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Philippines Country Case Study

*Strategic Directions for the United States International
Development Finance Corporation (DFC)*

LEAD AUTHOR
Daniel F. Runde

AUTHORS
Romina Bandura
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A Report of the CSIS PROJECT ON PROSPERITY AND DEVELOPMENT

CSIS

CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES

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Context

The Philippines has made significant strides towards economic development in recent years. Poverty has declined by 27 percent, the gross national income (GNI) per capita has almost doubled, and internet access has increased six-fold since 2009.¹ In fact, economic growth has remained above 6 percent annually since 2012, and the country's projected gross domestic product (GDP) growth will surpass the region's average in 2018 and 2019.² The Philippines is now on trend to be only a few years away from the GNI per capita threshold needed to be classified as an upper-middle income country by the World Bank (Table 1).³ The country now ranks 63.8 on the World's Economic Freedom Index, which is above the regional and world averages (60.6 and 60.8 respectively), to place the island nation in the "moderately free" category.⁴ Global credit rating agencies, Moody's and S&P, give the Philippines an investment credit rating of Baa2 with stable outlook and BBB with stable outlook, respectively.⁵ Improved credit ratings have attracted international donors such as Japan, China, South Korea, and the World Bank to compete for deals in the Philippines in recent years.

The Philippines' relative strengths include macroeconomic stability, the quality of its labor market, the size of its market, and business dynamism.⁶ Unfortunately, these strengths are offset by its weak infrastructure provision, institutional impediments to doing business, corruption, and substantial income inequality. The strongest pillar of the Filipino economy is the sheer size of the market both in terms of the country's GDP, estimated to amount to \$331 billion in 2018 (38th in the world out of 205 countries and territories), and its population size (more than 100 million people).⁷ Approximately 10 percent of the Philippines' population lives abroad, with remittances amounting to approximately 10.4 percent of the GDP in 2017, the majority of which come from Filipinos residing in the

1. "World Bank Open Data," The World Bank, <https://data.worldbank.org/>.

2. The World Bank, *Philippines Economic Update: Investing in the Future*, (Washington, DC: The World Bank, 2018), <http://pubdocs.worldbank.org/en/2807415238376587/Philippines-Economic-Update-April-15-2018-final.pdf>.

3. "GDP Growth (annual %)," The World Bank, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=PH>.

4. The Heritage Foundation, *2019 Index of Economic Freedom: Philippines* (Washington, DC: The Heritage Foundation, 2019), <https://www.heritage.org/index/pdf/2019/countries/philippines.pdf>.

5. "Philippines – Credit Rating," Trading Economics, <https://tradingeconomics.com/philippines/rating>.

6. "Philippines: The Global Competitiveness Index 2017-2018 edition," World Economic Forum, April 2017, http://www3.weforum.org/docs/GCR2017-2018/03CountryProfiles/Standalone2-pagerprofiles/WEF_GCI_2017_2018_Profile_Philippines.pdf.

7. "Gross Domestic Product 2018," The World Bank, <https://databank.worldbank.org/data/download/GDP.pdf>.

Middle East and the United States.^{8,9} Remittances constitute a significant proportion of the country's GDP, especially when compared to neighboring countries such as Thailand (1.4 percent), Malaysia (0.5 percent), and Japan (0.1 percent).¹⁰

For the past decade, the Philippines has received the lowest foreign direct investment (FDI) inflows in the region, showing negligible progression that remains under \$10 billion annually. While other countries in the Association of Southeast Asian Nations (ASEAN) such as Singapore, Thailand, and Indonesia have seen noticeable fluctuations in their FDI inflows since the late 1990s, the Philippines' FDI has remained constant. Singapore is in the lead with \$82 billion of FDI inflows or 15.7 percent of the region's total, whereas the Philippines' FDI inflow accounts for a feeble 1.9 percent of the region's total. The Philippines' FDI investments largely come from a few actors: Japan (making up 30 percent of investments in 2017), followed by Taiwan and Singapore at a high of about 10 percent each, and the United States at 8.3 percent.^{11,12}

In terms of trade, main export markets for Philippines include Asia, North America, and Europe.¹³ In 2017, 20 percent of all Philippine exports went to China, with Hong Kong and the United States close behind at 15 percent and 13 percent respectively.¹⁴ Electrical machinery and equipment account for 49 percent of total exports, and technological equipment (e.g., computers), make up 14 percent of total exports; in addition, the country possesses a rapidly growing fruits and nuts export sector (3.1 percent of total exports).¹⁵ The Philippines' biggest source of imports is China (with a 21 percent share of total imports), primarily through integrated circuits and refined petroleum.¹⁶ Japan and South Korea are also premier trading partners. United States represents approximately 8 percent of the Philippines' total imports in the form of integrated circuits; wheat and soybean meal; and planes, helicopters, and spacecraft.¹⁷

The United States has a unique relationship with the Philippines because the island nation is the United States' sole former colony in Asia. Ideas of religious freedom, free education, and democracy are a direct result of U.S. influence in the Philippines. Furthermore, the fact that English is the country's second national language is indicative of the United States' impact, as well as the nation's affinity for American music, cuisine, and fashion. The United States has long been a partner to the Philippines, but as China and others have arrived on the global stage as development catalysts, U.S. influence has

8. "Personal remittances, received (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS?locations=PH>.

9. The World Bank, *Philippines Economic Update: Investing in the Future*.

10. "Personal remittances, received (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS?locations=PH-ID-MY-SG-TH-JP>.

11. "The Philippines: Foreign Investment," Santander Trade, July 2019, <https://en.portal.santandertrade.com/establish-overseas/philippines/foreign-investment>.

12. "Foreign Direct Investment, net inflows, BoP current US\$," The World Bank, <https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=PH-Z4>.

13. Daniel Workman, "Philippines Top 10 Exports," *World's Top Exports*, June 1, 2019, <http://www.worldstopexports.com/philippines-top-10-exports/>.

14. "Where does the Philippines import from? (2009)," The Observatory of Economic Complexity (OEC), https://atlas.media.mit.edu/en/visualize/tree_map/hs92/import/phl/show/all/2009/.

15. Ibid.

16. "What does China export to the Philippines? (2017)," OEC, https://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/chn/phl/show/2017/.

17. "Highlights of the Philippine Export and Import Statistics : December 2018," Philippine Statistics Authority, February 12, 2019, <https://psa.gov.ph/statistics/foreign-trade/fts-release-id/137717>.

dwindled and, to many, the United States lacks visibility. President Duterte has called for significant reductions in crime and has pushed forward a “Golden Age of Infrastructure” agenda as some of the key goals of his administration.¹⁸ With the proper approach, the U.S. International Development Finance Corporation (DFC) can be a part of this wave of reforms, invest in infrastructure and other underserved sectors, and reinvigorate Filipino attitudes toward the United States.

18. European Chamber of Commerce of the Philippines, “BUILD, BUILD, BUILD: a closer look at the administration’s ambitious infrastructure program,” *EuroPH Connect* 33, no.3 (May/June 2017), 21-23, <https://www.eccp.com/storage/app/media/europh-connect/EuroPH%20Connect%20May-June%20Final%20File%20V2.pdf>.

Table 1: Country Summary

Population (2018)	106.6 million. ¹⁹
Population under 25 years old	52.7 million, 50.2% of population. ²⁰
GDP per capita (2018)	\$3,103 ²¹ Lower Middle-Income Country ²²
Fragility	The Philippines now ranks 50th in the world out of 179 countries for most fragile states according to The Fund for Peace's Fragile State Index (2019). ²³ Terrorism is one of the biggest concerns in the country and contributes to the country's fragility. Despite the Fund for Peace ranking, the Philippines is not a fragile state according to the OECD. ²⁴
Main economic sectors	GDP by sector, (2018, %): Agriculture: 9.2% ²⁵ Industry: 30.7% ²⁶ Services: 60% ²⁷ Employment by sector in 2018 (% of total employment): Agriculture 25.2% ²⁸ Industry 18.3% ²⁹ Services 56.5% ³⁰
FDI net inflows (2017)	\$10 billion. ³¹
U.S. presence	Mainly USAID and USTDA programs
Private sector development	The outdated and inefficient legal system in the Philippines hinders the development of its private sector. Combined with the difficulty of accessing funding, the private sector, especially MSMEs, have difficulty expanding. ³²
Financial markets development	From a ranking of 0 (worst) to 1 (best) in the Financial Markets Development Index, the Philippines scores 0.365 (a ranking of 56 out of 183 countries), with a financial institutions subindex score of 0.342 (104/183) and financial market subindex score of 0.381 (42/183). ³³

19. "Population, total," The World Bank, <https://data.worldbank.org/indicator/SP.POP.TOTL?locations=PH&view=chart>.

20. United Nations Department of Economic and Social Affairs (DESA), *United Nations Demographic Yearbook* (New York, NY: United Nations, 2018), <https://unstats.un.org/unsd/demographic-social/products/dyb/dybs-sets/2017.pdf>.

21. "GDP per capita (current US\$)," The World Bank, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=PH>.

22. "World Bank Country and Lending Groups," The World Bank, 2019, <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519>.

23. "Fragile States Index: Philippines," Fund for Peace, 2019, <https://fragilestatesindex.org/country-data/>.

24. Organization for Economic Cooperation and Development (OECD), *States of Fragility 2018* (Paris, France: OECD, 2018), <http://www.oecd.org/dac/states-of-fragility-2018-9789264302075-en.htm>.

25. "Agriculture, forestry and fishing, value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=PH>.

26. "Industry (including construction), value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.IND.TOTL.ZS?locations=PH>.

27. "Services, value added (% of GDP)," The World Bank, <https://data.worldbank.org/indicator/NV.SRV.TOTL.ZS?locations=PH>.

28. "Employment in agriculture (% of total employment) (modeled ILO estimate)," The World Bank, <https://data.worldbank.org/indicator/SL.AGR.EMPL.ZS?locations=PH>.

29. "Employment in industry (% of total employment) (modeled ILO estimate)," The World Bank, <https://data.worldbank.org/indicator/SL.IND.EMPL.ZS?locations=PH>.

30. "Employment, Philippines," The World Bank, <https://data.worldbank.org/indicator/>.

31. "Full-Year 2017 FDI Hit All-Time High of US\$10 Billion," Bankgo Sentral NG Pilipinas, March 12, 2018, <http://www.bsp.gov.ph/publications/media.asp?id=4630>.

32. Bertelsmann Stiftung, *BTI 2018: Philippines Country Report*, (Gütersloh, Germany: Bertelsmann Stiftung, 2018), <https://www.bti-project.org/en/reports/country-reports/detail/itc/PHL/>.

33. Katsiaryna Sviridzenka, *Introducing a New Broad-based Index of Financial Development*, (Washington, D.C.: IMF, 2016), <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Introducing-a-New-Broad-based-Index-of-Financial-Development-43621>.

Opportunities and Challenges for Private Sector Development

The dynamism of the Filipino economy and the development of the private sector is hindered by a number of weaknesses. In the 2017 executive opinion survey from the World Economic Forum, there were several major factors listed as serious impediments to doing business in the Philippines. The factors were ranked on a weighted scale based on the responses from the participants in the survey. “Inefficient government bureaucracy” scored a 19.7 out of 20, making it the top concern chosen in the survey. Of the many underlying factors in this category, “number of procedures to start a business” and “time to start a business” were some of the Philippines’ most poorly-rated areas.³⁴ “Inadequate supply of infrastructure” scored a 17.9, with “quality of air transport infrastructure” and “quality of port infrastructure” both flagged as being in particularly poor condition.³⁵ “Corruption” ranked third with a score of 13.7, and the underlying factors of “favoritism in decisions of government officials” and “reliability of police services” weighed heavily on this score.³⁶

The World Bank’s 2019 Doing Business Report on the Philippines also contains insight as to what is holding back business operations. In multiple categories, the Philippines was ranked near the bottom of all countries examined in the full report. Out of the 190 countries considered in the rankings, the Philippines was ranked as the following: 184th in “Getting Access to Credit,” where lack of credit information and weak legal rights were seen as impediments;³⁷ 166th in “Starting a Business,” where the length of time required to complete all formal procedures ranked as a crucial hurdle;³⁸ and 151st in “Enforcing Contracts,” where again, the length of time regarding the legal process of enforcing a contract was a top concern.³⁹

Similarly, the 2015 World Bank Enterprise Survey for the Philippines took a more concentrated look at the issues confronting businesses. The main challenges Filipino firms identified, among others, were “Informality” (chosen by 20 percent of firms),

34. “The Global Competitiveness Index,” World Economic Forum.

35. Ibid.

36. Ibid.

37. The World Bank, *Doing Business 2019: Philippines* (Washington DC: The World Bank, 2019), <https://www.doingbusiness.org/content/dam/doingBusiness/country/p/philippines/PHL.pdf>.

38. Ibid., 6.

39. Ibid., 52.

where firms indicated they had to compete against unregistered or informal firms;⁴⁰ “Corruption” (chosen by 11.5 percent of firms), where expectations to give gifts to government officials for things such as import licenses and construction permits were picked as major obstacles;⁴¹ and “Access to Finance” (chosen by 10.4 percent of firms), where the value of collateral needed for a loan and the necessity of financing investments internally were seen as obstacles.⁴²

Private sector growth in the Philippines is hampered by the strict regulatory framework by which businesses are forced to operate. These regulations fall substantially under three categories: i) significant state intervention, ii) barriers to entry, and iii) restrictions to foreign investment. In 2016, government-owned and controlled corporations (GOCCs) accounted for 193 firms in the Philippines. Distinct to the Philippines, these organizations exist outside of the infrastructure sector, where private participation is often viable. According to the Philippines private market regulation (PMR) questionnaire, the government has at least partial ownership of 18 of the 27 industries evaluated. Throughout most of the major industries in the Philippines, regulations exist which attempt to limit foreign direct investment.⁴³ Additionally, Philippine law dictates that only citizens of the Philippines and companies with more than 60 percent domestic ownership can purchase land, creating steep barriers to entry for foreign interests. Restrictive regulations on building permits and foreign investment approvals, in addition to the rising domestic interest rates, act as disincentives to private-sector borrowings and new foreign investment growth.⁴⁴

Restrictive regulations on building permits and foreign investment approvals, in addition to the rising domestic interest rates, act as disincentives to private-sector borrowings and new foreign investment growth.

Moreover, the quality of infrastructure—mainly poor transport networks, unreliable energy sources, and spotty internet access—hinders economic productivity and social mobility. The Philippines is consistently among the lowest of the ASEAN countries in quality infrastructure.⁴⁵ The country has consistently ranked below the region’s average and often falls to the bottom two countries when it comes to roads, railroads, ports, air transport, electricity supply, and overall infrastructure.⁴⁶ In addition, there is weak private sector participation in infrastructure, which makes the Philippines’ capital stock of 35

40. “Enterprise Survey for the Philippines: 2015,” The World Bank, <https://www.enterprisesurveys.org/data/exploreconomies/2015/philippines#informality>.

41. Ibid.

42. Ibid.

43. Graciela Miralles Murciego, Roberto Martin Nolan Galang, Sara Nyman, Tilsa Guillermina Ore Monago, and Leandro Deambrosio Zipitria, *Fostering Competition in the Philippines: The Challenge of Restrictive Regulations* (Washington DC: The World Bank, 2018), <http://documents.worldbank.org/curated/en/478061551366290646/Fostering-Competition-in-the-Philippines-The-Challenge-of-Restrictive-Regulations>.

44. The World Bank, *Philippines Economic Update: Investing in the Future*.

45. Takuji Komatsuzaki, *IMF Working Paper: Improving Public Infrastructure in the Philippines* (Washington, DC: IMF, 2016), <https://www.imf.org/external/pubs/ft/wp/2016/wp1639.pdf>.

46. Ibid.

percent of GDP (2013) one of the lowest in the ASEAN, where the average is about 75 percent. Filipino investment in transport in conjunction with private participation totaled \$2.5 billion in 2016 but fell to \$745 million in 2017.⁴⁷

The Japan International Cooperation Agency (JICA) has expressed the urgent need for intervention in the Philippine's increasingly worrying infrastructure, with higher costs to be expected in the coming years if the traffic congestion is not addressed.⁴⁸ For example, Manila's traffic congestion consistently ranks as some of the worst in the world and the country has the highest sea transport costs in the ASEAN.^{49,50} Filipinos are active mobile phone and social media users, yet the country possesses the second slowest broadband Internet speed in the world.⁵¹ The Philippines is an archipelago of over 7,000 islands, which makes connectivity amongst all Filipinos a challenge. The Philippines needs to ensure its future infrastructure projects are of quality and resilient enough to withstand earthquakes, typhoons, and other effects of climate change or else it will continue to lag behind its ASEAN neighbors.

47. "Infrastructure," The World Bank, <https://data.worldbank.org/topic/infrastructure?locations=PH>.

48. Ian Nicolas P. Cigaral, "Philippines' infrastructure challenge: A huge gap or a black hole?" *BusinessWorld*, January 7, 2018 <https://www.bworldonline.com/philippines-infrastructure-challenge-huge-gap-black-hole/>.

49. Reuters, "Manila's traffic jams are so bad, even President Rodrigo Duterte has been forced to admit failure," *South China Morning Post*, February 27, 2019, <https://www.scmp.com/news/asia/southeast-asia/article/2187836/manilas-traffic-jams-are-so-bad-even-president-rodrigo>.

50. Arangkada Philippines, *Seaports and Shipping: Policy Brief No. 9* (Makati City, Philippines: American Chamber of Commerce of the Philippines, 2018), <http://www.investphilippines.info/arangkada/wp-content/uploads/2015/09/Seaports-24Aug2018-SEPT11-compressed.pdf>.

51. Akamai, *Q1 2017 State of the Internet - Connectivity Report* (Cambridge, MA: Akamai, 2017), <https://www.akamai.com/us/en/multimedia/documents/state-of-the-internet/q1-2017-state-of-the-internet-connectivity-report.pdf>.

Fostering Private Sector Growth and Countering China: The Role of the New DFC

Several development partners are working in the Philippines to assist the country in filling its developmental gaps (Boxes 1 and 2). The Philippines received a total of \$14.8 billion in official development assistance (ODA) in 2017, with \$12.3 billion allocated across 70 loans while the remaining \$2.5 billion was appropriated for 352 grants.⁵² Japan, through JICA, is the main provider with \$5.9 billion in loans and grants in 2018 (or 41 percent of the country's total ODA), mainly in the areas of infrastructure and health provision.^{53,54} The United States is the leading provider of grants to the Philippines with over \$1.3 billion provided.⁵⁵ The main U.S. agencies that currently have active programs in the Philippines include USAID, the U.S. Trade and Development Agency (USTDA), the Overseas Private Investment Corporation (OPIC), and the Department of Commerce (Box 3).

52. The National Economic and Development Authority (NEDA), ODA Portfolio Review Report, (Pasig City, Philippines: NEDA, 2017), http://www.neda.gov.ph/wp-content/uploads/2018/10/2017-ODA-Portfolio-Review_online_10.05.18-1.pdf.

53. Melissa Luz T. Lopez, "Japan still Philippines' top ODA partner," *BusinessWorld*, December 28, 2018, <https://www.bworldonline.com/japan-still-philippines-top-oda-partner/>.

54. "Philippines - Project Financing," Export.gov, November 27, 2018, <https://www.export.gov/article?id=Philippines-Project-Financing>.

55. NEDA, *ODA Portfolio Review Report*.

BOX 1: MULTILATERAL DEVELOPMENT BANKS OPERATING IN THE PHILIPPINES

- **Asian Development Bank (ADB):** Headquartered in Manila with a staff of over 3,000 (60 percent of which work in the Manila office), the ADB is one of the Philippines' top multilateral development partners, with an average annual lending of \$800 million over the past decade.⁵⁶ As of December 2018, the ADB's cumulative lending, grant, and technical assistance commitments from various sectors totaled \$19.3 billion, spanning 682 projects for a 20 percent share of the Philippines' total ODA in 2018.⁵⁷ The majority of these projects are in public management (85 projects for \$5.1 billion) and energy (76 projects for \$3.4 billion). The latest projects approved by the ADB include a loan for the Malolos-Clark Railway Project (PFR 1), costing \$2.7 billion, of which the bank will finance \$1.3 billion.⁵⁸ Another project approved in May 2019 is the Secondary Education Support Program, where the ADB will finance \$300 million of the total \$24 billion.⁵⁹
- **World Bank Group:** The World Bank Group has been a solid partner to the Philippines for over 70 years. This partnership has been recently reinforced through its country partnership strategy for the Philippines (2015-2019), which focuses on poverty reduction, as well as the 2015 Philippine Rural Development Project (PRDP), which seeks to help improve rural incomes and market access.^{60,61} The World Bank, through the International Bank for Reconstruction and Development (IBRD) and International Finance Corporation (IFC), is the second-largest development partner in the country, with \$450 million in operations approved for FY 2019 and a total portfolio of 315 projects, of which 23 are active.⁶² In March 2019, IBRD and the International Development Association (IDA) jointly committed \$450 million to the improving fiscal management project and pledged \$207 million in 2017 for the Metro Manila Flood Management Project.⁶³ Since 1962, the private sector arm of the World Bank, IFC, has had an active advisory service program in the country, focusing on enhancing the investment climate, climate finance, public and private

56. "Asian Development Bank and the Philippines: Fact Sheet," Asian Development Bank, July 2019, <https://www.adb.org/publications/philippines-fact-sheet>.

57. "Philippines: By the Numbers," Asian Development Bank, <https://data.adb.org/dashboard/philippines-numbers>.

58. "Philippines: Malolos-Clark Railway Project (PFR 1)," Asian Development Bank, <https://www.adb.org/projects/52083-002/main#project-pds>.

59. "Philippines: Secondary Education Support Program," Asian Development Bank, <https://www.adb.org/projects/45089-004/main#project-pds>.

60. "The World Bank in the Philippines," The World Bank, <https://www.worldbank.org/en/country/philippines/overview#2>.

61. "Philippine Rural Development Project," The World Bank, <http://projects.worldbank.org/P132317/philippine-rural-development-program?lang=en>.

62. "Projects and Operations," The World Bank, http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=PH.

63. "Metro Manila Flood Management Project," The World Bank, <http://projects.worldbank.org/P153814/?lang=en&tab=overview>.

partnership projects, disaster insurance, sustainable agribusiness, and financial inclusion, with a commitment of \$661 million as of 2018.⁶⁴

- **The Asian Infrastructure Investment Bank (AIIB):** The AIIB, which opened its doors in 2016, currently has a relatively small footprint in the Philippines but will likely become a larger player in coming years. According to data from the Philippines National Economic and Development Authority (NEDA)'s 2017 ODA portfolio review, the AIIB ranked 10th in ODA with only one loan worth \$207.6 million (a 1.4 percent share of total ODA to the Philippines). This loan is to be disbursed in conjunction with the World Bank and the government of the Philippines to improve flood management in select drainage areas of Metro Manila.⁶⁵ Manila is in great need of infrastructure—recent speculations have described the AIIB as highly interested in this sector, with explorations into financing options taking place for the Camarines Sur Expressway and Pasacao-Balatan Tourism Coastal Highway in the Camarines Sur province (southeast of Manila) last year.⁶⁶ In 2018, the AIIB was looking to build off of their initial investments into the drainage systems by financing other infrastructure projects.⁶⁷
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64. "IFC in the Philippines," International Finance Corporation, https://www.ifc.org/wps/wcm/connect/region__ext_content/ifc_external_corporate_site/east+asia+and+the+pacific/countries/ifc-in-philippines.

65. AFP, "As US relations sour, Philippines taps China - backed AIIB to fix crumbling infrastructure," *South China Morning Post*, December 19, 2016, <https://www.scmp.com/news/asia/southeast-asia/article/2055748/us-relations-sour-philippines-taps-china-backed-aiib-fix>.

66. Ben O. de Vera, "AIIB eyes funding for 2 big-ticket PH projects," *Philippine Daily Inquirer*, August 31, 2018, <https://business.inquirer.net/256411/aiib-eyes-funding-2-big-ticket-ph-projects>.

67. Ibid.

BOX 2: MAIN BILATERAL PARTNERS IN THE PHILIPPINES

- **The Japan International Cooperation Agency (JICA):** One of the major strategic bilateral development partners of the Philippines is JICA, whose work in the country spans more than six decades. In December 2011, the Japan-Philippines Economic Partnership Agreement also came into effect, aimed at creating employment opportunities, furthering poverty reduction, and fomenting peace and stability in Mindanao through the further promotion of investment.⁶⁸ JICA is the largest provider of ODA to the Philippines, contributing \$5.3 billion out of the \$14.7 billion the Philippines received in 2017.⁶⁹ JICA's investments are concentrated in infrastructure development (expressways, road bypasses) and health prevention and treatment projects.⁷⁰ JICA supports the Philippines' development primarily through loans, but also through aid and technical assistance.⁷¹
- **China:** Since President Rodrigo Duterte's visit to China in 2016, the Philippines has received more than \$24 billion in Chinese FDI and foreign aid in order to finance the country's \$180 billion Build, Build, Build program.⁷² While the figures suggest reasons to be optimistic about improvements to Filipino infrastructure, according to the US-Philippines Society, studies have found that of the \$24 billion received from China in 2016, \$15 billion came from Chinese "private" businesses whose negotiations with the Duterte administration have either been stalled, modified, or canceled.⁷³ Despite several announcements, for now, China remains a smaller development player in the Philippines compared to Japan and the United States. According to the latest data, China vowed to provide \$9 billion in ODA in 2016, but that figure has remained unfulfilled as of 2018.⁷⁴ The Philippines remains cautious not to fall into the "Chinese debt-traps" often observed in other developing countries like Sri Lanka.⁷⁵ Despite these concerns, however, a rift is being created between the Philippines and their U.S. allies due to increased diplomatic and developmental proximity with China.⁷⁶

68. "Country Assistance Policy for the Republic of the Philippines," Embassy of Japan in the Philippines, April 2012, <https://www.ph.emb-japan.go.jp/bilateral/image/oda%202010%20update/countryassistancepolicy.pdf>.

69. NEDA, *ODA Portfolio Review Report*.

70. "Maps of JICA major projects," JICA, October 01, 2018, https://libportal.jica.go.jp/library/Data/PlanInOperation-e/SoutheastAsia/012_Philippines-e.pdf.

71. "JICA Philippines operations map," JICA, February 2019, https://www.jica.go.jp/philippine/english/activities/c8h0vm00004cez31-att/index_01.pdf.

72. Karen Lema, "Duterte's 'Build, Build, Build' plans hit Philippine peso," Reuters, August 05, 2017, <https://www.reuters.com/article/us-philippines-economy-infrastructure-idUSKBN1AM01R>.

73. "China's Infrastructure Investments in the Philippines," US-Philippines Society, <https://www.usphsociety.org/2018/08/02/chinas-infrastructure-investments-in-the-philippines/>.

74. Julie McCarthy, "Will Political Strains Pull The China-Philippines Cozy Relationship Off Course?" National Public Radio, November 22, 2018, <https://www.npr.org/2018/11/22/670119606/will-political-strains-pull-the-china-philippines-cozy-relationship-off-course>.

75. Ralf Rivas, "Philippines 'extra careful' with China loans - NEDA," Rappler, June 27, 2018, <https://www.rappler.com/business/205903-philippine-government-extra-careful-china-loans-neda>.

76. Julie McCarthy, "Will Political Strains?"

- **Australia:** Australia's ODA to the Philippines in 2019-2020 is embarked for approximately \$79.7 million.⁷⁷ According to Australia's Department of Foreign Affairs and Trade, the economic partnership with the Philippines focuses on partnerships in "inclusive economic growth, effective governance, and peace and stability."⁷⁸
- **Other countries** such as South Korea are also increasingly interested in potential investments in the Philippines. A proposed FTA deal discussion between South Korea and the Philippines is due to take place in November 2019.⁷⁹ The European Union is also looking to produce an FTA agreement with the Philippines, which will expand their trading capabilities even further.⁸⁰

Although the United States has a significant presence in terms of development programs (Box 3), FDI, and trade, there has been a sense of U.S. neglect toward the Philippines among local business leaders since the 1990s. In place of the United States, Japan and China have invested heavily in large-scale rail, energy, road, and information and communications technology (ICT) projects. As a result of their efforts, those countries have become significantly more visible in Filipino society. This visibility is valuable not only to commercial interests, but also to diplomatic, military, and political interests.

77. "Overview of Australia's aid program to the Philippines," Australian Government Department of Foreign Affairs and Trade (DFAT), <https://dfat.gov.au/geo/philippines/development-assistance/pages/development-assistance-in-philippines.aspx>.

78. Ibid.

79. "South Korea and the Philippines agree to conclude FTA by November," Bilaterals.org, 18 April, 2019, <https://www.bilaterals.org/?south-korea-and-the-philippines>.

80. "Countries and Regions: The Philippines," European Commission, June 17, 2019, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/philippines/>.

**BOX 3: A BRIEF DESCRIPTION OF ACTIVE U.S. PROGRAMS
IN THE PHILIPPINES**

- The **United States Agency for International Development (USAID)** works closely with the Philippines in projects related to economic development and governance, education, environmental sustainability, health, humanitarian assistance, and assistance to Marawi (a city in Mindanao devastated by armed-forces conflict), which helps displaced peoples affected by armed forces and ISIS.⁸¹ In terms of economic development and governance, USAID has worked to implement E-PESO and a Mindanao Youth for Development initiative, which utilized more than \$1 million from local stakeholders to link youth to jobs, education, and training.^{82,83} USAID's total obligations to the Philippines were \$123.4 million in 2018 and \$25 million so far in 2019.⁸⁴ Top sectors for USAID activities include maternal/child health and family planning (\$22 million); government and civil society (\$17 million); and conflict, peace, and security (\$16 million). Partners such as RTI International and Development Alternatives Inc. annually contribute \$13 million and \$11 million respectively.⁸⁵
- In the Philippines, the **U.S. Trade and Development Agency (USTDA)** has focused primarily on energy, aviation security, environmentalism, and procurement training. In 2016, USTDA awarded a grant to the Philippines' Cagayan Electric Power and Light Company, Inc. (CEPALCO) to support the utilization of smart grid technologies to manage, monitor, and distribute electricity more efficiently. USTDA's Global Procurement Initiative (GPI) has worked to train government officials to incorporate tools such as life-cycle cost analyses, total cost of ownership, and savings over time into their procurement practices (see page 17).
- Two examples of past **Overseas Private Investment Corporation (OPIC)** programs in the Philippines are a) a \$2.5 million OPIC loan, which helped Quantum ID Technologies of Cambridge, Massachusetts, invest in an air cargo management system which will improve the competitiveness and efficiency of the air cargo industry in the Philippines,⁸⁶ and b) OPIC's landmark investment in the Philippines through WaterEquity's \$50 million flagship fund, where 4.6 million people across India, Indonesia, Cambodia, and the Philippines secured access to safe water or sanitation. In

81. "The Philippines: The Marawi Response Project (MRP)," Plan International USA, <https://www.planusa.org/the-philippines-marawi-response-project-mrp>.

82. "Welding Hopes & dreams: Out-of-school youth in the Philippines forge a brighter future," USAID, September 18, 2017, <https://usaidpubs.exposure.co/welding-hopes-and-dreams>.

83. "U.S. Foreign Aid by Country," USAID, https://explorer.usaid.gov/cd/PHL?fiscal_year=2018&implementing_agency_id=1&measure=Obligations.

84. Ibid.

85. Ibid.

86. "OPIC in Action: Regional Priorities," Overseas Private Investment Corporation (OPIC), June 14, 2019, <https://www.opic.gov/content/opic-action/regional-priorities>.

2019, OPIC financed \$10.5 million and committed \$20 million to two WaterEquity projects and also committed \$5 million towards a WaterHealth project, which aims to provide accessible purified water to poor communities across Cambodia, Indonesia, India, and the Philippines.⁸⁷

- **The U.S. Commercial Service**, the trade promotion wing of the Department of Commerce, helps small and medium-sized U.S. businesses increase international sales through business matchmaking, market intelligence, trade advocacy, and commercial diplomacy activities. In part due to efforts from the U.S. Commercial Service, the United States was the Philippines' second-largest export market, with 15 percent of total exports as U.S.-Philippines bilateral trade reached \$20 billion in 2017.⁸⁸
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As many development experts have noted, the United States cannot contend with China in the developing world on a dollar-for-dollar basis. China simply has too much capital and is willing to undercut its financial gains for long-term diplomatic and strategic influence. There is also a large discrepancy in terms of project completion speeds; whereas it may take about seven years for the United States and other development players to complete a project, China can finish the job in two or three. Chinese infrastructure is often said to be of poor quality with rapid degradation, yet this can be easily overlooked by governments when China offers to build a shiny new facility at a low cost and with a swift construction time. China is also notorious for its opaque contracts and “no questions asked” development policy, which remain significant barriers the United States must overcome when vying for deals in countries with poor procurement policies and ubiquitous corruption.

While China has risen significantly as a world development player, there is certainly opportunity for the United States to foster private sector development in the Philippines and offer an alternative development model through the DFC. In fact, many of China's deals with the Philippines have only been announced and lack any tangible progress (see Box 2).⁸⁹ The United States should reinforce its competitive advantages by enhancing U.S. presence, investing in key strategic sectors, collaborating with other U.S. development agencies and allies, and using development finance tools more creatively.

In addition to the competitive advantages which the United States possesses, it is helpful to consider how Filipinos think of their country's relationship with the United States, China, and their other allies. In a recent poll conducted by Pulse Asia in the Philippines, 89 percent of respondents stated they trusted the United States. This made the United States the most trusted ally in the survey, with Japan coming in second at 79 percent. On

87. “OPIC supports two projects to expand access to safe drinking water,” OPIC, June 14, 2019, <https://www.opic.gov/press-releases/2019/opic-supports-two-projects-expand-access-safe-drinking-water>.

88. “Philippines - Market Overview,” Export.gov, November 27, 2017, https://www.export.gov/article?series=a0pt0000000PAuhAAG&type=Country_Commercial_kav.

89. “Arangkada Philippines Major Infrastructure Tracker,” Joint Foreign Chambers of the Philippines, June 19, 2019, <http://www.investphilippines.info/arangkada/infrastructure-tracker/>.

the other hand, 74 percent said they did not trust China.⁹⁰ Similarly, the Social Weather Station published a survey from the end of 2018 where 44 percent of respondents said they did not think China's presence had the best interests of Filipinos in mind. Only 27 percent indicated they thought the Chinese government did have good intentions for them.⁹¹ Upon review of this data, it is clear the United States is well-positioned in the Philippines when it comes to favorability. Even as the Philippine government engages in aid deals with China for infrastructure, it appears the people are still apprehensive about that relationship. This means the DFC could possess yet another competitive advantage over similar types of offers from China.

Enhancing U.S. Presence through a New Development Approach

U.S. values and approaches such as transparency in procurement; free-market economic principles; technology transfer and local capacity building; strong environmental, governance, and social safeguards; debt sustainability assessments; and quality infrastructure standards can be leveraged against the Chinese model. While China offers tremendous speed and low costs, U.S. companies competing for contracts can illustrate that they may have higher costs in the short-term, but through lower lifecycle costs and the benefits of U.S. technical training, it becomes clear the United States is the better partner in the long term. The Philippines has millions of capable workers but many of them lack access to skills development. China often brings its own workers for projects and does not pass skills on to local laborers; the DFC has a great opportunity to demonstrate the cascading effects of technical training amongst a local population. Making this strong case is critical for the DFC and other U.S. agencies and allies to start winning more deals in the Philippines and other countries where China is investing heavily.

The DFC should not be another large, bureaucratic institution that operates slowly and increases red tape for project development. The DFC operations should underscore a series of key U.S. principles. First and foremost, the DFC is meant to increase U.S. visibility. This can be done by choosing two or three key investments that have significant development impact. Moreover, it must have more of an on-the-ground presence. Second, it should be speedier in the execution of its deals but without compromising standards. Third, to illustrate how the DFC provides a better offer than China, it needs to make a dedicated effort towards explaining the benefits of U.S. free-market principles; higher quality standards; and the innovation, expertise, and knowledge that it transfers to the country with each investment it makes. By emphasizing high standards and fostering relationships with locals, the resiliency of DFC projects will prompt Filipinos to recognize a renewed U.S. presence and perhaps convince them to work with the United States instead of China. Fourth, the DFC has a wider set of development finance tools at its disposal, and this gives the institution added flexibility in terms of both the kinds of investments and types of sectors it can support.

The DFC is meant to collaborate more closely with other U.S. agencies such as USAID, the Department of State, and the Millennium Challenge Corporation (MCC), but it can only

90. Xave Gregorio, "Pulse Asia: More Filipinos lose trust in China, Russia," CNN Philippines, July 26, 2019, <https://cnnphilippines.com/news/2019/7/26/Pulse-Asia-Russia-China-Filipinos-trust.html>.

91. Social Weather Survey, "Most Pinoys disagree that the Chinese government has good intentions for the Filipino people," *Social Weather Station*, April 5, 2019, <https://www.sws.org.ph/swsmain/artclldispage/?artcsy-scode=ART-20190405180119>.

do so if these other U.S. development actors understand what the DFC can do and plans to do. Without a coordinated understanding of the DFC's role in a broader foreign policy toolkit, U.S. development efforts will be distributed inefficiently and the value-add of the U.S. brand will be diminished. To counter this possible drawback, it is critical that DFC officials in Washington explain the functions and potential of the DFC to the foreign policy community and other U.S. agencies, especially the Department of State. In this regard, U.S. ambassadors in each country the DFC operates in should adapt their roles toward greater oversight of interagency coordination on the ground. Without a "commander" in charge of U.S. development efforts, the DFC's impact will be wildly inconsistent across countries and, in some instances, it may even harm the gains made by other development agencies that have been there for a greater period of time. The U.S. ambassador in these countries must ensure that the DFC and the range of other U.S. development agencies are working collaboratively, not competitively.

Moreover, the United States often "does development" in a piecemeal approach with various agencies supporting different needs with sparse coordination. The DFC should consider modeling itself after the Japanese framework of development finance. The Japan Bank for International Cooperation (JBIC) and JICA include a holistic package in their offers to the Filipino government; they come to the negotiating table with Japanese private sector firms in tow, a checkbook in hand, as well as an agreement to foster in-country technical capacity training. The DFC should highlight its allocations of in-country technical training when making offers for projects. Feasibility studies and technology training are areas where USAID and USTDA can partner with the DFC to help projects become commercially viable.

The DFC must recognize the value of having representatives on the ground in geostrategic regions. To win deals, relationships are critical, and relationships built over the phone or during a few business trips per year cannot be cultivated to the same degree as frequent, face-to-face interactions. The DFC could adopt a regional approach, by placing a number of staff members in a key U.S. embassy in the region (such as the Philippines, where the Asian Development Bank (ADB) is headquartered, or Thailand, where OPIC's managing director for Asia-Pacific is located). An in-country staff for the DFC enables greater synergy with other U.S. agencies and allies, forges stronger relationships with local political and business leaders, and increases the overall likelihood of winning a contract. Another approach would be to have local partners that assist the DFC to source deals. These partners could be companies that have been vetted by the U.S. government a priori and would help source deals and respond to business opportunities in a speedier manner. A third approach is to enter into partnerships with other development finance institutions (DFIs) that are present on the ground and join financing consortiums. The DFC could also leverage the expertise of the ADB's vast staff on the ground who have spent decades researching investment opportunities and forming relationships with regional stakeholders.

Focusing Investments in Sectors with High Development Impact

The Philippines is an investment hotspot. Becoming increasingly attractive to foreign businesses, the Philippines' labor market conditions and skills currently make it one of the principal destinations for Business Process Outsourcing (BPO)—with the United States as one of the major players. To increase the visibility of the U.S. brand in the Philippines

even more and provide an alternative to China, the DFC should prioritize its investments in underdeveloped sectors where the United States can add value. Some of the strategic sectors identified through the research process where the DFC could make an impact are i) investing in agro-processing and infrastructure development in Mindanao, ii) developing technology for urban services (i.e., smart cities initiatives), and lastly, iii) fostering SMEs linked to global value chains. The DFC should consider choosing two regions or cities of the Philippines to make significant investments into projects that are highly visible and at scale.

To increase even more the visibility of the U.S. brand in the Philippines and provide an alternative to China, the DFC should prioritize its investments in underdeveloped sectors where the United States can add value.

Agro-Processing and Infrastructure Development in Mindanao: The DFC could work with USAID and other partners in the Mindanao region, improving agricultural productivity and infrastructure connectivity in the region. The region comprises 40 percent of the Philippines' land area and 20 percent of its population. It is a region with significant internal conflicts, sources of terrorism, and high poverty and inequality relative to the rest of the country, yet it is blessed with a favorable climate and arable land.

The region needs to create more than 5 million jobs in the next 6 years to meet labor market demands.⁹² Agricultural endeavors account for the primary source of income for Mindanao households: 60 percent of the region's GDP and employment derives from agricultural value chains.⁹³ However, the agricultural sector remains underdeveloped and needs significant investments and policy interventions to be a source of employment growth. Key crops such as rice, corn, bananas, and mangos suffer from high farm-to-consumer losses with about 20-50 percent of fresh produce lost in transit in the Philippines versus 6 percent in neighboring Thailand.⁹⁴ Cold storage facilities are absent, roads are poor, and power is expensive and unreliable. Moreover, small farmers have little access to credit, although the government has instituted policies such as the agri-agra law that requires banks to set aside 25 percent of their portfolios to the farm sector. The risks are very high, and banks are conservative in their policies, willing to pay a penalty for not complying with the law.

The World Bank has identified several areas where the government can work with development partners to realize the potential of agriculture in Mindanao: increasing farmers' productivity through better irrigation systems and increased partnerships with larger enterprises; improved logistics services, reliable power, and roads; and the development of ports and exports procedures to connect farmers to global markets.⁹⁵ The DFC could support these interventions through greater use of the Development Credit

92. The World Bank, Australian AID, and KTF, *Philippines Mindanao Jobs Report: A Strategy of Mindanao Regional Development* (Washington, DC: The World Bank, 2017), <http://documents.worldbank.org/curated/en/395661498616337079/pdf/117354-REVISED-PUBLIC-Philippines-Jobs-Report-FINAL.pdf>.

93. Ibid.

94. "Agribusiness Policy Brief No. 5," USAID, September 5, 2016.

95. The World Bank et al., *Philippines Mindanao Jobs Report*.

Authority's (DCA) guarantees for agricultural lending, co-financing infrastructure projects with other donors, and using political risk insurance for infrastructure projects.

To win deals, relationships are critical, and relationships built over the phone or during a few business trips per year cannot be cultivated to the same degree as frequent, face-to-face interactions.

Smart Cities—Technology for Urban Services: Many of the Philippines' major cities and population hubs are suffering from a lack of infrastructural efficiency, with issues such as traffic congestion and waste management hindering progress. Manila, for example, has the third-worst traffic of any city in Southeast Asia. It is estimated the city loses over \$21.9 billion annually in missed opportunities as commuters spend an average of 66 minutes in traffic daily.^{96,97} JICA is funding the Metro Manila Subway Project, as well as improving current transit systems in the city, through ODA.⁹⁸ The loan agreement was signed in January 2019, with JICA committing over \$1.5 billion to the construction of a new railway system that will connect Quezon City in the north and Paranaque in the south.⁹⁹

Davao City, located in Mindanao, is the third-largest city in the Philippines. The steady growth of the city's economy has generated a rise in congestion problems, caused by the increased number of vehicles on the road, but also by the lack of extensive transport systems. Efforts to curb these inefficiencies are being given priority by the city's mayor, such as Davao's High Priority Bus System (HPBS), which will be implemented in 2020.^{100,101} Inefficient waste management problems also plague cities such as Cebu City. The closure of its only government-owned landfill site in 2016 means the 600 tons of daily collected waste have had fewer places to be dumped, causing waste disposal to become one of the city's most pressing concerns.¹⁰² Officials have attempted to implement a waste source separation initiative; however, a lack of public awareness has prompted only 50 percent of the city's residents to cooperate.¹⁰³

96. The Boston Consulting Group, *Unlocking Cities: The impact of ridesharing in Southeast Asia and beyond* (Boston, MA: The Boston Consulting Group, 2017), http://image-src.bcg.com/Images/BCG-unlocking-cities-2017_tcm93-178660.PDF.

97. "JICA to help Philippines ease traffic congestion in Metro Manila," JICA, September 20, 2018, <https://www.jica.go.jp/philippine/english/office/topics/news/180920.html>.

98. "JICA launches ODA map for Metro Manila marking new projects in transport infrastructure," JICA, January 28, 2019, <https://www.jica.go.jp/philippine/english/office/topics/news/190128.html>.

99. "Signing of Japanese ODA Loan Agreements with the Philippines: Contributing to the alleviation of traffic congestion and flood damage in Metro Manila with Japanese technology," JICA, January 22, 2019, https://www.jica.go.jp/english/news/press/2018/190122_01.html.

100. Digna Banzon, "Davao City to implement initial stages of bus system," Philippine News Agency, January 10, 2019, <https://www.pna.gov.ph/articles/1058433>.

101. Mick Basa, "ADB hopes design of Davao City's bus system out by 2019," *Rappler*, March 10, 2018, <https://www.rappler.com/business/197863-adb-design-davao-city-bus-system-out-2019>.

102. Morexette Marie. B Erram, and Doris Mae C. Mondragon, "The Trouble With Trash," *Cebu Daily News*, May 05, 2018, <https://cebudailynews.inquirer.net/173684/the-trouble-with-trash>.

103. Premakumara Jagath Dickella Gamaralalage, Matthew Hengesbaugh, Kazunobu Onogawa, and Nida C Cabre-ra, *Planning and Implementation of Integrated Solid Waste Management at Local Level: The Case of Cebu City*, (Osaka and Kanagawa, Japan: UN Environment and Institute for Global Environmental Strategies, 2017), <https://pub.iges.or.jp/pub/planning-and-implementation-integrated-solid>.

Moreover, since 2013, the Philippines has been experiencing an unusual amount of power shortages.¹⁰⁴ These occurrences have impacted consumers, investors, and the economy as a whole, with a noticeable correlation between power shortages and price hikes that could hinder the Philippines' development even further if left unaddressed.¹⁰⁵ Similarly, the pace of internet and general IT infrastructure lags significantly behind regional standards, providing a second area for potential gains from modernization. In the third quarter of 2015, the Philippines was recorded to have the second slowest average downloading speed of any Asia Pacific nation at 2.8 Mbps.¹⁰⁶

To fully connect the Philippines through transport, internet, and electricity networks and bring cities to twenty-first century standards, the DFC should underscore the potential of smart cities. Smart cities use new technologies such as the internet of things (IoT) to collect city data to enhance the quality of life of their citizens. Traffic flow is improved, less energy is wasted, and overall efficiencies of how the city operates rise significantly when IoT becomes integrated in urban environments.

The DFC could make a strategic investment to develop smart cities initiatives in Manila, Davao, or Cebu in the south. The DFC can help the Philippines in this regard by prioritizing energy infrastructure development and by creating efficient data systems for managing and processing the massive amounts of data needed for smart cities to function.¹⁰⁷ Via equity stakes, loans, and credit guarantees, the DFC can finance impactful technological projects such as an integrated system of multimodal transportation that would reduce congestion in a large city like Manila, Davao, or Cebu.

Furthermore, the next major frontier of technology is expected to be 5G internet networks, which are a critical component of smart cities; however, most Filipinos' perception of China's Huawei does not fall in line with the recent warnings issued by U.S. intelligence agencies.

MSME Development: Although supporting MSMEs is less visible than hard infrastructure, the DFC could aid firms that are linked to global value chains through financing and technical assistance by working with USAID.¹⁰⁸ Innovation is also another important factor for the success of MSMEs in the Philippines. Technology empowers business entrepreneurs by cutting costs and increasing connectivity, efficiency, and productivity by accessing different markets.¹⁰⁹ According to a 2018 survey conducted by the Asian Institute of Management, MSMEs comprise 99.6 percent of total firms in the Philippines and make up more than 60 percent of all jobs. Yet the Filipino economy is dominated by a few large conglomerates that own the majority of the industry, banking, and housing sectors. Despite accounting for a third of the Philippines' gross value added (GVA), MSMEs are typically not part of the formal

104. Hannah Viola, "Commentary: The real deal behind Philippines' power crisis," *Philstar*, April 13, 2019, <https://www.philstar.com/other-sections/news-feature/2019/04/13/1909737/commentary-real-deal-behind-philippines-power-crisis>.

105. Ibid.

106. "Broadband Policy Brief No. 6," USAID, 2016.

107. Agnes Dasewicz, Todd Moss, Dan Runde, and Kate Steel, *America's Global Infrastructure Opportunity* (Washington D.C: CSIS, 2019), <https://www.csis.org/analysis/americas-global-infrastructure-opportunity-three-recommendations-new-us-development-finance>.

108. "Supporting Private Enterprise," USAID, March 23, 2017, <https://www.usaid.gov/what-we-do/economic-growth-and-trade/supporting-private-enterprise>.

109. Nikki Natividad, "Infographic: Filipino SMEs at a glance," *Rappler*, March 29, 2017, <https://www.rappler.com/brandrap/create-success/146187-globe-mybusiness-filipino-sme>.

economy and are concentrated in the services and agriculture sectors with low productivity.¹¹⁰ There are still obstacles to achieving the full potential of MSMEs in the Philippines, including the inadequacy of infrastructure, the lack of financial support and marketing tools, and the inability to meet international market standards.¹¹¹

Using Development Finance Tools More Creatively

The DFC cannot match China's investments dollar for dollar, but it is equipped with new authorities that give it added flexibility when making investment decisions. It can use its development finance toolbox more strategically in order to attract investments from abroad and spur the domestic capital base. The Philippines has a well-developed banking sector but has an undeveloped domestic capital market, and FDI levels are below its ASEAN peers. Some of the tools that the DFC could deploy in the Philippines, beyond direct lending, include DCA guarantees; technical assistance; and using other allies more strategically such as investing in equity funds, co-investing in projects, or sharing risks through the use of political risks guarantees.

The Philippines banking sector is very well-developed. According to the International Monetary Fund (IMF), the Philippines is deemed to have a sound financial system, supporting the Central Bank of the Philippines' (BSP) actions on price stability, liberalization reforms, and foreign exchange policies.¹¹² The Philippines has 585 banks, 83 percent of which are rural and cooperative banks (commercial and thrift banks occupying 7.5 percent and 9.5 percent respectively), including 12 foreign banks.¹¹³ The Philippines has a very large banking system; nevertheless, much of the population remains unbanked. In fact, as of 2018, 52.8 million Filipinos do not own a bank account, 60 percent of whom stating the reason to be a lack of sufficient funds.¹¹⁴ Furthermore, the banking sector does not lend to some underserved sectors such as SMEs, the poorest of the poor, and agribusiness. Under the agri-agra law, 25 percent of bank loans in the Philippines are required to go to agribusiness, but this requirement is not respected as banks choose to pay fines instead of lending to this growing sector. Lastly, companies in the Philippines have to pay higher costs of capital relative to their Asian peers: more than 14 percent for equity and between 2 and 3 percent for debt.¹¹⁵

The total stock market capitalization listed on the Philippine Stock Exchange (PSE) in 2018 was \$257 billion—a very small amount when compared to peer countries such as Malaysia

110. Daño-Luna, Maribel, Tristan Canare, and Jamil Paolo Francisco, *Drivers of Philippine SME Competitiveness: Results of the 2018 SME Survey* (Makati City, Philippines: AIM Rizalino S. Navarro Policy Center for Competitiveness, 2018), https://www.researchgate.net/publication/329584820_Drivers_of_Philippine_SME_Competitiveness_Results_of_the_2018_SME_Survey.

111. Boh Wai Fong, "Realizing the full growth potential of SMEs in PH," *Philippine Daily Inquirer*, May 18, 2018, <https://business.inquirer.net/251036/realizing-full-growth-potential-smes-ph>.

112. *Philippines : 2018 Article IV Consultation - Press Release; Staff report; and Statement by the Executive Director for Philippines*, (Washington, DC: IMF, 2018), <https://www.imf.org/en/Publications/CR/Issues/2018/09/27/Philippines-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-46278>.

113. "Philippines - Banking Systems," Export.gov, July 18, 2019, <https://www.export.gov/article?id=Philippines-Banking-Systems>.

114. Luchi de Guzman, "77% of Filipinos remain unbanked - BSP," CNN Philippines, July 11, 2018, <https://cnn-philippines.com/business/2018/07/11/2017-financial-inclusion-survey-bsp.html>.

115. Nitin Jain, Fumiaki Katsuki, and Kristine Romano, "Deepening capital markets in the Philippines", Mckinsey & Company, September 2017, <https://www.mckinsey.com/featured-insights/asia-pacific/deepening-capital-markets-in-the-philippines>.

(\$438 billion), Indonesia (\$482 billion), Thailand (\$552 billion), and Singapore (\$767 billion). The market is too concentrated; there are not enough small companies that would consider PSE to augment their capital.¹¹⁶

Loan portfolio guarantees are one of the new tools of the Better Utilization of Investments Leading to Development (BUILD) Act that can be leveraged in countries like the Philippines. One component of the BUILD Act calls for DCA of USAID to be integrated into the DFC. The DCA uses loan portfolio guarantees, which are partial credit guarantees, to encourage private capital lending to creditworthy but underserved borrowers in emerging markets.¹¹⁷ The DFC should expand the DCA guarantee portfolio in the Philippines because the country contains developed financial institutions and local capital but little lending exists for certain sectors such as SMEs (particularly technology startups) and agribusiness.

Technical assistance is significantly needed in the Philippines to develop domestic capital markets in order to fund longer-term investment such as infrastructure.¹¹⁸ This is an area where the expertise of USAID, the U.S. Department of Treasury, and the DFC could be leveraged. Capital markets take a long time to develop and they do so in stages, with money markets and government bond markets easier to create than local bond markets, especially corporate bonds.¹¹⁹ Corporate bond markets require stronger legal architecture and a more developed private sector than government bonds.¹²⁰ Local bond markets can be a source of long-term financing and can improve access to local currency financing to help manage exchange-rate risk. The U.S. Department of Treasury's Government Debt Issuance and Management Program works with developing countries' governments to assist them in creating regulatory frameworks and markets for local currency government securities. This work has also included the pursuit of closer coordination between the finance departments and central banks of these countries.¹²¹

Another area where the Philippines needs more technical assistance is in procurement reforms and carrying out feasibility studies. In this regard, the DFC could provide technical assistance together with the USTDA. The USTDA is a small, independent federal agency whose mission is to help U.S. companies create U.S. jobs through the export of U.S. goods and services for priority development projects in emerging economies.¹²² Feasibility studies provide comprehensive analysis at the early stages of project development when a project's technology options and requirements are defined. In 2017, USTDA provided grants for conducting 30 feasibility studies, and more than half were developed in Sub-Saharan Africa.¹²³ The USTDA also provides advice to support policy, legal, and regulatory reform in topics related to commercial activities, transaction costs and infrastructure development, the establishment of industry standards, and other market-opening and facilitation activities.

116. Ibid.

117. "Development Credit Authority," USAID, January 28, 2019, <https://www.usaid.gov/dca>.

118. Nitin Jain, Fumiaki Katsuki, and Kristine Romano, "Deepening capital markets"

119. Dubravko Mihaljek, Michela Scatigna, and Agustin Villar, *Recent trends in bond markets*, (Basel, Switzerland: Bank for International Settlements), <https://www.bis.org/publ/bppdf/bispap11c.pdf>.

120. Ibid.

121. "Government Debt Issuance and Management Program," U.S. Department of the Treasury, March 5, 2012, <https://www.treasury.gov/about/organizational-structure/offices/Pages/OTA-government-debt.aspx>.

122. Daniel F. Runde, Romina Bandura, and Brunilda Kosta, *What is the U.S. Trade and Development Agency?* (Washington D.C.: CSIS, 2018), https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180130_Runde_USTDA_Web.pdf?OP9tthkFui9w3W0UBelvEQAAmLiUo4gB.

123. Authors' calculations based on the USTDA annual report of 2017.

These technical assistance programs aim to create more favorable business and trade environments for U.S. goods and services.¹²⁴ Finally, since 2013, the USTDA has utilized its Global Procurement Initiative (GPI), whereby training is provided to overseas partners to help level the playing field for U.S. exporters. By signing a memorandum of understanding with partner countries, the GPI provides training and knowledge on how to establish procurement systems that integrate best-value determination and life-cycle cost analysis, as well as how to promote objective evaluation through a trained, professionalized procurement workforce. Having the lowest price is no longer the only determining factor in awarding tenders, and exporting this view to Filipino stakeholders would be a major win for the U.S.

Coinvesting with other DFIs: The DFC can work with other DFIs and leverage their instruments to make investments in urban infrastructure. Through its mandate to foster strong relationships with other partners such as the Japanese, Korean, and Australian development finance agencies, the DFC can use its new equity authority to invest in funds. Or it can use loan syndication combined with co-guarantees to offer a full suite of incentives to develop, for example, a public transit project. With shared risk and a true stake in the fate of these companies, the DFC will be more likely to attract additional investors of a higher quality.

124. Ibid.

About the Authors

Daniel F. Runde is senior vice president, director of the Project on Prosperity and Development, and holds the William A. Schreyer Chair in Global Analysis at CSIS. A global thought leader and change agent, his work centers on leveraging U.S. soft power and the central roles of the private sector and good governance in creating a more free and prosperous world. Mr. Runde has been recognized for influencing the debate on USAID-State Department relations, as an architect of the BUILD Act, and led the debate surrounding the role and future of the World Bank Group. Mr. Runde has also influenced thinking about U.S. economic engagement with Africa (of which he is in favor of much more) and domestic resource mobilization. Mr. Runde holds the Officer's Cross in the Order of Isabel la Católica, a Spanish Civil Order.

Previously, Mr. Runde held senior leadership roles at the International Finance Corporation (IFC). From 2005 to 2007, he was director of the Office of Global Development Alliances (GDA) at the U.S. Agency for International Development (USAID), and he led the GDA partnership initiative by providing training, networks, staff, funds, and advice to establish and strengthen public-private partnerships. His efforts at USAID leveraged \$4.8 billion through 100 direct alliances and 300 others through training and technical assistance.

Mr. Runde is the chairman of the Advisory Committee on Voluntary Foreign Aid (ACVFA) and serves on the board of the International Foundation for Electoral Systems (IFES), the Millennium Challenge Corporation (MCC) Advisory Council, and the Ashesi University Foundation (a private university located in Accra, Ghana). Mr. Runde is a regular contributor to The Hill and hosts a podcast series, Building the Future with Dan Runde: Freedom, Prosperity, & Foreign Policy.

Romina Bandura is a senior fellow with the Project on Prosperity and Development and the Project on U.S. Leadership in Development at CSIS. Her current research focuses on the future of work in developing countries and the United States' economic engagement in the developing world. She has also conducted extensive research on enhancing the reach and impact of the Multilateral Development Bank system. Before joining CSIS in September 2017, she was a senior consultant at the Economist Intelligence Unit (EIU). She worked closely with clients to design research and manage projects that included index building, quantifying qualitative variables, policy analysis, and strategies for investment and growth. EIU flagship projects include benchmarking indices like the Global Microscope on

Financial Inclusion and the Latin America and Caribbean Infrascopes project. Ms. Bandura is an economist with 18 years of experience in international development research, policy analysis, and project management. Before joining EIU, she was an economist at the International Labour Organization's Washington office. In her previous capacity as a business manager at DAI's Economic Growth Sector, she managed a \$90 million private-sector development portfolio of projects in Africa, Asia, and Eastern Europe. She has also served as a policy analyst for the UN Development Programme. Earlier in her career, she worked in the banking sector in Argentina. Ms. Bandura holds an MPA in international development from Harvard University's Kennedy School of Government and a BA in economics from the Universidad Católica Argentina, Buenos Aires.

Owen Murphy is a program coordinator for the Project on Prosperity and Development (PPD) and Project on U.S. Leadership in Development (USLD) at the Center for Strategic and International Studies (CSIS), where he coordinates events and supports the projects' research agenda. Prior to becoming program coordinator in October 2018, he was an intern in the PPD and USLD programs at CSIS, as well as the National Development Agency of Mongolia. His research interests and publications focus on emerging technologies, mass urbanization, social protection systems, and U.S. engagement with the developing world. He holds a bachelor's degree in urban studies and history from Furman University.

Annex: Project Description

Background

The Project on Prosperity and Development (PPD) at CSIS partnered with the Smith Richardson Foundation (SRF) in January 2019 on a research project examining the strategic directions for the new U.S. development finance institution, the United States International Development Finance Corporation (DFC). This report provides an independent, medium-term assessment for the DFC as it begins operations in October 2019. The recommendations produced in this report lay out a vision for the next 5 to 10 years that are acceptable to both sides of the U.S. political spectrum—Republicans and Democrats alike.

CSIS was one of the Better Utilization of Investment Leading to Development (BUILD) Act’s key architects. Over the past seven years, CSIS participated in several Congressional hearings and produced numerous research materials in support of the BUILD Act and development finance modernization (see Annex C for a listing of related research). Starting in 2011, CSIS has run a very active program to strengthen and enable development finance in the United States. Some examples of our written work include “Sharing Risk in a World of Dangers and Opportunities” (2011), “Development Finance Institutions Come of Age” (2016), and, most recently, “The BUILD Act Has Passed: What’s Next?” (October 2018). PPD Director Daniel F. Runde testified twice regarding the BUILD Act.

The DFC is not designed to be simply another development finance institution—in addition to a greater proposed focus on development impact, it is an agency also embedded in the U.S. foreign policy and national security architecture. This report offers concrete and independent ideas on how the DFC can better support U.S. national security interests but also highlights its limitations. Within this context, the three key U.S. national security challenges that CSIS highlights include a) China’s rising influence in the developing world, b) actions the United States and others can do to further mitigate violent extremism, and c) addressing the root causes of migration. The main questions we sought to answer through this project are:

How the DFC can support U.S. foreign policy, development, and national security goals via a series of key strategic questions:

- *Where and how can the DFC counter the rise of China as a development player?*

- *Where and how can the DFC address instability and counter the rise of violent extremism?*
- *Where and how can the DFC address the root causes of migration?*

CSIS approached the project through a two-part method:

- a bottom-up approach, consisting of country case studies to better understand local stakeholders' views on the DFC; complemented by
- a top-down approach, consisting of the expertise of Washington-based policymakers and high-level staff from allied development finance institutions.

During the first half of 2019, CSIS met key stakeholders (U.S. embassy teams, local business leaders, country government officials, and multilateral development agencies) in three developing countries to gather views on the ground on how the DFC could be most effective in meeting their country's needs. CSIS focused on three very different but strategically important regions of the world: Central America, North Africa, and Southeast Asia. Within these regions, we chose the Philippines, Tunisia, and Guatemala as country case studies due to a large U.S. influence or presence and their representation of the three key U.S. national security challenges of China's rise, violent extremism, and youth migration. Over 25 experts were consulted in each country. These case studies have been published as separate papers.

CSIS also convened two private roundtable discussions in Washington, D.C., with nearly 30 stakeholders from various academic institutions, multilateral development banks, private sector entities, and allied development agencies. Finally, 15 in-person interviews were conducted to better understand how the DFC can fit into a changing development landscape, work more collaboratively with other partners, focus on the proper sectors, and achieve its development impact and financial goals.

Country Case Studies

CSIS chose the Philippines, Tunisia, and Guatemala as case studies to provide a series of lessons learned for future programs by the United States International Development Finance Institution (DFC). These countries are representative of the major U.S. geostrategic issues of China's rise as a development player, violent extremism, and forced migration. In choosing the countries, CSIS sought to balance representation in different regions and varied economic structures and development status (two are lower middle income—the Philippines and Tunisia—while one is a fragile, upper-middle-income country—Guatemala). These case studies have been published as separate papers.

In each country, CSIS met with government officials, executives from businesses, directors of aid agencies, high-level staff at U.S. embassies, security actors, bilateral development finance institutions (DFIs) and multilateral development bank (MDB) representatives (the Asian Development Bank [ADB], the Inter-American Development Bank [IADB], the African Development Bank [AfDB], and the World Bank), chambers of commerce members, and think tanks. CSIS also interviewed counterparts of the DFC, such as Japanese, Korean, and German stakeholders in both the private and public sector, to hear their perspectives.

During the first half of 2019, CSIS interviewed 80 stakeholders in those three countries (31 in Tunisia, 22 in the Philippines, and 27 in Guatemala) as well as 15 experts from

DFIs and other development agencies. CSIS also undertook an extensive desk review that utilized the publications listed in Annex C.

The following questions were asked in all three countries:

- What are some areas that you think the new DFC will be able to pursue in collaboration with other development finance institutions (DFIs)?
- What concrete joint projects or products should be pursued? What new products or approaches would you like the new DFC to undertake?
- If you have ever collaborated with the Overseas Private Investment Corporation (OPIC), what were the main barriers hindering the process?
- How can the DFC leverage the work of the other U.S. development agencies (OPIC, Millennium Challenge Corporation [MCC], Export-Import Bank of the United States [EXIM], U.S. Agency for International Development [USAID])?
- What types of new financing instruments are needed?
- Do you see a role for the new DFC in working with impact investors?
- What do you foresee as the DFC's main limitations?
- What three key technologies will have the most impact in achieving the Sustainable Development Goals?
- How can DFIs accelerate and enable the adoption of key technologies in developing countries?
- How have DFIs in the past supported telecommunications infrastructure development (e.g., cellphones)?
- With new technologies like big data or 5G wireless communication entering the markets, how can DFIs be more strategic about the risks they pose to society?

The Philippines exemplifies a developing country where the contested security and economic forces of China and the United States are present. Its location in the South China Sea makes it an attractive area of investment for U.S. and Chinese firms. The Philippines case study was meant to inform the DFC on the tools, technical assistance programs, and sectoral approaches that Southeast Asian countries need but China cannot offer. Questions to stakeholders in the Philippines included:

- What strengths do you identify in the U.S. approach (government programs, private sector) compared to China's? What are the U.S. weaknesses?
- What are some areas that you think the new DFC will be able to pursue in collaboration with other DFIs on the ground? (e.g., infrastructure? Small and medium-sized enterprise [SME] development? entrepreneurship?)
- How should the DFC approach infrastructure financing?
- What tools and approaches are most needed in the Philippines? Southeast Asia?
- How can the DFC collaborate with the government of the Philippines and its other partners to engage youth and counter violent extremism? What are the most promising economic sectors to engage youth?

Tunisia is a good example of the Middle East and North Africa (MENA) region's challenges, which include weak private sectors, youth disengagement from the workforce, and the potential for violent extremism. The youth unemployment rate in Tunisia has not dipped below 30 percent since 2010. Even youth that are highly educated (tertiary level) struggle with unemployment levels over 60 percent because of the low demand for highly skilled labor in Tunisia. These high levels of unemployment have led to as many as 6,000 suspected Tunisian youth joining violent extremist groups in recent years.¹²⁵ The Tunisia case study aimed to guide the DFC on how it can collaborate and work with allies and other DFIs, specifically in economic sectors that can engage youth. Questions to stakeholders in Tunisia included:

- What should be the DFC approach to private sector development in Tunisia?
- What tools and approaches are most needed in Tunisia? North Africa?
- What are the most promising economic sectors to engage youth?
- How can the DFC collaborate with the government of Tunisia and other partners on the ground to engage youth and counter violent extremism?

With close to 17 million people, Guatemala is a good representation of the problems in the Northern Triangle—particularly the perennial challenge of migration that stems from a lack of jobs and internal security. The challenges in the Northern Triangle will likely last for the next 20 years and will continue to impact U.S. national security. Countries in the Northern Triangle face a significant gang and criminal activity problem that magnifies a lack of economic opportunity as gangs find recruits among the region's unemployed or underemployed. Although there is less overall gang violence in Guatemala, Guatemalans migrate mostly to the United States because of extreme poverty, especially among its very large indigenous community. The Guatemala case study strived to inform the DFC strategy on the specific tools and approaches that are needed to develop the private sector in ways that mitigate economic migration. Questions to stakeholders in Guatemala included:

- What are the most successful approaches and financing instruments to develop the private sector in Guatemala? What are the main challenges? What should be the DFC's role?
- Which promising industries or sectors should the DFC focus on in order to trigger economic growth and employment?
- How can the DFC leverage the work of other U.S. government programs in combatting the root causes of migration?
- How can the DFC collaborate with the government of Guatemala and other partners on the ground to provide better alternatives to migration?

125. Counter Extremism Project, "Tunisia: Extremism & Counter-Extremism," (New York, NY: 2019), Counter Extremism Project, https://www.counterextremism.com/sites/default/files/country_pdf/TN-07252019.pdf.

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