



# Program Information Document (PID)

---

Concept Stage | Date Prepared/Updated: 01-Oct-2018 | Report No: PIDC25593



**BASIC INFORMATION**

**A. Basic Project Data**

Country Philippines	Project ID P167651	Project Name Improving Fiscal Management (P167651)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Dec 18, 2018	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Republic of the Philippines through the Department of Finance	Implementing Agency Department of Finance		

**Proposed Development Objective(s)**

The DPL aims to support the high-level objective of the Government of the Philippines to improve fiscal management with three development objectives: A) Increasing revenue potential and economic efficiency of tax policy; B) Improving budget planning and execution efficiency of spending; and C) Strengthening financial risk management of public assets

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	300.00
------------------------	--------

**DETAILS**

<b>Total World Bank Group Financing</b>	300.00
World Bank Lending	300.00

**Decision**

The review did authorize the preparation to continue

**B. Introduction and Context**

Country Context

**1. Inclusive growth and poverty reduction remain at the center of the Philippine development agenda.** The Philippines Development Plan (PDP 2017-2022), launched in June 2017, reflects heightened ambition to lift roughly six million Filipinos from poverty and to achieve upper middle-income status by 2022. Grounded in its strong election mandate of 2016, the government is aiming to leverage the solid position of the Philippine economy to scale up public investment for poverty reduction, job creation and economic growth. The government has proposed new approaches for



attaining these objectives in the context of a wide-ranging legislative agenda, which has at its core a comprehensive tax reform package with the objective to sustainably raise the necessary revenue to expand public investment that would lead to more inclusive growth. Relative to its regional and emerging market peers, the Philippines has still one of the lowest revenue-to-GDP ratios (15.7 percent of GDP in 2017 from 15.2 percent in 2016) and tax-to-GDP ratios (14.2 percent in 2017 from 13.7 percent in 2016) which constrained in the past the fiscal space for spending on development priorities.

**2. The Philippines' economic fundamentals are solid.** In the past 5 years the country experienced high economic growth of an average of 6.6 percent, supported by a favorable external environment and robust domestic demand, especially public investment. In line with the government's focus on increasing investments in infrastructure and human capital, it followed an expansionary fiscal path for the third year in a row, widening the fiscal deficit to 2.3 percent of GDP in the first half of 2018 from 2.0 percent of GDP a year ago, but remained within the government's deficit ceiling of 3.0 percent of GDP. The country's balance of payments turned into a small deficit in 2018, driven by a widening trade deficit and higher capital outflows as the external conditions are slowly shifting, underlining the importance of policies to support domestic demand. However, as the economy is operating close to its capacity limits, inflation started to trend upwards<sup>1</sup> over the past couple of years, averaging 4.5 percent in the first seven months of 2018, higher than the 2.8 percent average in the same period in 2017. It moved beyond the central bank's target range of 2-4 percent and the Bangko Sentral ng Pilipinas (BSP) responded by entered a gradual tightening cycle in May 2018. The economic outlook remains positive, supported by continued high public investment spending and robust private consumption, bolstered by steady remittances. Risks to the economic outlook remain prominent and will require continued strong economic management.

#### Relationship to CPF

**3. This DPL forms an integral part of the Philippines Country Partnership Strategy (CPS) which aims to support the government's fiscal and budget reforms.** The proposed DPL aims to address key policy and institutional bottlenecks in support of the government in strengthening tax policy, enhancing budget and public financial management (PFM), and improving fiscal risk management. The DPL builds on a number of on-going operations and TA to achieve the outcomes of the CPS. The Bank's knowledge services (analytical work and technical assistance) are being extensively used in each of the reform areas of the DPL to build the evidence base for reforms, e.g., the potential revenue impact, and to provide inputs into the design and implementation of reforms. In the area of tax policy reforms, the Bank provides extensive analytical and advisory services, including through the Game Changers, which is partly supported by DFAT. In support of ongoing PFM reforms, the Bank built a solid analytical base and since 2017 is in a Reimbursable Advisory Service agreement with the government to support key PFM reforms, including on procurement. To enhance the capacity of the government to manage the impacts of natural disasters, the Philippines had a Disaster Risk Management DPL with a Catastrophe-Deferred Drawdown Option (CAT-DDO) in 2011 and a second one since 2015, complemented by multi-sectoral and partly trust-funded on-going technical assistance.

### C. Proposed Development Objective(s)

**4. This DPL supports the government's core objective to strengthen fiscal management by mobilizing higher domestic revenue, improving budget management, and reducing fiscal risks.** The DPL aims to support the Government of the Philippines priorities for improving fiscal management to further the country's medium-term economic development and shared prosperity goals with three development objectives: A) Increasing revenue potential and economic efficiency of tax policy; B) Improving budget planning and execution efficiency of spending; and C) Strengthening

---

<sup>1</sup> A combination of factors was driving this trend, including: domestic food supply constraints, higher global oil prices filtering through higher domestic fuel prices, a weaker peso and increasing demand pressures.



financial risk management of public assets. The operation is selectively focusing on government initiatives and reforms that are expected to contribute significantly to the overall fiscal reform objectives in the medium-term.

#### Key Results

**5. Tax revenue is expected to increase through a set of tax reforms aimed at improving the equity, efficiency, and simplicity of tax system towards a low-rate and broad-based system.** The specific measures supported by the DPL in the prior action on tax policy are expected lead to higher tax revenue collection from excise tax on petroleum and the VAT. These reforms would increase the needed fiscal space for higher investment in physical and human capital that would ultimately help achieve more inclusive growth.

**6. Supported budget reforms are expected to ensure that the additional revenue raised by the tax reforms will be used more effectively and transparently.** Prior actions related to improvements in public financial management are expected to achieve progress in the implementation of the new Budget and Treasury Management System (BTMS) that would lead to improvements in efficiency, timeliness and accuracy of budget recording and reporting across government. It is expected that the BTMS is being piloted in the two main spending agencies, Departments of Education and Public Works and Highways by end-2019. Another expected result here is that the 2019 and subsequent budgets for central government are prepared and approved based on one-year cash appropriations as opposed on the basis of expenditure obligations. This will require better planning and improved efficiency in the execution of procurement plans because payable by the end of the budget year will lapse. Better budget management and reporting would help target spending to achieve the government's goal of more inclusive growth.

**7. Finally, prior action that strengthen the management of fiscal risks in relation to the impact of natural disaster on public assets will result in better disaster risk financing, including the establishment of key institutions and risk insurance instruments.** It is expected that the basic elements for establishing an assets registry will be in place, and the registry will be fully functional by end-2019. A budget for asset insurance premium payments and appraisal fees is expected to be included in the 2019 Budget with an insurance program for strategically important high value assets launched. These reforms would support the government in becoming a proactive risk manager rather than emergency responder to natural disaster shocks. Building higher financial resilience to shocks would protect the national fiscal balance, support local governments, and protect the most vulnerable against falling back into poverty, in line with the government's objective of more inclusive growth.

#### D. Concept Description

**8. The DPL is structured around the following three pillars, set of objectives and government program reform areas, reflected in five prior actions:**

- **Pillar 1: Strengthening Tax Policy.** *PDO: Increasing revenue potential and economic efficiency of tax policy* by (i) amending and expanding tax instruments; and (ii) taking regulatory measures against tax base erosion. Prior actions are: adjusting the excise tax on petroleum products for the first time since 1997 and expanding the Value-added Tax (VAT) base by repealing 54 out of 61 special laws with non-essential VAT exemptions.
- **Pillar 2: Enhancing Budget and Public Financial Management.** *PDO: Improving budget planning and execution efficiency of spending* by (i) improving central government budget reporting; and (ii) strengthening the predictability of the budget. Prior actions are: the adoption of a Budget Reform Program which introduces and pilots a centralized budget management system and the government shifts from obligation-based budget planning and execution to a one-year cash appropriation for the national budget.



- **Pillar 3: Improving Fiscal Risk Management.** *PDO: Strengthening financial risk management for public assets* by implementing a policy for disaster risk financing, including setting up the necessary institutions and risk insurance instruments. The prior action is: a new asset registry is set-up and fully functional, an insurance program for strategically important high value assets is launched with a budget for covering insurance available.

## E. Poverty and Social Impacts and Environmental Aspects

### Poverty and Social Impacts

**9. The operations actions are designed to enhance the long-term welfare of the poor and bottom 40 percent of the population.** For example, for each of the proposed tax reform actions, analysis has been conducted to assess the inclusive growth impact. Increasing excise tax rates and eliminating exemptions for kerosene, diesel and LNG could improve the distributional equity of the country's tax system, as higher-income households consume the vast majority of petroleum products. Many VAT exemptions that focus on specific individuals or firms had little economic justification but led to revenue losses which limited the government's fiscal space for public spending, including to the benefit of the poor. In the short-term the removal of selected VAT exemptions supported by a prior action might affect the poor adversely as they were beneficiaries of the exemptions, yet these are poor targeting mechanisms to support poorer segments of the population and can easily lead to fraud and misuse. As a result of lowering VAT exemption, higher VAT revenues can be used for enhanced social services, such as public education, health, and social assistance that can offset the loss in progressivity. In addition, as part of the tax reform, the government has taken steps to soften the potential adverse impact of the increase in excise prices and VAT exemptions on poorer households, including an unconditional cash transfer program to households in the first to seventh income deciles. Together with higher revenues from other taxes, the welfare of poorer households is expected to improve relative to the previous system. The supported budget reform initiatives are likely to positively benefit the poor through increased budget effectiveness and transparency. The policy action on improved fiscal risk management to natural disasters and protection of public assets are expected to have significant positive effects on poor people and vulnerable groups.

### Environmental Impacts

**10. The environmental impact of the reform actions supported by the DPL are estimated to be positive overall.** The DPL operation's proposed prior actions to improve the risk management of public assets, especially by increasing the availability of data and funds for quick asset reconstruction helps institutionalize a well-planned rehabilitation process following disasters. Ongoing World Bank operations and ASA are working with the government to address technical barriers to enable the adoption of risk informed approaches to development, including through the integration of climate change and disaster risk assessments in public investment projects and environmental risk assessments. The government has integrated in the safeguards country systems the harmonization in the Environmental Impact System for the proper identification and management of climate resilience and DRM development challenges and these challenges are included in local development and climate action plans.



**CONTACT POINT**

**World Bank**

Birgit Hansl  
Program Leader

**Borrower/Client/Recipient**

Republic of the Philippines through the Department of Finance

**Implementing Agencies**

Department of Finance  
Donalyn Minimo  
Division Chief - Multilateral Assistance Division  
dminimo@dof.gov.ph

Charissa Hipolito  
Director  
chipolito@dof.gov.ph

**FOR MORE INFORMATION CONTACT**

The World Bank  
1818 H Street, NW  
Washington, D.C. 20433  
Telephone: (202) 473-1000  
Web: <http://www.worldbank.org/projects>

**APPROVAL**

Task Team Leader(s):	Birgit Hansl
----------------------	--------------

**Approved By**

Country Director:	Mara K. Warwick	01-Oct-2018
-------------------	-----------------	-------------