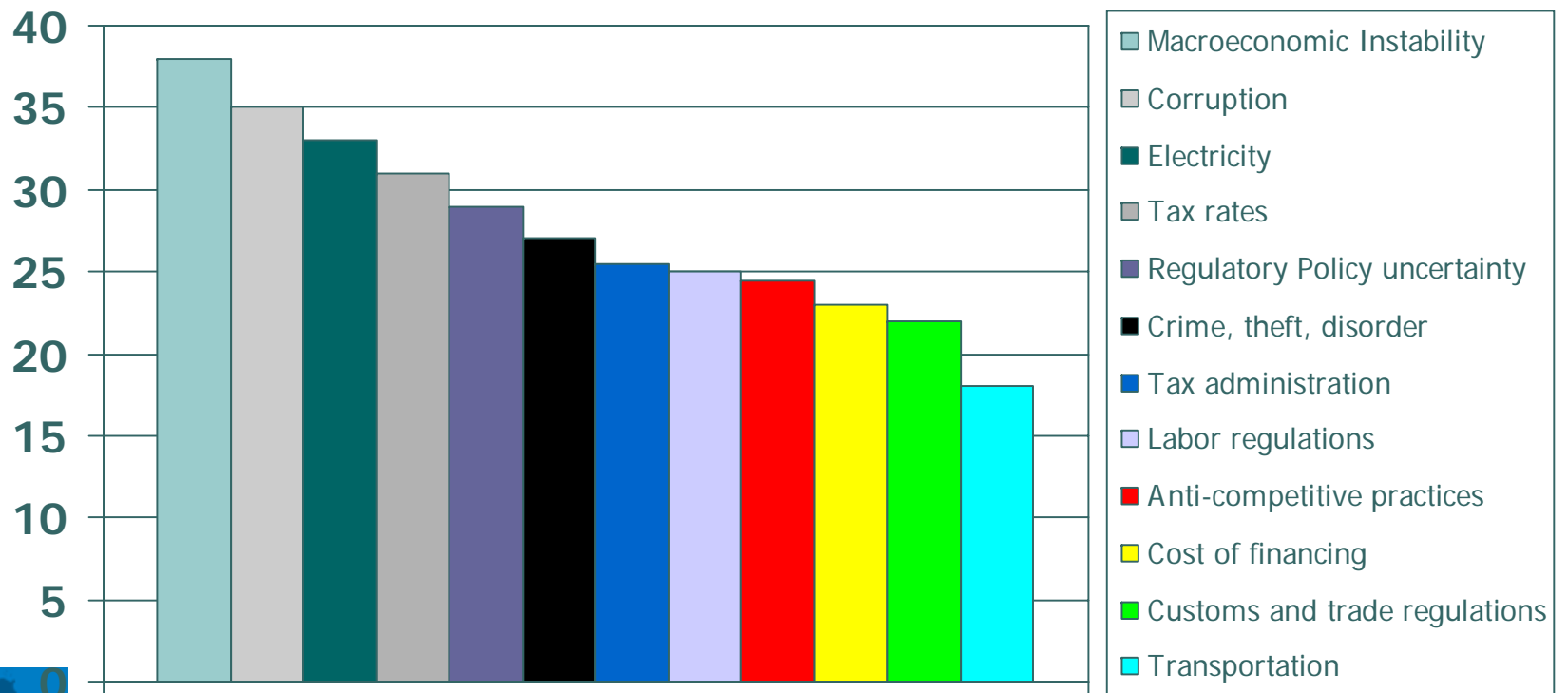
# Investment Lagging Behind the Region

Gross Capital Formation (% of GDP)



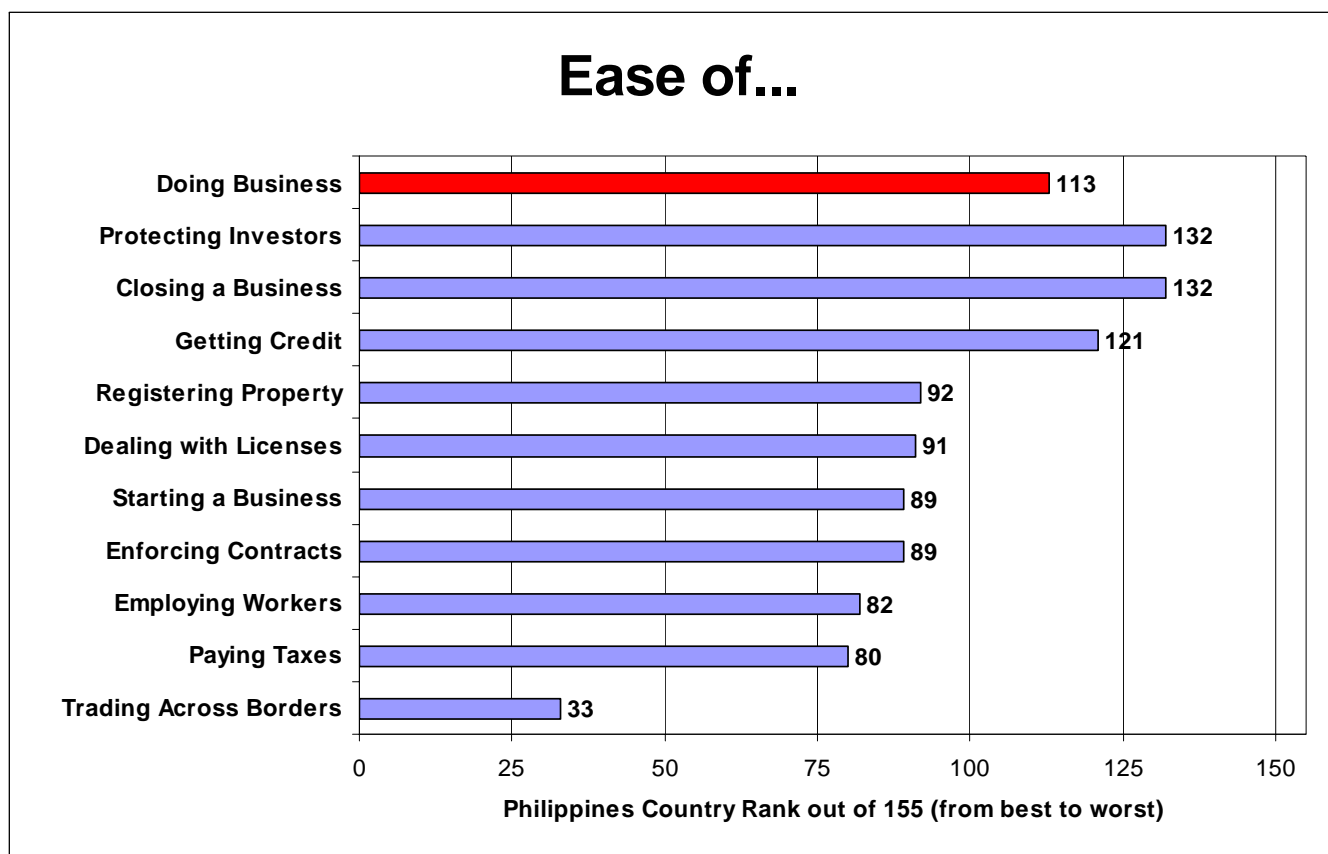
# The Obstacles to Investment Seen By Business

Important investment constraints (% of firms surveyed)



# Cost of doing business is relatively high

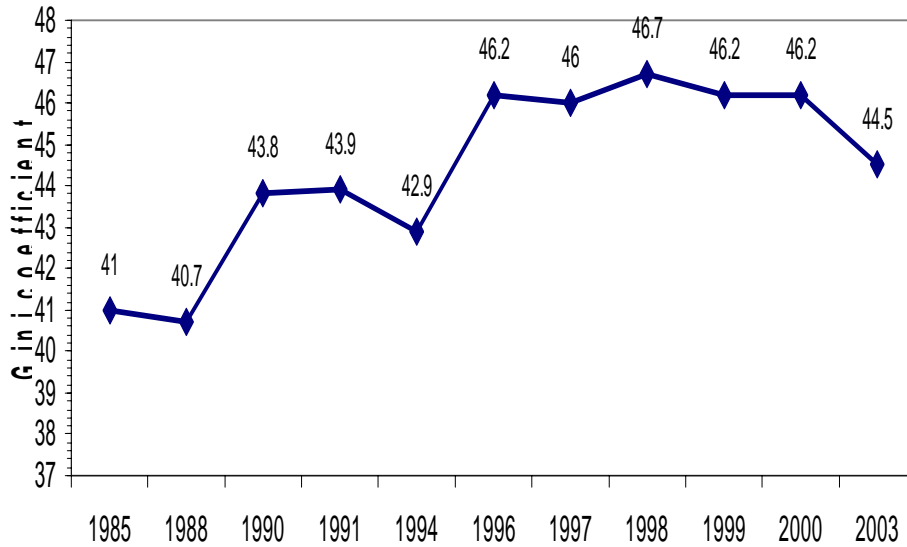
*Weak institutions increase the cost of doing business*





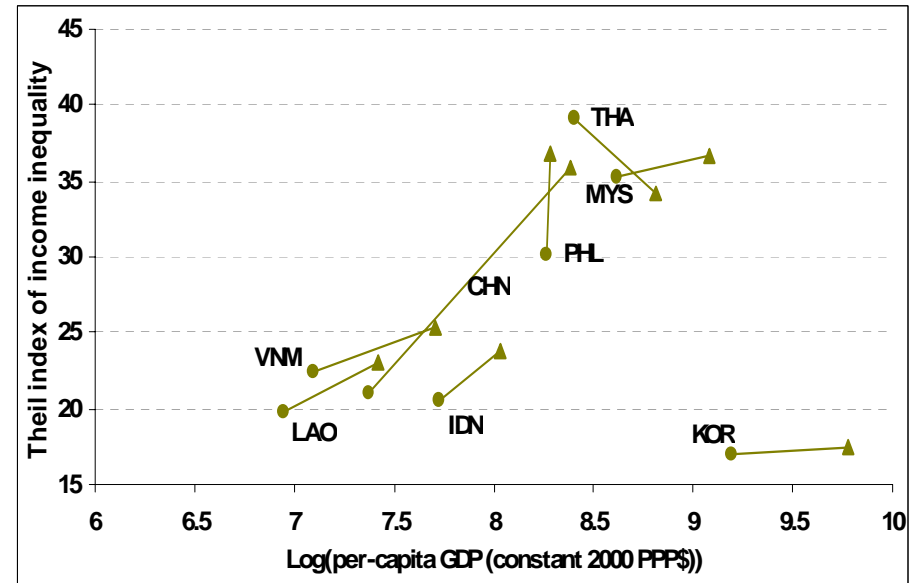
# Inequality in the Philippines is high

## *Inequality in the Philippines*



Source: East Asia Update and PovcalNet

## *Inequality in East Asian countries 1990 and 2002*

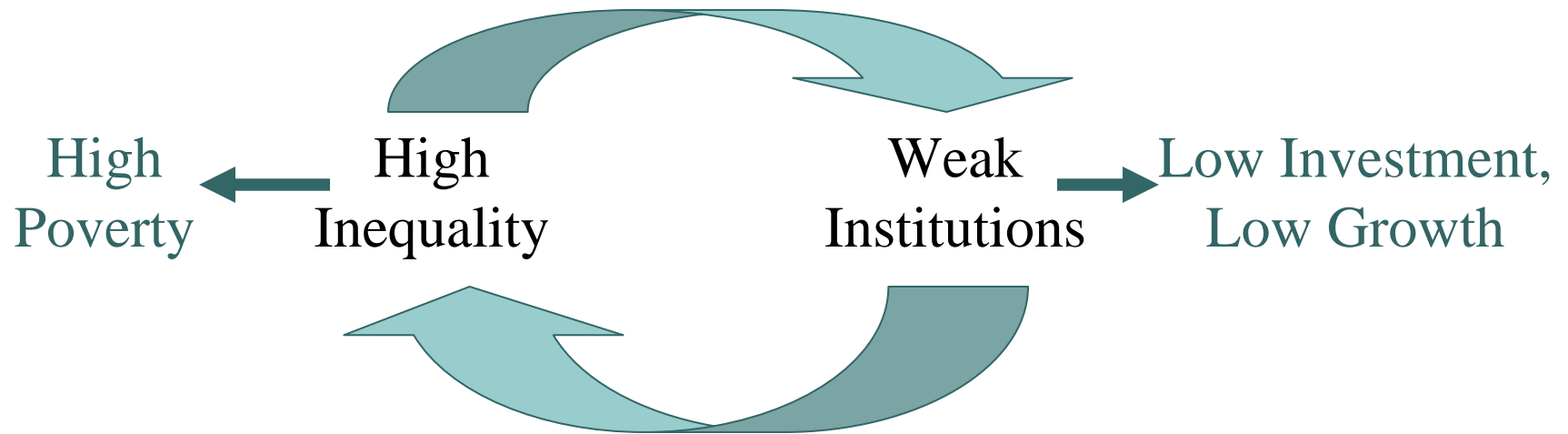




# A Hypothesis: The Inequality Trap

A vicious circle of high inequality perpetuating weak institutions is holding back the country

*State capture– rent-seeking, corruption*



*Under-spending on public services; policies that favor elites*

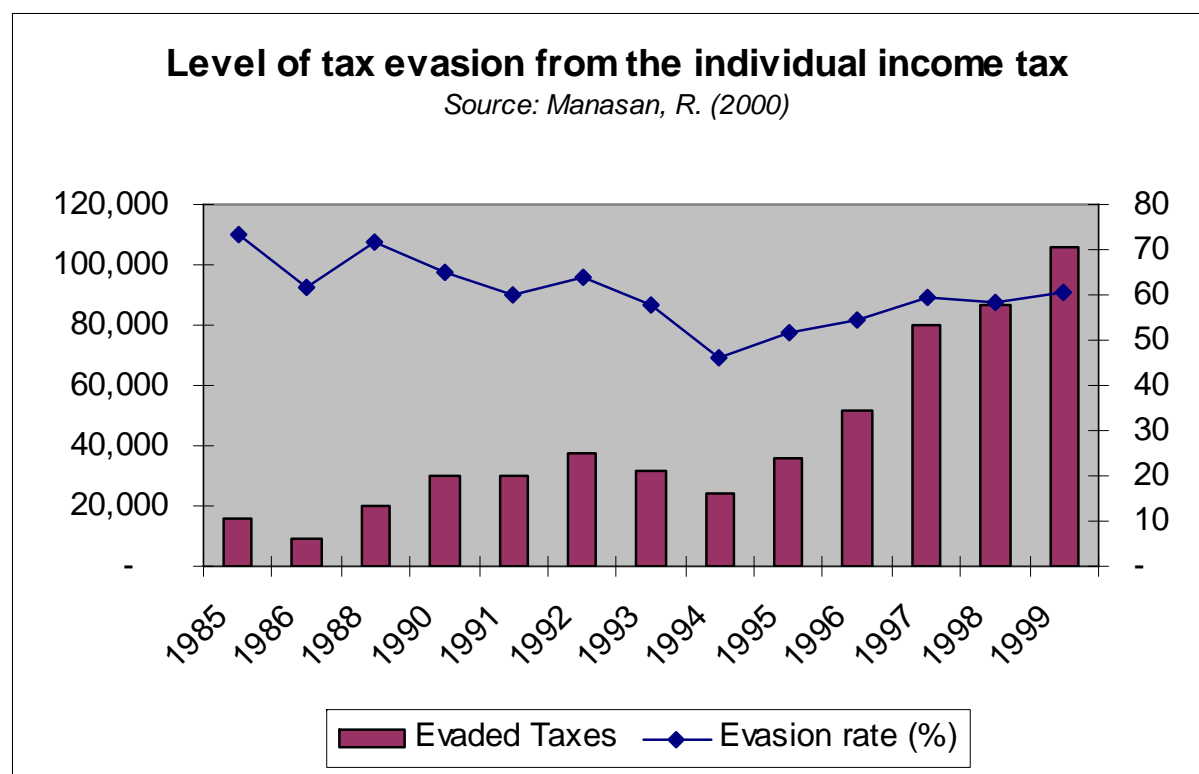


# High inequality can undermine effectiveness of public institutions

- Political and economic inequality can undermine independence, legitimacy, credibility and hence effectiveness of public institutions, including institutions that are critical for investments.
- Those with high levels of resources and access to power can influence decisions of the state in their favor and undermine rule of law.

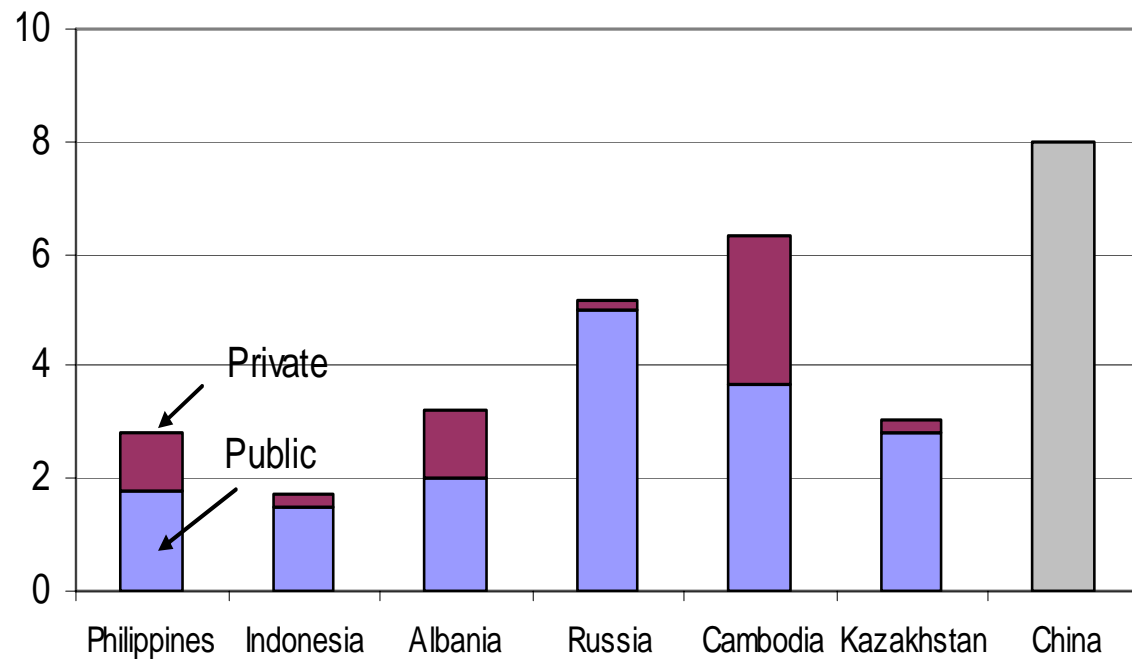
# Weak tax effort a reflection of state capture

*Weak tax effort due to tax evasion and exemptions*



# Infrastructure investments in the Philippines have been low...

Infrastructure investment as % of GDP



*Weak tax effort  
= low public  
investments*

Note: No breakdown for China, figures are 1991-2000 average. Philippines and Indonesia (2002 figures), Albania and Russia (2000) and Cambodia (2001).

Sources: World Bank Private Participation in Infrastructure Database, World Bank Public Expenditure Reports, China Statistical yearbook (various years).



# Weak institutions end up reproducing inequality

- **Concentrated access to finance and public services**
- **Limited social and infrastructure investments that could equalize opportunities**



# **From Vicious to Virtuous Cycles:**

**Policies to promote  
equity and build  
credible public  
institutions**



# (1) Sustaining Fiscal Stability

- Tax administration improvements to increase transparency, efficiency, and equity of tax collection
  - Credible tax enforcement
  - Transparency of exemptions



## (2) Improving quality and efficiency of public spending

- Strategic public investment planning and targeting
- Implementation of procurement reforms
- Transparency and information disclosure
- Increasing anti-corruption efforts



## (3) Pursuing Microeconomic Reforms

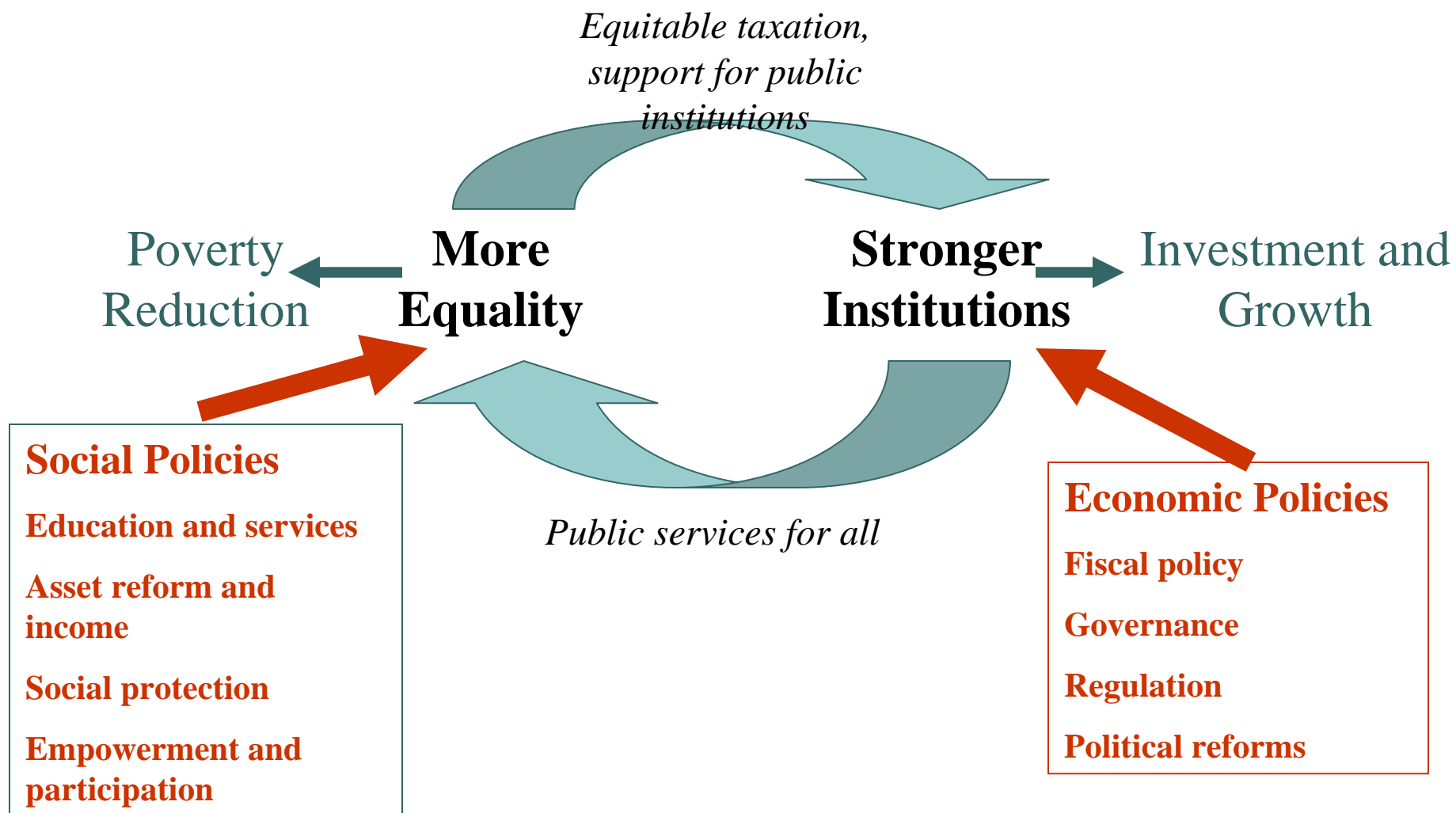
- Strengthen the Rule of Law and credibility of contract agreements
- Pursue “competition for competitiveness”
  - Further progress in deregulation
  - More vigorous market for corporate control
- Shift focus more and more towards economy-wide deregulation and incentives, and away from sector/firm specific incentives
- Reducing transactions costs and red tape
- Increase regulatory capacity for public-private partnerships
  - Open and competitive process for bidding
  - Independent and fact-driven setting and administration of regulations
  - Designing and managing concession contracts



## (4) Strengthening Social Policies

- Education and social services
- Asset reform and income
- Social protection
- Empowerment and participation

# A Virtuous Circle: Equity and Development





# From Agenda to Action

- Many Good Policies in Place
- Few Structural Obstacles
- Implementation – One Step at a Time
  - Tax Administration
  - Privatization
  - Infrastructure Projects
  - Corruption
  - Well-targeted Social Programs



# Two Scenarios for 2010

- Rapid progress is possible
- Two possible scenarios:
  - Muddle-through
  - Take-off
- Strong policy signals and credibility followed by real investment distinguish the two scenarios



# Maraming Salamat Po MABUHAY!