

Philippines



Philippines 2024 Constraints Analysis Report



MILLENNIUM
CHALLENGE CORPORATION
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Authors and Acknowledgements



The Millennium Challenge Corporation's (MCC's) Board of Directors selected the Philippines as eligible to develop a Threshold Program in December 2023. MCC undertook this Constraints to Economic Growth Analysis (CA) under its subsequent Threshold program engagement with the Philippines from January through June 2024.

Over this period, members of the country team and contractors held more than 30 meetings with more than 90 representatives of the Government, civil society, and the private sector to inform this analysis.

CA team Economists Mesbah Motamed and Brian Epley were supported by Economic Program Analyst Arin Kerstein and received inputs from Katherine Farley and Zaidoon Khouri (Finance, Investment, and Trade), Andrew Tarter (Gender and Social Inclusion), and Jason Jones (Environmental and Social Performance). MCC's Country Team Lead Sarah Olmstead was supported Senior Policy Officer Emily Schultz. We gratefully acknowledge the valuable contributions of Ronald Mendoza.

Abstract



With one of the best performing economies in Southeast Asia, the Philippines has grown rapidly over the past decade, led by its electronics manufacturing and business process management (BPM) sectors.¹ Stark disparities in well-being persist throughout the country, and poverty remains entrenched in rural and remote areas.

Since December 2023, when the MCC Board of Directors selected the Philippines as eligible for development of a Threshold program, the MCC Philippines Threshold Program team (country team or CT) has reviewed the country's economic profile and undertaken an analysis of constraints to its economic growth, highlighting cross-cutting challenges posed by its geography and climate.

MCC identified the following areas as binding constraints to economic growth in the country:

Energy: The high cost and unreliability of power raises production inefficiencies and limits opportunities for firm expansion;

Local Governance: Poor governance at the local level limits investment opportunities and incentives for growth;

Transportation and Logistics Bottlenecks: Concentrated growth in the National Capital Region (NCR) coupled with lagging transport infrastructure elsewhere has created bottlenecks in the movement of goods, both international and domestic; and

Agriculture: Constraints to economies of scale in agricultural production and protectionist trade policies limit productivity and increase the country's food insecurity.

¹ Business Process Management (BPM) and Business Process Outsourcing (BPO) refer two related concepts in business focusing on the management of business processes to boost efficiency. BPM services referred to in this report also include the country's BPO services.



Country Context

With 118 million inhabitants spread across a vast archipelago of more than 7,000 islands off the coast of Southeast Asia, the story of economic growth in the Philippines has deep roots in its geography and location. The challenges of inter-island connectivity, vulnerability to extreme weather events, and a succession of foreign influences, including three centuries of colonial Spanish rule and nearly 50 years of American occupation, have left deep imprints on the country's economy, culture, and governance. Following independence from the United States in 1946, the Philippines has fitfully forged democratic institutions, including holding regular elections while fostering a diverse and active civil society. Nevertheless, challenges persist, including endemic corruption, weak rule of law, and dynastic power struggles. Recent geopolitical flashpoints, including domestic separatist movements in southern Mindanao and mari-

time boundary disputes with China, further complicate the picture. In 2022, Ferdinand “Bongbong” Marcos, Jr., won the presidential election, promising a new chapter of national unity, modernization, and a pragmatic approach to foreign relations.

Over the past few decades, the government of the Philippines has achieved rapid, poverty-reducing growth, in part due to sustained foreign direct investments, particularly in electronics manufacturing and business process management (BPM) and from remittances from overseas Filipino workers (OFWs). The benefits of these activities, however, have materialized primarily in the NCR, and as a result, regional disparities in the country persist. Inequality is among the world's worst, and poverty remains entrenched in rural agricultural areas, particularly in eastern Visayas and southern Mindanao.

What is a Constraints Analysis?

MCC’s evidence-based approach begins with a constraints-to-economic growth analysis (CA). In a CA, MCC works with a partner country to examine and prioritize the issues that constrain its economy. The CA approach builds on the “growth diagnostic” framework put forward by economists Ricardo Hausmann, Dani Rodrik, and Andrés Velasco (HRV). As HRV point out, all developing countries face significant economic and development challenges, but these challenges do not all equally restrict growth. The diagnostic framework provided by HRV helps to structure the investigation of potential binding constraints. It has been refined through application, both within MCC and the broader economic development community.

Why Does MCC Use Constraints Analysis?

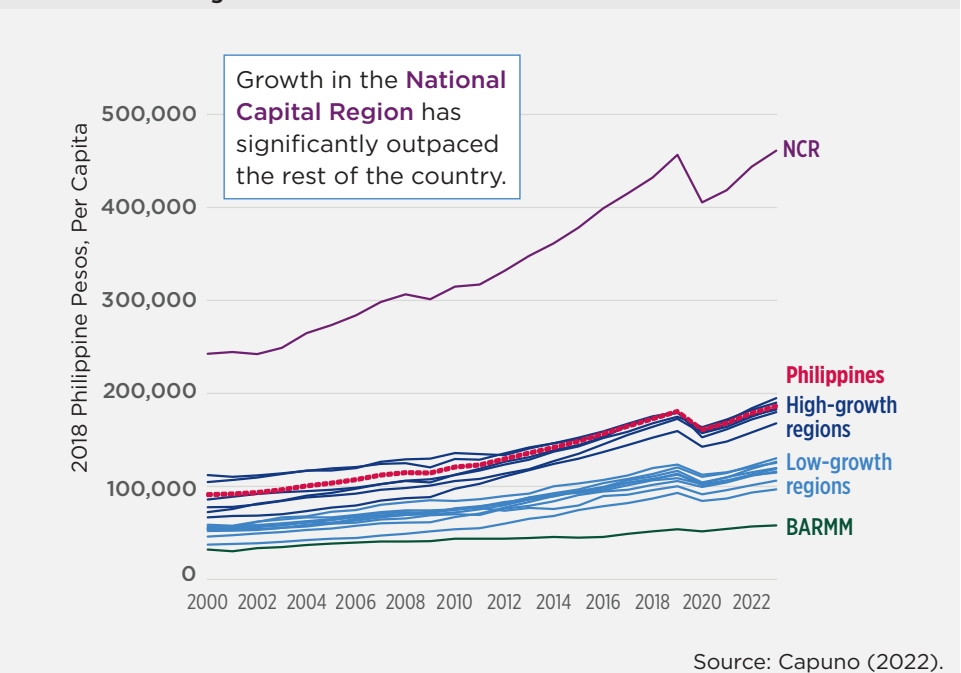
Identifying the most binding constraints to growth helps MCC target its investment on the areas that, if addressed, are most likely to promote sustainable, poverty-reducing growth in a given country. Prioritization helps maximize the limited financial resources and implementation capacity needed to effect change. As HRV also argue, focusing on the most binding constraints helps to minimize the risk that development interventions create negative unintended economic consequences.

MCC’s previous investments in the Philippines include a \$20.7 million threshold program implemented by USAID from 2006–2009 that focused on anti-corruption efforts, followed by a \$434 million compact from 2011–2016 that invested in modernizing the government’s tax-revenue processes, road rehabilitation, and community-driven development.²

Economic Performance and Paths of Growth

The Philippines’ economy has grown rapidly over the past decade, averaging more than 5% annually, with per capita income reaching \$3,500 in 2022.³ The bulk of this growth, and consequently higher incomes, has centered on the National Capital Region (NCR) and its immediate environs (Figures 1 and 2)⁴, home to booming sectors of electronics manufacturing and BPM as well as recipient of the bulk of recent investments in major infrastructure. Powering this growth are the country’s high literacy and school completion rates, English-fluent workforce, and the know-how of returning OFWs. Meanwhile, more than 400 special economic zones, located mostly in the NCR, offer export-oriented multinational firms rapid and hassle-free entry points to set up shop and capitalize on this labor force.

FIGURE 1: Gross Regional Domestic Product Growth

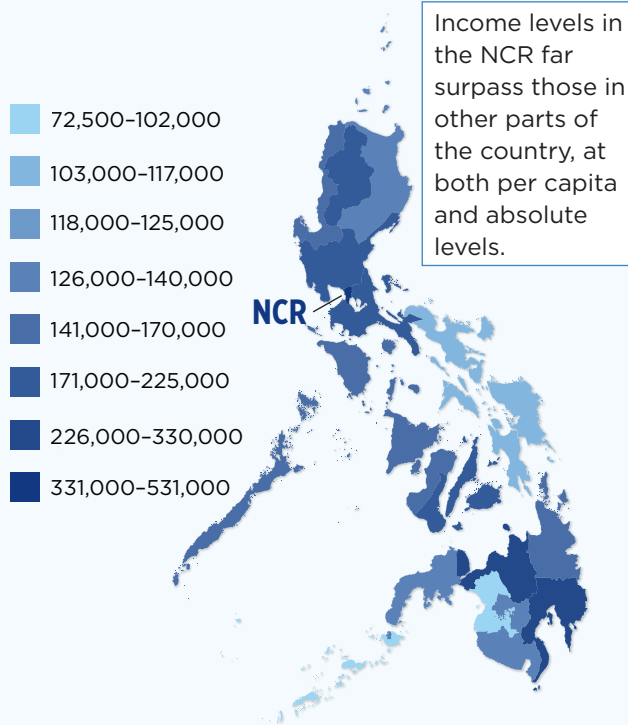


² MCC initiated a second compact in 2015 but ultimately could not reach an agreement with Government to finalize the program and commence works.

³ Source: World Bank (2024). In Q1 2023 the Philippines GDP growth of 6.4% was higher than Malaysia (6%), Indonesia (5%), Vietnam (3%) and Thailand (3%).

⁴ Bangsamoro Autonomous Region of Muslim Mindanao (BARMM) lags the rest of the country following a decades long insurgency. A peace agreement was ratified in 2019, leading to a transition period that will continue until the first elections for the now autonomous region. These elections are set for 2025.

FIGURE 2: Gross Regional Domestic Product Growth, Per capita, 2023, in Philippine Pesos



Source: Philippine Statistics Authority, 2024

For its income level, the Philippine economy is remarkably diverse. The country ranks 33rd on the Economic Complexity Index (ECI) thanks to an array of productive sectors spanning manufacturing, information and communication technology (ICT), raw materials, and agriculture (Figure 3). As a result, the economy has grown along several paths, i.e. sectors and clusters of activity, with varying degrees of inclusion and sustainability.

Business Process Management (BPM)

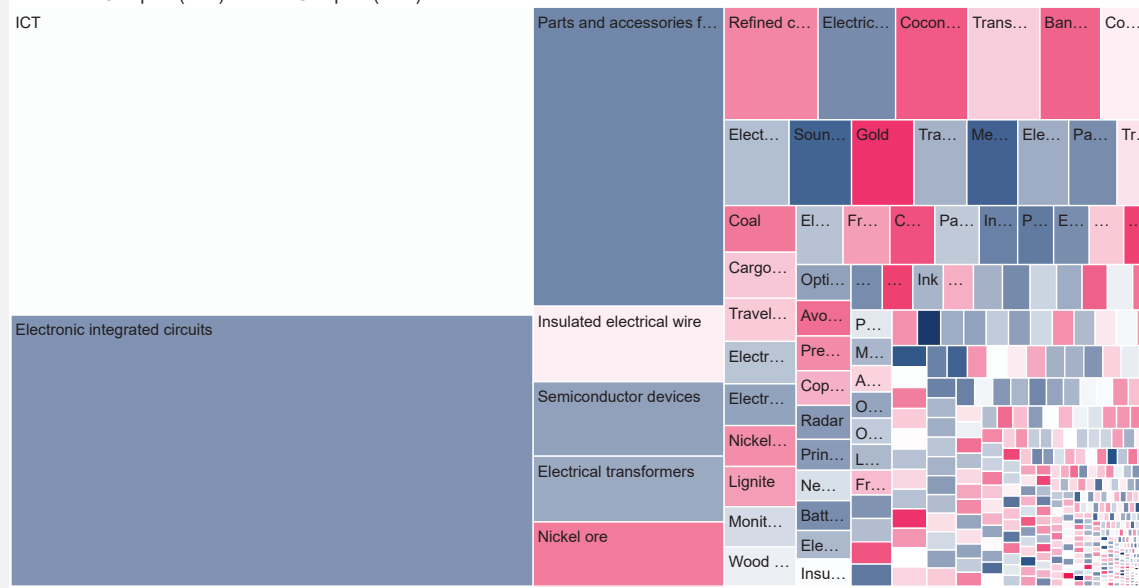
The BPM sector has created more than 1.5 million relatively high-paying jobs, mostly concentrated in the NCR. Workers in this sector, 55 percent of which are women, count on their technical skills in IT, engineering, and business—coupled with English language ability—to connect with overseas firms looking for cost-effective labor solutions for office functions such as call centers, IT support, and accounting services. BPM firms have grown at 8 percent annually, in line with the growth of other business services in the country (Figure 4), pushing the Philippines’ global share of the industry to 15 percent. That said, questions about sustainability arise as the advent of artificial intelligence technologies potentially

FIGURE 3: The Philippines’ export basket

Economic Complexity in the Philippines in 2021

From Less Complex (Red) to More Complex (Blue)

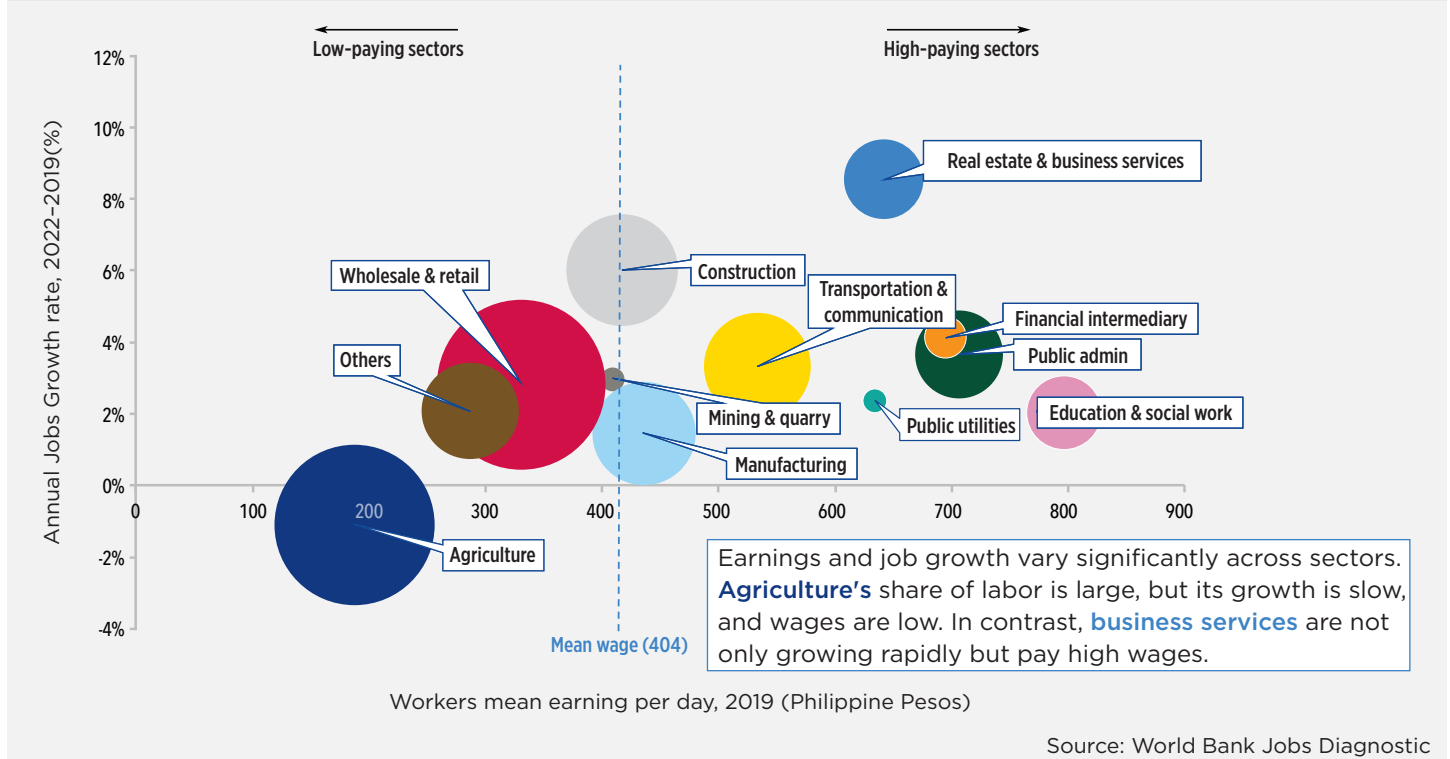
ICT



The Philippines’ ranks 33rd globally for the economic complexity of its export basket, due in large part due to its high volume of exports in **high complexity** products in electronics and machinery.

Source: The Atlas of Economic Complexity

FIGURE 4: Job Growth in low-paying and high-paying sectors, 2002-2019



displace a segment of the relatively less-skilled call center and customer support operations, provoking interest in movement up the value chain into higher skilled roles.

Electronics Manufacturing

Assembly of computer chips and circuits and the manufacture of IT equipment and auto parts, collectively grouped under “electronics and electrical machinery,” have grown by close to 5 percent per annum over the last decade and account for more than half of Philippines’ goods exports.⁵ Partially offsetting this benefit, however, the sector relies heavily on imported inputs such as high-tech wafers and machinery, needed to undertake assembly operations. Efforts to build upstream capacity in the higher-value chip design and battery manufacturing remain nascent.

Thanks to its labor-intensive production processes, electronics manufacturing has generated more than 200,000 jobs.⁶ Assembly line workers are usually high school-educated, often receive on-the-job training, and

draw from rural areas where opportunities for upward income mobility are otherwise scarce. The sector’s work force is 70 percent female and young, with the vast majority of line workers under age 30 (Frederick and Gereffi, 2016). However, most factories locate within the NCR, Calabarzon, Northern/Central Luzon, and Cebu, limiting the absorption of workers from the country’s most impoverished regions.

Food Manufacturing

A key component of the food sector, food manufacturing has also grown rapidly, more than 4 percent annually, adding value to raw goods and strengthening supply chains with upstream farms. Similar to electronics manufacturing, food manufacturers employ hundreds of thousands of workers that are relatively low-skilled. But unlike their electronics counterparts, the spatial distribution of food manufacturing is less concentrated in the NCR, a consequence of the greater dispersion of the country’s farm production. While processed food does not contribute to the country’s export basket significantly— in

5 SEIPI (2023); Atlas of Economic Complexity (2021).

6 Philippines Statistical Authority (2022).

fact, the Philippines relies heavily on imports of certain cereals— it does account for half of the country’s overall manufacturing output. As the Philippines’ income continues to rise, predictable evolutions in preferences, particularly for meat, processed foods, and more diverse diets, suggest a sustained demand for food manufacturing activities.

The Blue Economy

Comprising a broader spectrum of activity, the Blue Economy entails a variety of new and growing opportunities in fisheries, tourism, maritime transport, offshore energy, and resource extraction. Currently, more than 2 million workers earn their livelihoods from the country’s fisheries, but efforts to preserve and add value to their highly perishable catch are uneven and inadequate, and often vary with the quality of governance and infrastructure at the local level. Off-shore wind farms offer a valuable alternative to thermal energy sources, but hurdles of connecting them to the national grid remain high.

Meanwhile, the Philippines’ coastal landscapes present an underexploited opportunity for international tourism, with the current tourism market bolstered by domestic travelers. The sector has always underperformed relative to its peers, with international arrivals to the Philippines at one-half of Indonesia’s and one-fifth of Thailand’s.⁷ Additionally, the sector’s recovery from the pandemic has been slow, with contribution to GDP falling from 23 to 6 percent (WTTC 2022). A key component of the services economy, tourism accounts for 11 percent of total employment, with high female labor participation.⁸ Costly and complex transportation to reach tourist destinations and inadequate local infrastructure for power and roads inhibit growth in this high-potential and inclusive sector.

Poverty and Inclusion

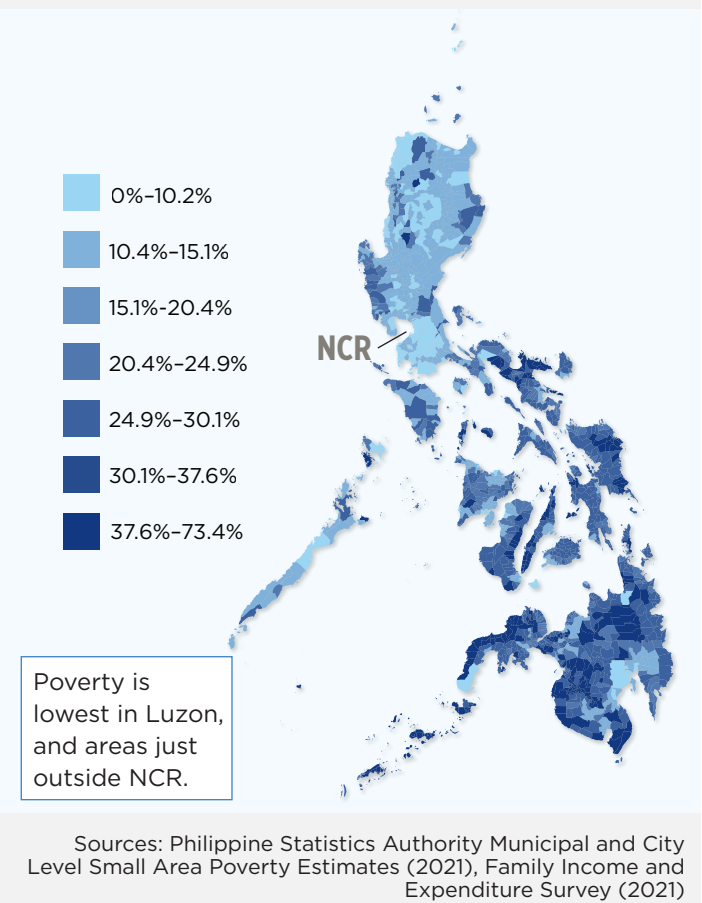
Based on the Philippines’ most recent household survey, 22 percent of the population, or about 25 million people, lives below the national poverty line. Poverty rates have

⁷ IFC 2020; World Bank (2019a).

⁸ PSA 2023; WTTC 2022.

⁹ Ibid.

FIGURE 5: Estimated population in poverty, in percentages, 2021 estimates

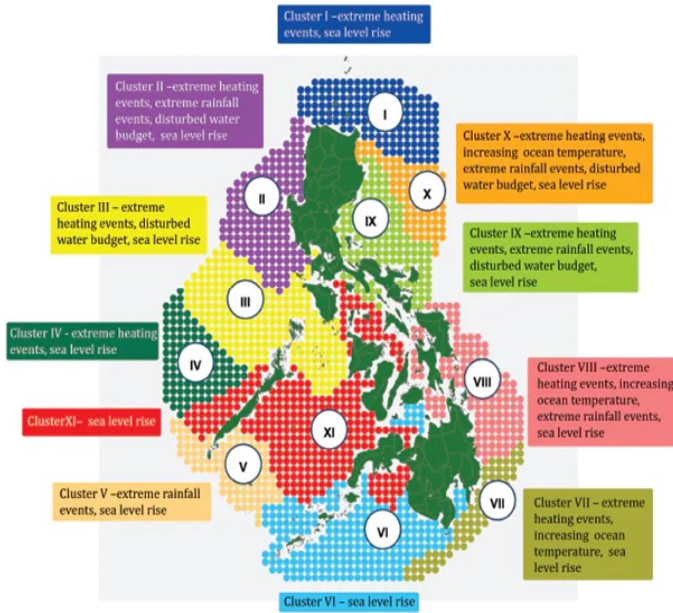


declined at the national level, a reflection of the country’s broadly pro-poor growth over the past generation. This is most visible in the largest urbanized areas, particularly the NCR region, which exhibits the lowest poverty rate (5 percent). But significant pockets of poverty persist in rural and remote parts of the country, with rates in eastern Visayas and Mindanao exceeding 40 percent (Figure 5). Roughly 75 percent of the population that lives below the national poverty line inhabit rural areas, primarily occupied in agriculture and fisheries.⁹

Despite slowing population growth, the country remains relatively young, with 30 percent of its citizens under 14 years of age. Youth labor force participation in the Philippines is low, possibly attributable to relatively scarce domestic opportunities, greater tertiary edu-

FIGURE 6: Every region of the Philippines faces threats from an array of disaster and climate change risks.

PHILIPPINE EXPOSURE MAP ON CLIMATE CHANGE



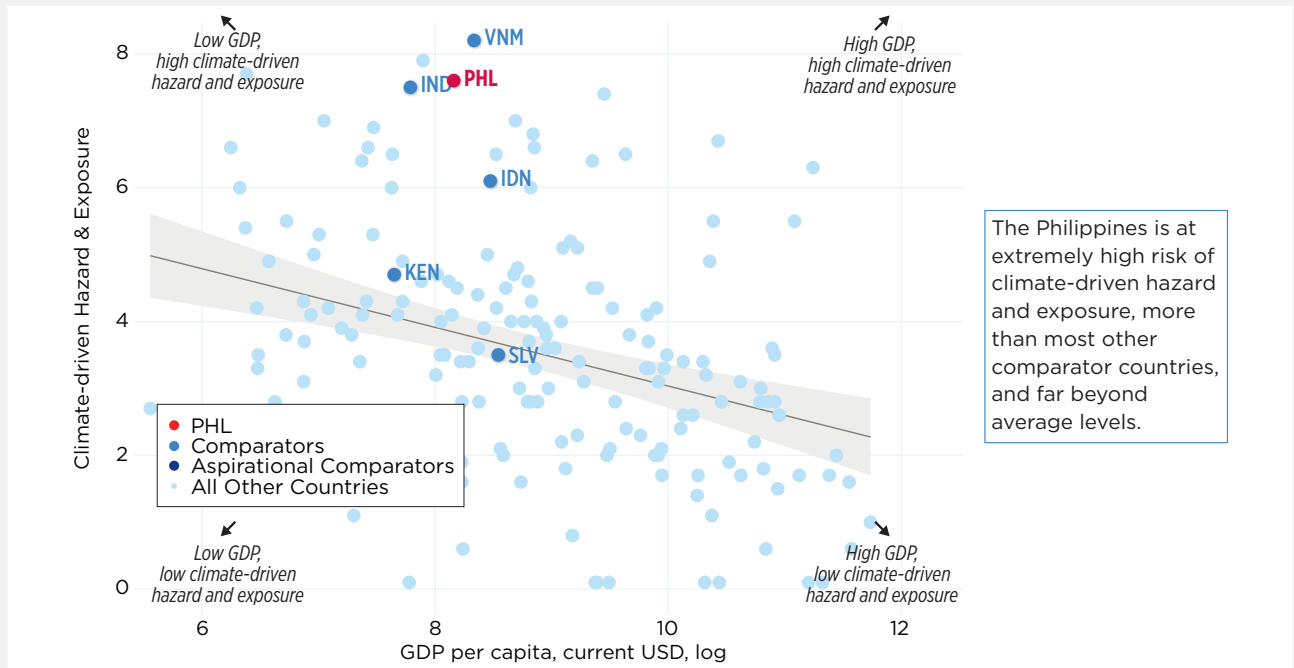
Source: Philippine Department of Environment and Natural Resources as cited by Washington Post (2013)

cational attainment, or more lucrative opportunities abroad.¹⁰ In terms of gender, Philippines ranks 16th best in the world on the Gender Gap Index (GGI), which measures gender parity across economic participation and opportunity, education; health and survival; and political empowerment. Meanwhile, more than 110 designated indigenous ethno-linguistic groups account for between 9 to 20 percent of the population (World Bank, 2019b; World Bank, 2021b). Located largely in Mindanao and northern Luzon, these groups, along with the country’s Muslim Moro/Bangsamoro minority, have historically experienced displacement, destruction of traditions and ways of life, and a loss of group identity or culture in the face of assimilation, with consequences for literacy, drinking water access, sanitation, and electricity.

Extreme Weather Events and Climate

The Philippines experiences repeated natural disasters, including typhoons, floods, and landslides (Figure 6). Such events dampen and even reverse growth, push households back into poverty and further immiserate others (Skoufias et al., 2019). MCC estimates that every

FIGURE 7: Climate-driven hazard and exposure



The Philippines is at extremely high risk of climate-driven hazard and exposure, more than most other comparator countries, and far beyond average levels.

Source: ICF

¹⁰ Philippines Statistical Authority (2024). TABLE A Key Employment Indicators with Measures of Precision, Philippines. Available here.

additional typhoon event in a region is associated with a 5 percent reduction in its 10-year average growth. The Philippines also ranks highest in the 2023 World Risk Index for climate vulnerability and tops many other indices for climate-driven hazard and exposure (Figure 7). These include extreme heat, higher exposure to flood zones, greater water stress, and land degradation.

Disasters affect all facets of the Philippine economy. Flooded roads choke transport and mobility, disabled power networks can halt production, lost harvests threaten food security, and disrupted tourism starves a critical sector of revenues. Homes, schools, and clinics, often built well below extreme weather standards, regularly suffer damage and can go unrepaired for extended periods. Meanwhile, the cost of frequently rebuilding infrastructure and assets can deplete the budgets of national and local governments, businesses, and households in disaster-prone areas, while simultaneously discouraging new investment.

Review of Past Constraints

MCC last analyzed constraints to economic growth in the Philippines in 2015, as part of preparations for a proposed second Compact program. At that time, the team iden-

tified several constraints: government coordination and implementation capacity, high transport logistics costs, high electricity costs, and market failures in the rural economy. While progress has taken place, particularly regarding transportation infrastructure outside of the shipping sector, many of these challenges persist and are echoed in the current CA report.

Growth Question

The Philippines' archipelagic geography limits domestic connectivity among workers and firms and reduces opportunities for scale economies. Moving people and goods under such circumstances imposes unique costs on the economy, pushes markets out of reach, and weakens ties between national and local governments. Not surprisingly, under these conditions, remoteness and isolation can pose insurmountable obstacles, resulting in slow growth and persistent poverty. Additionally, the country's heightened exposure and vulnerability to extreme weather shocks regularly threatens investments and harms growth. These challenges confront the Philippines economy as it aims to further diversify its production, extend its successes and opportunities beyond the NCR, and reach upper middle-income status.

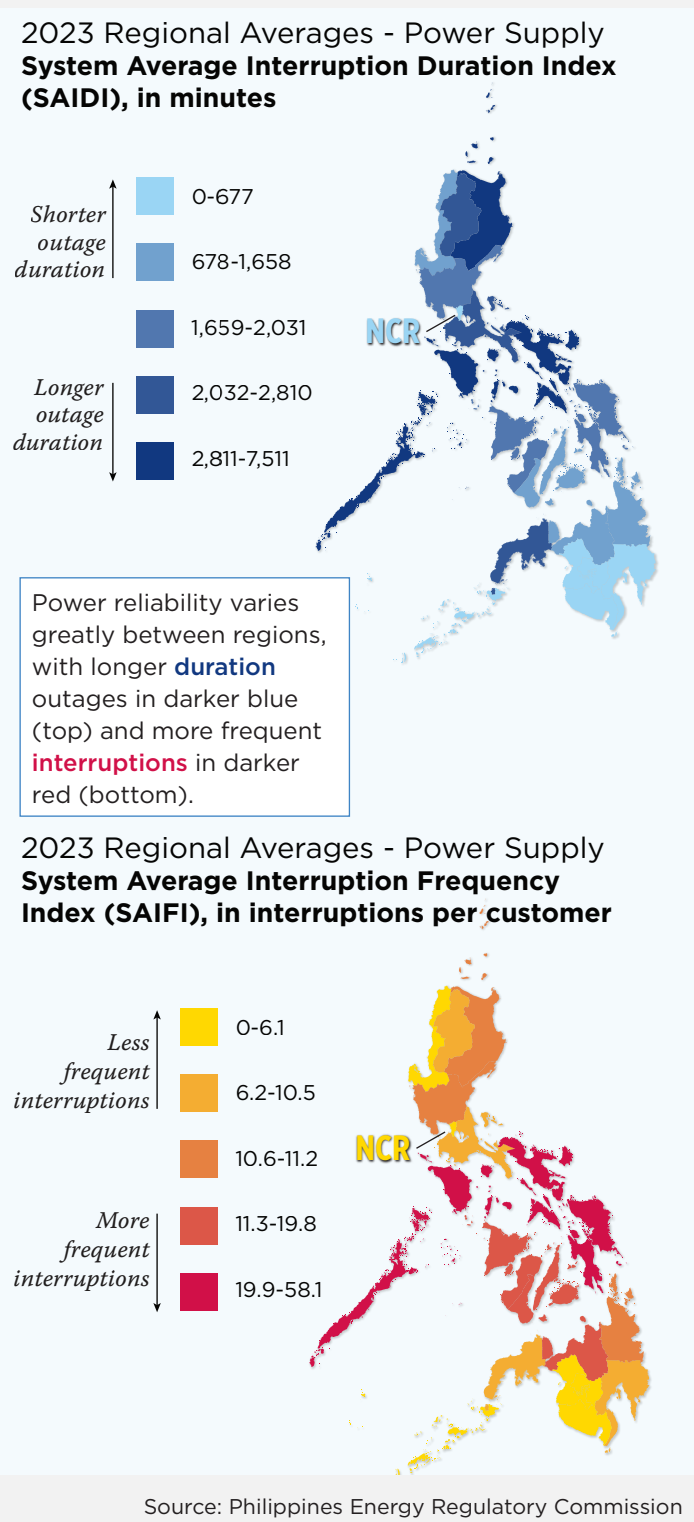
Discussion of Constraints

MCC analyzed the binding constraints to growth through desk review, interviews, consultations with government officials, experts, and stakeholders, as well as a mission to the Philippines in March 2024. A discussion of these constraints follows below. Parts of the analysis rely on comparisons of the Philippines to five countries with

similar economic, geographic, and demographic traits (Indonesia, India, Vietnam, Kenya, and El Salvador) based on a "closest distance" methodology to detect indicative outliers in performance.¹¹ Malaysia and the Dominican Republic were added as aspirational comparators.

¹¹ Comparator countries were selected beginning by calculating multi-dimensional Mahalanobis distances between each country in the world and the Philippines. Dimensions cover physical geography, i.e., coastal compactness, terrain ruggedness, and climate, as well as demographic and economic variables, namely trade patterns, poverty gap, natural resource rents, and GDP per capita. Comparators were chosen from the countries that emerged closest in "distance" to the Philippines. Additional qualitative judgments further refined the list.

FIGURE 8: Power reliability measured by duration and frequency of power-supply related outages and interruptions



Energy

The high cost and unreliability of power raises production inefficiencies and limits opportunities for firm expansion.

Firms in the Philippines face among the highest electricity prices in Southeast Asia, constraining growth in power-intensive sectors (Ravago, 2023). In 2023, prices ranged from \$0.16 to \$0.21 per kWh, for industrial and residential rates, respectively.¹² Forty percent of firms report electricity as a major constraint, and nearly 20 percent describe it as their biggest obstacle, the highest among comparators (World Bank, 2024b).

Driving much of these prices is the high cost of generation. Coal and natural gas, fossil fuels which account for 80 percent of the Philippines’ energy mix, are costly to import and extract. The sector imports two-thirds of its coal supply, exposing users to high and volatile international prices.¹³ Meanwhile, domestic gas fields are rapidly approaching depletion, further raising dependence on imports and further exposing consumers to volatility.¹⁴ In response, the Philippines has pursued alternative domestic sources, including nuclear, solar, geothermal, and wind. Renewables are particularly promising—estimates of potential capacity reach as high as 1,200 GW— and have led to ambitious renewable supply targets of 50 percent by 2040.¹⁵ However, potential entrants into the sector struggle to participate in the market on account of regulatory hurdles and access to grid connection. On a more basic level, the country’s electric grid may lack the capacity to absorb and transmit additional supply.

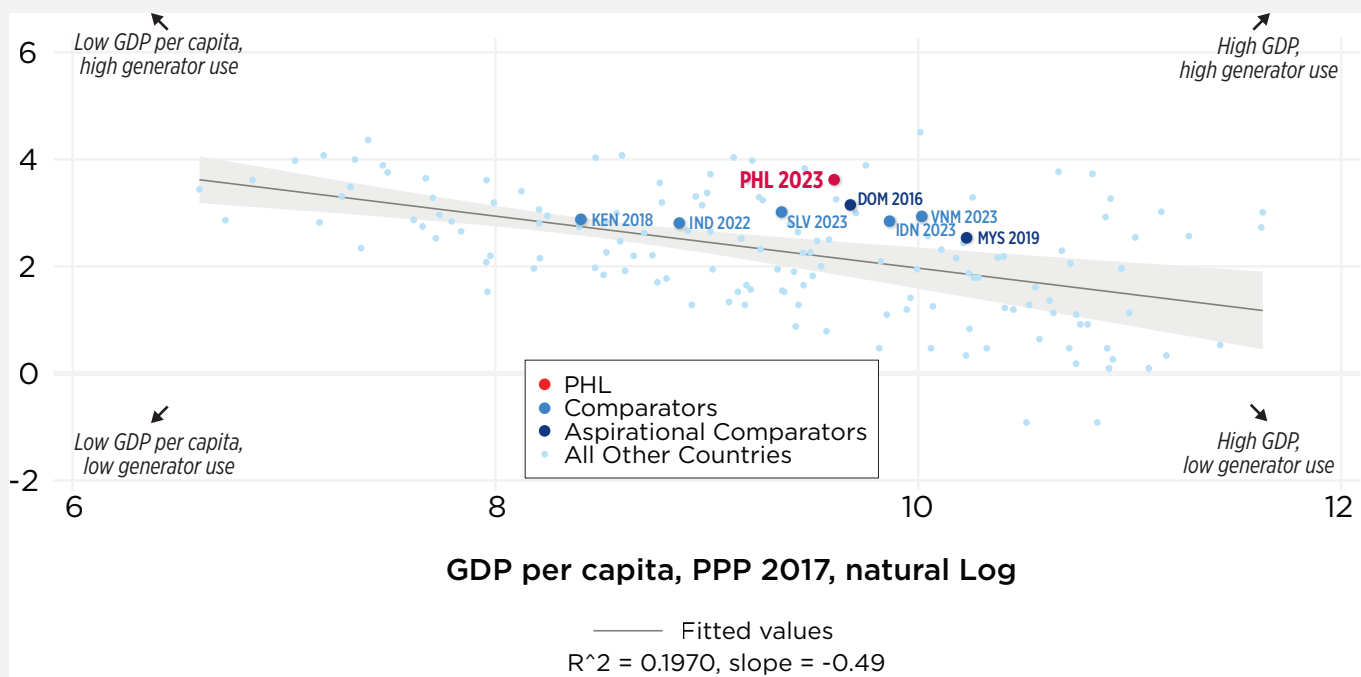
Meanwhile, despite high rates of consumer access to the grid (more than 95 percent), the quality and stability of supply is poor, with sizable variation across regions (Figure 8). Consequently, most firms own or have access to a generator and heavily rely on costly diesel-fueled generation to maintain operations (Figure 9). Behind much of the sector’s unreliability is the inadequate and intermittent supply, leading to both planned and unplanned outages (Francisco, 2022). Severe weather,

12 Prices taken from <https://www.globalpetrolprices.com/Philippines/>

13 International Energy Agency (2024). <https://www.iea.org/countries/philippines/coal>

14 <https://www.reuters.com/business/energy/philippines-marcos-signs-15-year-malampaya-gas-contract-renewal-2023-05-15/>

15 Climate Analytics, 2023; DOE.

FIGURE 9: If a generator is used, average proportion of electricity from a generator, in percentages, log

Source: World Bank Enterprise Survey, PHL 2024.

namely typhoons and strong storms, follow close behind, often disabling or damaging transmission and distribution infrastructure.

Separately, network unreliability also has roots in the power sector's fragmented structure of distribution. Nationwide, over 150 distribution utilities (DUs), half of which are non-profit electric cooperatives, supply electricity to relatively small markets, limiting economies of scale with respect to infrastructure, maintenance, and administration. Some evidence suggests that private DUs, motivated by performance-based incentives, offer greater service reliability than electric cooperatives (Francisco, 2022; ADB, 2018). Anecdotally, jobs in electricity coops also serve local political objectives, substituting loyalty for expertise that ultimately undermines quality of service. That said, cooperatives often exclusively serve remote or sparsely populated areas, where maintenance of distribution infrastructure is costly and technical expertise is often unavailable.

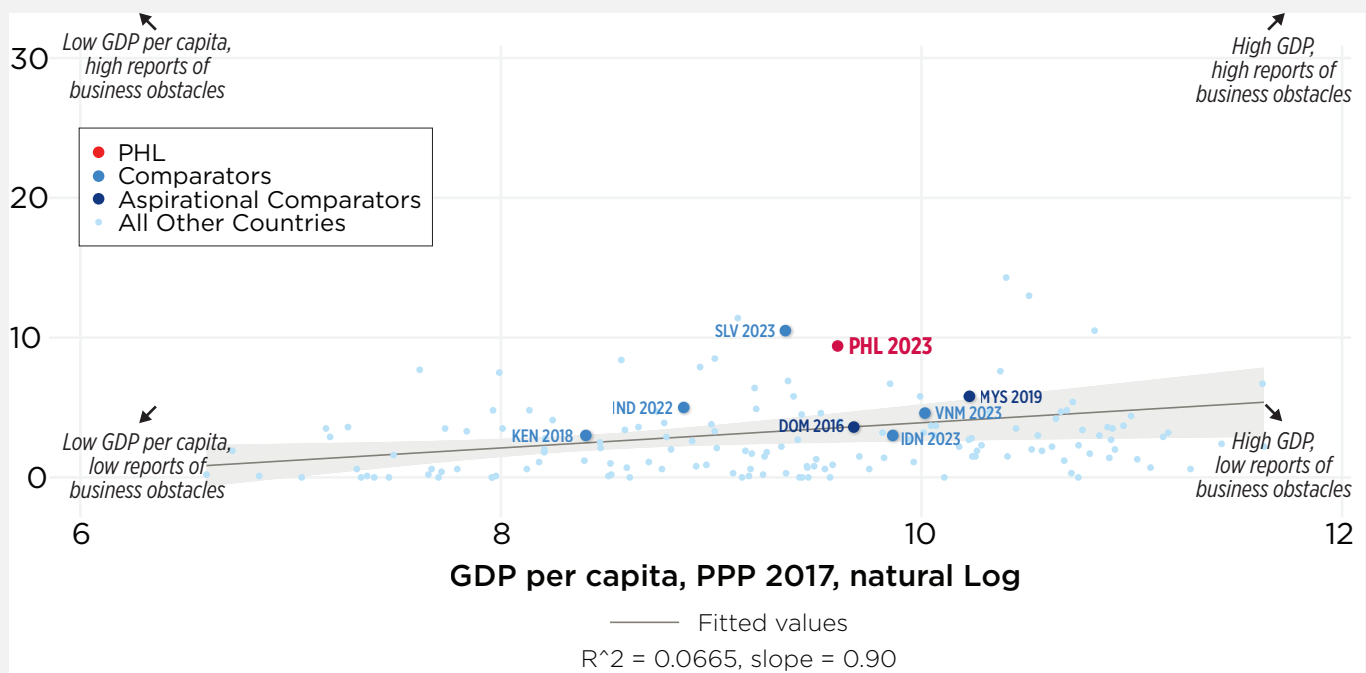
Local Governance

Poor governance at the local level limits investment opportunities and incentives for growth.

Stakeholders repeatedly pointed to the quality of local government units (LGUs) throughout the regions, particularly outside the NCR, as a significant impediment to private sector investment. Philippine firms report greater obstacles to business licensing and permits than all but a handful of countries in the sample (Figure 10).

In consultations, stakeholders asserted that national-level permits and requirements are manageable, but at the local level, a lack of policy coherence across localities significantly burdens firms, particularly micro, small, and medium enterprises (MSMEs). Much of this is due to the devolution of federal authorities and responsibilities to local governments beginning in 1991 (Juco et al., 2023). While this policy connected local communities with their governance more closely, the capacities and resources needed to execute these functions, e.g., road construction, education, and revenue collection, remain inadequate across much of the country. Accountability for these new roles remains blurred as well, inasmuch as

FIGURE 10: Percent of firms choosing business licensing and permits as their biggest obstacle



Source: World Bank Enterprise Survey, PHL 2024.

national and local roles often overlap, leading to confusion and gridlock.

Political dynasties in the Philippines also exert influence in every layer of governance. According to some accounts and empirical studies, the concentration of political power in the hands of elite political families is tied to poor development outcomes, especially in areas outside of Luzon (Mendoza et al., 2016). Reports suggest that local family politics can strongly determine the receptivity of a city, municipality, or barangay – the smallest level of local administration – to outside investment, whether through rent-seeking, neglect, or low capacity. Meanwhile, elite political families’ long-term ambitions to stay in power may also drive them to concentrate on local development via infrastructural investments or connections with firms to sustain their popularity. Although clientelist relationships with large firms can promote favorable business outcomes, those outcomes may not necessarily translate to other firms or broader segments of the local economy (Mendoza et al., 2022).

Some local authorities resist calls for reforms and instead perpetuate a status quo of rent-seeking at the expense of broad-based inclusive growth. Downstream outcomes

from these conditions, e.g., access to financial services, mirror the pattern in governance quality across the regions. Politicians and citizens often view elections transactionally, with investments more aligned with voting blocks than development goals. Mismatched timing of political and budget cycles, particularly at the local level, incentivizes short-term time horizons for public investment. As a result, development outcomes vary with the particular investment orientation of local leadership, with some communities standing out for their investor-friendly postures, e.g. Iloilo, Bacolod, Cagayan de Oro, and others.

Evidence of this constraint’s salience also manifests in the extent to which actors, especially foreign firms, circumvent LGUs when setting up businesses in the Philippines. The country already hosts more than 400 special economic zones – locations set aside by the national government to host firms outside the authority of LGUs – and demand for more has led to the creation of new zones in unlikely places, e.g. single floors in office buildings. Special economic zones enable firms to comply with regulatory and tax obligations more efficiently, offer tax holidays, and add certainty to the business environment. Despite the pure export focus of these zones, special

FIGURE 11: Net service and Dwell Times, by Region at Berth and Anchorage

Source: Philippine Ports Authority, 2024.

economic zones are home to some of the country's fastest growing emerging sectors such as manufacturing and BPM.

Transportation and Logistics Bottlenecks

Concentrated growth in the NCR coupled with lagging transport infrastructure elsewhere has created bottlenecks in the movement of goods, both international and domestic.

Booming growth in the NCR over the past two decades has cemented its status not only as the country's center of goods demand but also as the go-to hub for distribution and trans-shipment of international cargo (Figure 11).¹⁶ Indeed, some of the fastest growing municipalities in the Philippines extend from the NCR to the southern Luzon port of Batangas. Yet firms in the region identify transport as their biggest obstacle at one of the highest rates in the world (Figure 12).

Agglomeration economies in the NCR explain some of this dynamic, but firms' willingness to bear high congestion costs in the NCR suggests relatively worse conditions outside the NCR. Specifically, inadequate port

infrastructure in the regions, a consequence of lagging investment at both national and local levels, effectively diverts foreign ships to NCR's ports, further reinforcing its primacy as a transport hub.¹⁷ As a result, southern Luzon is the largest cargo hub by volume and among the slowest in shipping dwell times, driving congestion and delays (Philippine Ports Authority, 2022).

Evidence of similar logistics performance in comparable countries, e.g., Indonesia, points to the underlying challenges posed by island geographies and the multi-modal transport it compels. Beyond the barriers of geography and the limits of infrastructure, however, Philippine firms also report outsized obstacles to customs compliance, adding additional time and costs to transport, especially for exports (Figure 13). Taken together, inter-island connectivity remains a significant challenge to firms' ability to access inputs and move final goods.

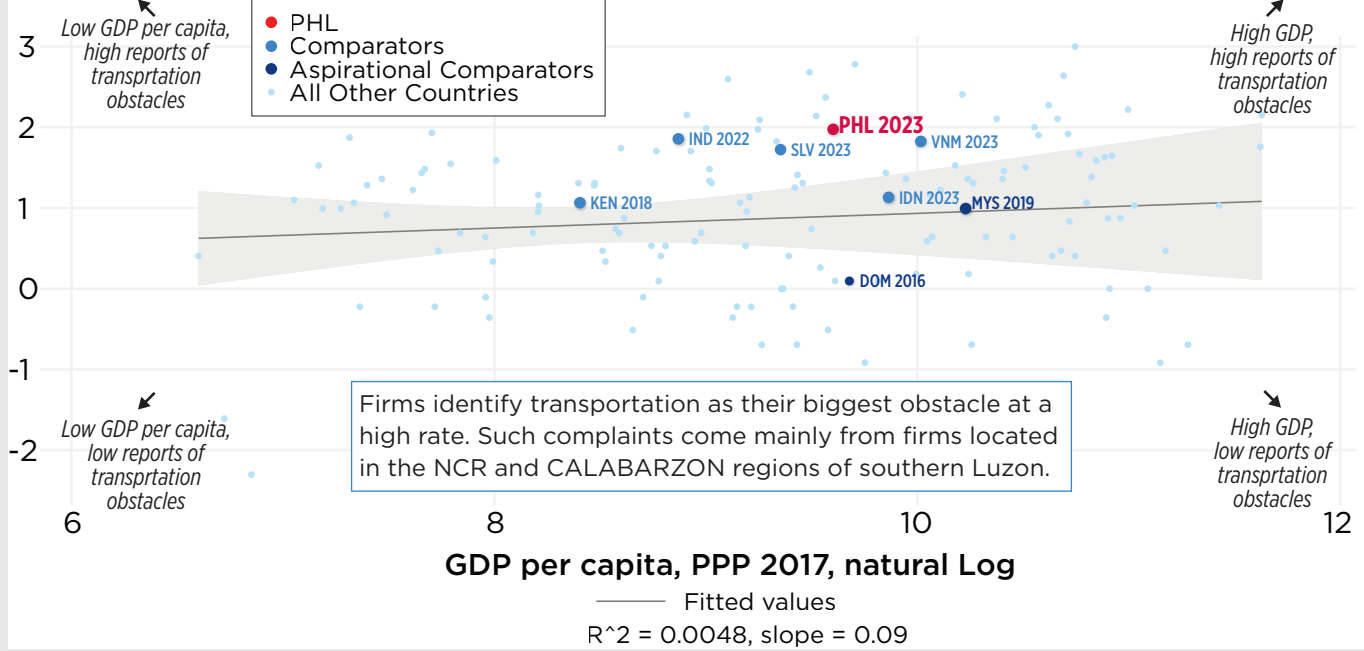
Agriculture

Constraints to economies of scale in agricultural production and protectionist trade policies limit productivity and increase the country's food insecurity.

¹⁶ Transshipment refers to the transfer of goods or cargo from one mode of transportation to another, e.g., from a truck to a boat, before they reach their final destination.

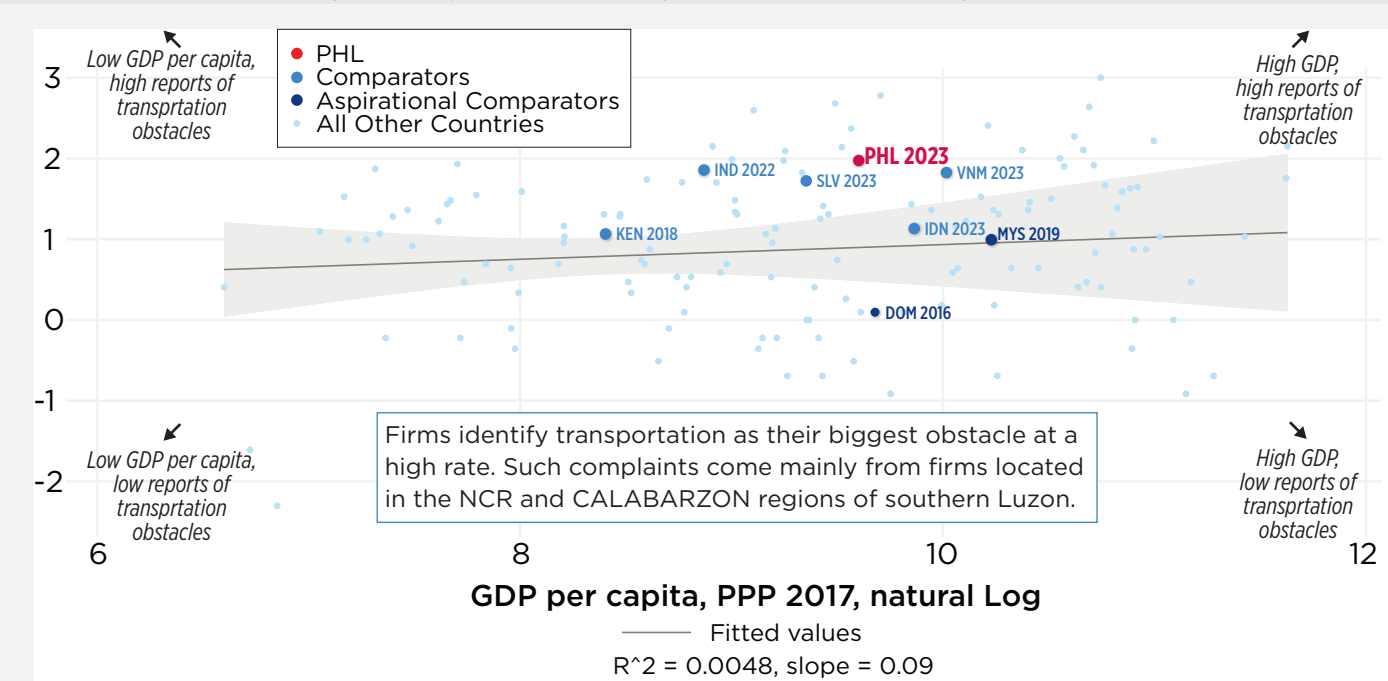
¹⁷ Inadequate transport infrastructure is particularly pronounced in the Bangsamoro Autonomous Region of Muslim Mindanao, driven by historical exclusion and the consistent armed conflict and displacement over the last 60 years (World Bank 2019b).

FIGURE 12: Firms choosing transportation as their biggest obstacle, as percentage



Source: WB Enterprise Survey, PHL 2024.

FIGURE 13: Burden of customs procedures, rated 1 as extremely inefficient to 7 as extremely efficient



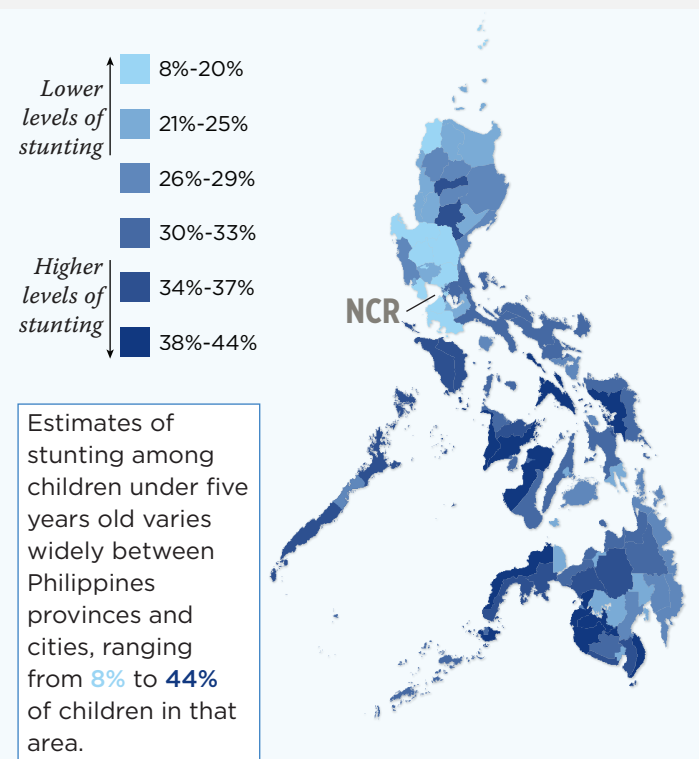
Source: World Bank World Development Indicators, 2023.

Moderate food insecurity afflicts up to 45 percent of the Philippine population, closely tracking the country’s spatial patterns of poverty.¹⁸ Stunting, a stark physical manifestation of food insecurity, afflicts nearly 30 percent of children under the age of 5 (Figure 14). Twenty percent of infants are born underweight (FAOSTAT, 2024). Food insecurity’s downstream effects on nutrition, health, and human capital carry significant implications for this population segment’s productivity and income-generating potential. Behind this phenomenon are policies that limit economies of scale in food production and artificially raise the price of food via import tariffs (Figure 15). Each of these effectively reduce efficiency and competition in the food sector.

Following centuries of concentrated agricultural land-holding, the Philippines implemented a Comprehensive Agrarian Reform Program (CARP) in the 1980s to redistribute land to peasant farmers. In an effort to prevent backsliding on elite land aggregation, CARP capped farm sizes at 5 hectares (ha), limiting scale economies in production and diminishing growth in yields and output. For comparison, rice yields in Philippines average 20 percent below Indonesia, 30 percent below Vietnam, and nearly 50 percent below its own potential, i.e. the yield gap.¹⁹ To overcome this limitation, the government has pursued strategies to support cooperatives that aggregate the output of smallholders through collective management. However, these cooperatives often lack leadership, market power, and managerial capacity, resulting in limited productivity growth.

A separate driver of low productivity and higher prices is the Philippines historic protection of domestic rice farmers from import competition. Strict tariff-rate quotas effectively insulated this politically sensitive population from foreign sources, disincentivizing investments in farm productivity. The Government’s recent passage of the Rice Tariffication Law, which replaced quotas on rice with less onerous 35–50 percent tariffs, reduces some of the distortion, but productivity in the sector remains

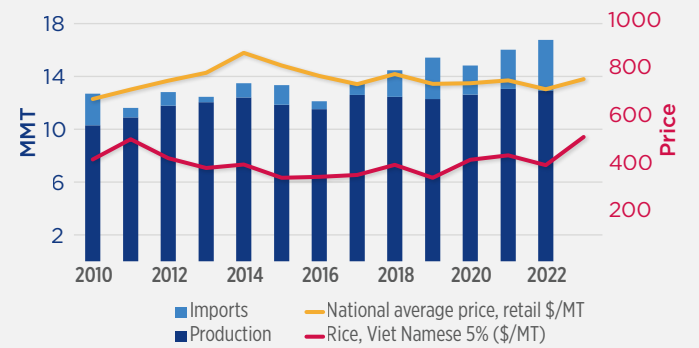
FIGURE 14: Stunting prevalence, percent of children under 5 years old



Source: 2018-2019, 2021 Expanded National Nutrition Survey (rolling sample), FNRI

FIGURE 15: Rice imports and production & rice prices

The Philippines increasingly relies on rice imports to meet its domestic demand, but its retail prices remain very high for the region, a consequence of the country’s market distorting trade restrictions.



Source: FAOSTAT (2024).

¹⁸ Moderate food insecurity refers to reduced quality and/or quantity of food intake, uncertainty about accessing food in the future, or a need to engage in coping strategies such as reducing the diversity of foods consumed or relying on less preferred or less nutritious foods.

¹⁹ Country comparisons taken from FAOSTAT (2024). Yield gaps capture the difference between current yield performance and performance under ideal input and management conditions. Yield gap details are available at Global Yield Gap Atlas.

stagnant.²⁰ In short, the Philippines simultaneously fails to fully supply its domestic rice needs while discouraging access to cheaper supplies abroad. As a result, retail prices remain stubbornly high and volatile, particularly compared to other neighboring producers, resulting in higher food insecurity for millions of poor consumers.

Moreover, the changing climate's well-known impacts on agricultural systems are particularly pronounced in the Philippines. Predicted decreases in Philippine productivity range from 9 to 21 percent by 2050, brought on by floods, typhoons, and droughts that affect up to 85 percent of strategically important agricultural land in the country (World Bank, 2021). Without adequate adaptation measures, by 2050, projections suggest cereal production will fall by approximately 6 percent, food prices will rise by 4 to 24 percent, and the number of people at risk of hunger would increase by 13 percent (Rosegrant et al. 2016).

Other Constraint Areas Considered

In addition to the binding constraints to growth discussed above, this analysis examined other factors potentially affecting growth. MCC ultimately judged these factors to be relevant but not as impactful to growth in the context of the Philippines as the areas identified as binding constraints.

Human Capital

Despite the high supply of human capital in the country, indicators point to potentially higher unmet demand.²¹ The increasing complexity and diversity of the Philippine economy requires a workforce with more skills and capacities. Firms indeed report high rates of worker training relative to comparator countries, if not constraints

in finding qualified employees. Managerial positions in Philippines are unusually likely to be filled by foreigners, a counterpoint to the pattern of the Philippines exporting its labor overseas. Certain growing sectors such as IT and BPM, report human capital as more binding and some have created guaranteed positions for students willing to study in-demand skills (e.g., programming or health care).

Separately, school quality varies significantly across the regions, as reflected in poor PISA exam rankings, outcomes exacerbated by small education budgets, particularly in more remote and underserved regions. While this analysis did not find human capital to be an immediately binding constraint, growing the country's stock of skills and competencies to meet future needs is a critical step in advancing to upper middle-income status.

Access to Finance for MSMEs in Poor Areas

Evidence suggests access to finance is not a constraint at the national level. However, regional inequalities in the access to finance of MSMEs are visible. For example, one third of cities and municipalities are still unbanked, with 45 percent of those in the Mindanao island group (Bangko Sentral ng Pilipinas, 2024). Network penetration of 4G broadband cellular is 14 percentage points lower in rural areas than urban areas, in part owing to the population's dispersion across a vast island geography, creating unequal access to digital financial services (OpenSignal, 2019). Similarly, four in five MSMEs are located outside the NCR, but their share of total MSME credit is only 16 percent. MSME's access to finance, while not determined to be a critically binding constraint, bears consideration in later program design when assessing beneficiaries and specifying program logics.

²⁰ Following the conclusion of MCC's constraints analysis in May 2024, President Marcos issued an executive order to take effect in August that further reduced rice tariffs to 15 percent. Intended to dampen food price inflation and protect consumer budgets, the move also aimed to inject more competitiveness in the domestic farm sector (USDA, 2024).

²¹ The country's high rates of literacy, nearing 95%, approach developed country levels, and lower secondary school completion rates approach 90% (having slowly increased since the 1970's). These gains have been, in part, achieved via social protection programs like Pantawid Pamilyang Pilipino Program (4Ps),

Conclusion

MCC presented the four binding constraints identified in this report to the government of the Philippines in June 2024. Following feedback from counterparts, attention subsequently focused on two constraints: the high cost and unreliability of power and low quality of governance at the local level. A Root Cause Analysis began in June to understand the drivers behind these two constraints, including an in-country mission that featured visits to multiple sites across Luzon, Visayas, and Mindanao. This culminated in a workshop in Manila in July 2024.



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