

### Reducing the Price That Government Pays in Procurement: the Case of the Philippines

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## Studie

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# **Reducing the Price That Government Pays in Procurement. The Case of the Philippines**

Roderica Taduran Stamer

### **Abstract**

The Philippine government now pays less for the same goods it used to procure some years ago. In some cases, the reduction in price reaches as much as 50 percent. What dramatic change is responsible for this result? How did the change take place? Recent economic research has emphasized the importance of institutions in fostering economic development. Further, institutional changes occur whenever organizations deem it profitable. This framework shall be used in order to answer the questions above. Firstly, it will be argued that the savings that the government now enjoys are due to the successful implementation of reform measures in its procurement system. In particular, electronic procurement was established and in 2003 a new comprehensive law was passed. The paper will analyze some of the reforms' features in clipping opportunities for corruption, removing barriers to entry, and lessening the likelihood of collusion. Secondly, the paper will argue that the public furor over corruption in government, which reached a climax during the impeachment of a previous president, provided the much-needed push for the reforms. The potential savings that the government was not able to realize in the old procurement system was the primary 'selling point' for the passage of the new law. (Manuscript received February 16, 2007; accepted for publication June 25, 2007)

*Keywords: Philippines, Public Procurement, Corruption, Institutional economic theory*

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## Studie

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# **Preisreduzierung im öffentlichen Beschaffungswesen am Beispiel der Philippinen**

Roderica Taduran Stamer

### **Abstract**

In den Philippinen muss die öffentliche Hand signifikant weniger Geld für Beschaffung von Gütern und Dienstleistungen aufbringen als noch vor wenigen Jahren. In einigen Bereichen ist sogar eine Preissenkung von 50% zu verzeichnen. Wie ist diese Entwicklung zu erklären? Wie ging dieser Wandel von statten? Diese Fragen sollen auf der Grundlage von Erkenntnissen der Institutionenökonomie, nach der Institutionen ökonomische Entwicklungen begünstigen und utilitaristisches Organisationskalkül institutionellen Wandel fördern, beantwortet werden. Es wird erstens argumentiert, dass die Ersparnisse durch Preisreduzierung primär auf erfolgreiche Reformanstrengungen der Regierung, worunter die Einführung eines elektronisch gestützten Beschaffungswesens und das In-Kraft-Treten eines umfassenden Gesetzes über das öffentliche Beschaffungswesen fallen, zurückzuführen sind. In diesem Zusammenhang werden in der vorliegenden Studie Reformaspekte wie Korruptionsabbau, Eintrittshürdensenkung und Vermeidung geheimer Absprachen behandelt. Es wird zweitens argumentiert, dass das öffentliche Aufsehen um Regierungskorruption, das seinen Höhepunkt in der Amtsenthebung des letzten Präsidenten fand, als Reformauslöser zu sehen ist. Darüber hinaus konnten die unter dem alten Gesetz nicht realisierten Ersparnisse als „Verkaufsargument“ für das neue Beschaffungsgesetz genutzt werden. (Manuskript eingereicht am 16.02.2007; zur Veröffentlichung angenommen am 25.06.2007)

*Keywords: Philippinen, öffentliches Beschaffungswesen, Korruption, Institutionenökonomie*

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## 1 Introduction

In 1998, each textbook provided by the Philippine government to public elementary schools had to be shared by six (6) children. In high schools, eight (8) children were in the same situation. But since then, the price of textbooks has plummeted by 50 percent, allowing the government to purchase more. Now each child in public elementary schools as well as in high schools has a textbook for him- or herself. This improvement in procurement is widespread and is shared by other branches of the Philippine government.

What dramatic change is responsible for this result? This paper<sup>1</sup> will argue that the savings that the government now enjoys are due to the reform measures in its procurement system. In particular, electronic procurement was established. Further, in 2003 a new comprehensive law was passed. Through these reforms, opportunities for corruption have been reduced, barriers to entry removed and likelihood of collusion lessened.

But what prompted the changes in the system? North (1990) explains that institutional changes occur whenever organizations deem it beneficial. In the case of procurement reforms in the Philippines, the paper will argue that the public furor over corruption in government provided the much-needed push. At a time when the highest office of the land was rocked by a serious corruption scandal resulting in the impeachment of the President, anti-corruption efforts were very much supported. When the new procurement law was passed, it was hailed by politicians of the new administration as a successful first step in fighting against corruption.

Section 2 reviews the literature on the importance of good institutions for economic development, highlighting the role that low transaction costs play. It goes further and examines the impact of corruption on transaction costs, particularly in procurement. Section 3 talks about the prevalence of poor institutions that marked the state of public procurement in the Philippines prior to the reforms. Section 4 discusses how the reform efforts came about, arguing that the potential savings that the government was not able to realize in the old

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<sup>1</sup> An earlier version of the paper was presented at the Workshop on Institutional Analysis of the Ronald Coase Institute on 16-21 September 2006 and at the 10<sup>th</sup> ISNIE Conference at Boulder, Colorado on 21-24 September 2006, at which the participation of the author was generously sponsored by the Ronald Coase Institute. The author is thankful for comments from participants thereat, especially Phil Keefer (World Bank) and John Nye (Washington University at St. Louis).

procurement system was the primary ‘selling point’ for the passage of the new law. Section 5 then analyzes some of the law’s features in reducing opportunities for corruption, breaking barriers to entry and lessening the likelihood of collusion, and presents some preliminary success indicators. Section 6 concludes.

In so doing, the paper adds to the efforts of Evenett and Hoekman (2005), who examine the available evidence on public procurement practices in developing countries, and concludes that while there is a considerable agreement on ends, little information is available on means, particularly on the effective and replicable strategies that developing countries can adopt to improve public procurement systems.

## **2 Institutions, Transaction Costs, and Economic Development**

Institutions, as defined by North (1990), are the humanly devised constraints that shape human interaction. They include both formal and informal constraints. Rules that human beings devise such as a country’s constitution, laws and statutes are examples of formal constraints, while conventions, norms and codes of behaviour are informal constraints.

Recent economic research has emphasized the important role that institutions play in the economy. The International Monetary Fund (IMF) (2005), using data for 1970-2004 among developing countries, calculates that improving the quality of domestic institutional frameworks is associated with a subsequent 2 percentage point increase in GDP growth, a durable though relatively modest improvement in the amount of private sector investment, and a substantial improvement in total factor productivity.

How do institutions impact on the economy? Institutions affect the performance of an economy by their effect on the costs of transaction and production. Transaction costs refer to the costs of carrying out a transaction by means of an exchange on the open market (Coase 1937). Elaborating, Coase (1961) explains, [i]n order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, etc.

Thus, if institutions prevailing in an economy create an environment where transactions costs are low, more transactions naturally will be undertaken.

But what makes transacting costly? In any transaction, one party would

always have an information advantage over the other party about some valued attribute of what is being exchanged. The original party may even stand to gain by concealing that information. A classic example is the market for second-hand cars, where the quality of the car is perfectly known to the seller but not to the buyer. Another example is presented by the labor market, wherein the job applicant knows exactly what she or he is capable of doing, but not the prospective employer. Thus, gathering information to measure such concealed attributes and monitor them result in the costs of transacting.

## 2.1 Transaction Costs in the Economy Increases with Corruption

The transaction cost literature has several subdivisions. For purposes of this paper, we shall take a look at non-market transaction costs. While other branches of the literature examine the effect of transaction costs on contractual arrangements of production, the non-market transaction cost literature looks into how transaction costs affect the amount and type of goods and services that are produced and available in the market. Examples of non-market transaction costs are the resources spent in waiting, getting permits, cutting red tapes, bribing officials, and so on.

De Soto (1989) documented the tremendous cost of doing business formally, i.e. the cost of meeting legal requirements for starting and running a business, and those of doing business informally in Peru. Stone, Levy and Paredes (1996) did a similar study for Chile and Brazil. Benham and Benham (2001) undertook comparative country studies to measure various costs of exchange and found that the variation in costs for the same good/service in different countries can be tremendously large. Emphasized in these works are the government-imposed cumbersome rules and regulations, such as registration and licensing requirements, rules on sale or lease of real estate, export and import regulations, and taxes.

These barriers force entrepreneurs to conduct some or all of their business outside the official economy, i.e. they engage in corrupt transactions, or discourage them from entry altogether. World Bank's *Doing Business in 2004: Understanding Regulation* (2004b) data show support for this claim.

The conduct of business outside the official economy gives rise to another layer of transaction costs. Lambsdorff (2002) explains that the transaction costs of corrupt agreements result from a) searching for the appropriate partner; and b) designing an enforceable contract that will minimize opportunistic behaviour during and after the course of the corrupt transaction. Thus, the need to

camouflage increases further the costs of exchange. It is then not surprising that Rose-Ackerman (1975), in modelling the behaviour of corrupt agents in public sector procurement, finds that corruption can lead to, among others, inflated costs of purchased goods and services. Finally, in constructing the Transactions Price Index covering 88 countries, Eigen-Zucchi (2001) observes that countries with the lowest transaction prices are also those that fair better in fighting corruption.

## 2.2 Corruption Is Prevalent in Procurement

Corruption pervades in various aspects of the economy. But is it particularly prevalent in procurement. The World Bank (Kaufmann 2005) estimates the amount of bribery exchanging hands for public procurement bids to be in the vicinity of USD 200 billion per year. Even bolder, Transparency International (Eigen 2005) reports that estimates of the amount lost due to bribery in government procurement put the figure at at least USD 400 billion per year worldwide.

## 2.3 Corruption Alters Procurement Outcomes

Apart from inflating the costs of exchange in procurement, corruption likewise alters procurement outcomes. The empirical works of Tanzi and Davoodi (1997) and of Mauro (1998) show that corruption alters government spending by favouring those spending sectors that present more lucrative opportunities for rents than other components of spending do.

In the first study, higher levels of corruption are found to be associated with a) higher share of public investment to total spending, b) lower productivity of public investment, and c) reductions in spending on categories outside public investments. The second study reports reduced government spending on education in corrupt governments, arguing that the sector provides limited opportunities for rent-seeking, because it requires widely available, mature technology.

Corruption tends to thrive more when there is a low level of competition among firms producing what the government purchases. Secondly, the illegal nature of corruption and the ensuing need for secrecy imply that corrupt officials will choose goods whose exact value is difficult to monitor. Thus, specialized high-technology goods and military aircrafts are particularly susceptible to corruption. Thirdly, corruption and weak controlling and auditing institutions tend to go hand in hand.

## 2.4 The International Dimension of Procurement Reforms

Recently, however, the major multilateral development banks – the World Bank, the African, Asian and Inter-American Development Banks, the European Bank for Reconstruction and Development – have all adopted new rules for procurement that apply to projects they finance. To use funds from their loans, borrowers must follow the prescribed rules and the banks supervise their loans to ensure that the rules are properly applied.

In 1994, the United National Commission on International Trade Law (UNCITRAL) adopted a Model Law on Procurement of Goods and Construction as a guide for countries to follow for the evaluation and modernization of their procurement laws and practices.

More recently, the Organization for Economic Cooperation and Development/Development Assistance Committee (OECD/DAC) and the World Bank coordinated a round table process in 2003-2004 among developing countries, bilateral and other multilateral donors to develop an integrated set of tools and good practices to improve developing country public procurement systems.

The World Bank, in addition, works together with a number of developing countries in the assessment of their procurement systems. The results of these processes are published in what is known as the *Country Procurement Assessment Report*.

The 27 member countries of the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific have conducted a review to curbing corruption in public procurement. The initiative sought to assist governments in better understanding the corruption risks inherent in their institutional settings and procurement practices. It likewise aimed to provide an analytical framework to design rules, procedures, and policies to enhance transparency and integrity in public procurement.

## 3 Public Procurement in the Philippines Pre-1999: Poor Institutions

The institutional framework in most Third World countries today, according to North (1990), is characterized by conditions that overwhelmingly favour activities that create monopolies rather than competitive conditions, and that restrict opportunities rather than expand them. Thus, the organizations that develop in this institutional framework will become more efficient – but more



efficient at making the society even more unproductive and the basic institutional structure even less conducive to productive activity.

The above assessment may well have been specifically written to depict public sector procurement in the Philippines prior to 1999. This section of the paper will explain how outdated, unclear and fragmented procurement laws and rules resulted in ambiguity and confusion. Weak oversight and regulation did not help the situation. Thus, an environment that fostered rent-seeking behaviour, where public procurement officials and suppliers/contractors enriched themselves at the expense of the government and society, came about, persisted and became wide-spread.

### 3.1 Corruption Was Said to Be Persistent in Philippine Public Sector Procurement

Corruption in the Philippines is pervasive, deeply-rooted and prevalent. In 1997, the Office of the Ombudsman estimated that some USD 48 billion have been lost to corruption over the preceding 20 years (Office of the Ombudsman 1997:1). In June 1999, the President noted that a recent study by his economic advisers found that 20 percent of government funds for projects in 1998 had ended up as kickbacks.<sup>2</sup> The country has likewise been governed by two presidents who have been identified by Transparency International (TI) as among the ten most corrupt leaders ever worldwide (Transparency International 2004). Not surprisingly, the Corruption Perception Index (CPI) score of the Philippines in 1999 stood at 3.6 (Transparency International 1999), from a range of 1.0 (high perception of corruption) and 10.0 (negligible perception). Among the 99 countries covered by the index, the Philippines ranked 54<sup>th</sup>.

The perception of corruption in the country does not only come out in international surveys, such as those on which the CPI is based. It is likewise reflected in surveys conducted among the locals. Filipinos perceive a very broad extent of corruption in the public sector. They see it rampant in two specific areas: tax collection and procurement.

In early 2000, when 51 percent of the respondents in the national survey of the Social Weather Stations (2000) believed that there was a 'great deal' of corruption in the public sector<sup>3</sup>, they also said that among government activities,

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<sup>2</sup> These figures from President Joseph E. Estrada are cited in PDI, 10.06.99: *Philippine Daily Inquirer* (1999), "Quotations from President Estrada," June 10, 1999, p.1.

it is in the following activities that greater than 50 percent of funds are wasted on corruption:

- pavement of roads,
- tax collection,
- purchase of vehicles and equipment, and
- purchase of school textbooks.

Correspondingly, the government departments primarily responsible for these activities have been rated as most corrupt, namely: Department of Public Works and Highways (DPWH), Bureau of Internal Revenue (BIR) and Department of Education (DepEd). At the DPWH, outright pocketing of public funds and compromising volume and quality of materials, and at the DepEd, the overpricing of textbooks, were seen as the most prevalent corruption practices.

The business sector is even more critical than the general public. According to the 2001 annual enterprise survey of SWS, 63 percent of respondents felt that there was ‘a lot’ of corruption in the government. A large majority of enterprise managers (67 percent) think that public sector corruption was found in ‘both revenue raising and spending’. However, a leaning is observed with 27 percent thinking that corruption can be ‘found more in government spending’ compared to the 3 percent who said that it was ‘found more in revenue raising’. Further, 55 percent of the respondents who mentioned the presence of corruption in the public sector also said that ‘almost all/most companies’ in their sector of business were involved in bribery to acquire government contracts, and that an average of 22 percent of the contract was said to be allotted as bribe.

As a consequence, the government departments largely involved in procurement are viewed as insincere in fighting corruption. The DPWH suffered from a Net Sincerity rating of -68 and the DepEd -9<sup>4</sup>.

### 3.2 Bribes Eat Up as Much as 65 Percent of Project Cost

As pointed out by Benham and Benham (2001), costs of exchange affect what is produced and what exchanges take place in the market. They affect which organizations survive and which rules of the game persist. So is the case with corruption in procurement. Corruption changes the goods and services

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<sup>3</sup> 33 percent of the respondents said there was ‘some’ corruption in the public sector; 10 percent ‘a little’; 6 percent ‘none’.

<sup>4</sup> The score for Net Sincerity in Fighting Corruption ranges from -100 to +100.

purchased by the government. It affects which procurement projects push through and which are shelved. It dictates the rules of the game and therefore limit opportunities to only those suppliers/contractors who know them and are willing to play them.

In 1998, an investigative report (Parreno 1998) called the attention of the country to the massive corruption scheme involving projects funded by the so-called pork barrel funds of the legislators. The report painted a very disturbing picture by claiming that as much as 65 percent of contract cost is eaten up by bribes in the procurement of books and medicines, with 40-50 percent of the contract cost going to the pockets of legislators. For the construction of roads, school buildings or local halls bribes eat up about 35 percent of project cost.

These so-called pork barrel funds started to be instituted in 1990, when the 8<sup>th</sup> Congress gave each legislator in the Lower House an annual allotment of PHP 12.5 million and each senator PHP 18 million for infrastructure projects, purchase of equipment and materials, and other activities. Known as the Countrywide Development Fund (CDF), it is supposed to correct the failure in the proposed budgets of national agencies, which according to legislators, are not responsive to the needs of their constituents.

By 1996, the legislators have allotted themselves a yearly PHP 30 million each for the Public Works Fund (PWF). In addition, each lawmaker had at least PHP 15 million in Congressional Initiative Allocation (CIA) (for senior senators, this amount runs up to PHP 100 million). These are budgetary items incorporated in allocations for various agencies over which legislators have the power to direct how, where and when they are to be disbursed. In 1998, CIA amounted to PHP 3 billion.

Projects funded by the pork barrel funds do not undergo the usual process of evaluation to determine their feasibility. Further, a special provision in the law, ensures that CDFs are automatically released once legislators submit to the budget department a list of projects and activities they want funded by their CDF allocations. Oftentimes, the proponent legislators themselves choose the contractors or suppliers for the projects.

More blatant, the report claims that the amount of bribes goes higher, depending on how goods are to be delivered: full, partial or ghost. For ghost deliveries, legislators get as much as 60 percent of the project cost. The implementing agency gets 25 percent since the paperwork for ghost deliveries is difficult to accomplish.

In a society where hierarchy is important and there is a strong tradition of deference to persons in authority, the poor constituents of these legislators see nothing wrong with the practice. Or at least calls for more transparency are not loud enough to effect material changes. Most of them see it as one of the perks of public office. As long as their congressional representatives do not turn them away when they need help for a wedding, a fiesta, or perhaps a burial, the legislators are seen as doing their jobs. Besides, the constituents can avail themselves of the temporary job opportunities offered by the infrastructure projects funded by the pork barrel funds.

Another investigative report (Chua 1999) relates that it is not only in pork barrel funded procurement that corruption prevails. Focusing on the procurement of textbooks and supplementary educational materials, the report says that local education departments have access to other funds that may be used for procurement. In the case of textbook purchases, some 20 percent of the contract cost goes to bribes, with as much as the half going to the education regional director. For procurement of supplementary materials, suppliers are willing to pay bribes of 40 percent of contract cost.

Suppliers explain that the higher affordable bribe in the purchase of supplementary materials is due to price caps and relatively rigid conditions (paper specifications, relatively higher print runs, etc.) governing the purchase of textbooks. Thus, there has been an observed increase in funds going to supplementary materials, where more bribes may be extracted, and a reduction in the funds allotted for textbooks.

The local school board fund is another source of financing for books. Drawn from the proceeds of the real property tax levied by the local government, this fund is at the disposal of the local school board, which is co-chaired by the provincial governor and the school division superintendent or the city mayor and the district supervisor. In some rich Metro Manila towns, this fund reaches about PHP 500 million each year. Bribes eat up 20-40 percent of contract cost, depending on the relative powers of the school division superintendent or the district supervisor. In any case, the provincial governor or the city mayor gets a share of 20 percent.

This situation of massive bribery in the purchase of educational materials was not always the case. In 1976, the government started the Textbook Project, whose aim was to provide textbooks to all public schools. In 1985, the government established the Instructional Materials Corp (IMC) to develop and distribute

textbooks to all public institutions. In line with this, the IMC invited authors to submit manuscripts, which the education department reviewed and ranked. The rights of top-ranked books were bought by the government and were developed by IMC. The printing and distribution of these titles were bid out to private entities. During that time, the average price of textbooks was around PHP 30.

In 1995, the Congress passed the Book Publishing Industry Development Act aimed at developing the book publishing industry. Thus, the IMC was replaced by the IMCS which evaluated manuscripts submitted by Filipino authors, based on a list of competencies. The IMCS then came out with a list of approved books (Textbook Call) with their corresponding price ceilings, which in turn were set by the National Printing Office (NPO), education department and private publishers. Additionally, the local education department offices were advised to negotiate for discounts.

Under this system, school principals were asked to select books from the list, and these orders were consolidated at the division and regional offices. In practice, the regional directors made the final choice of titles to be procured, which in many cases did not correspond to the orders of the principals. Accusations of graft and corruption in procurement of textbooks were rampant, and the average price of textbooks has risen to PHP 70 for grade school and PHP 120 for high school. The physical quality of books was likewise poor. Further, the textbook-pupil ratio in 1998 stood at 1:6 in the elementary grade schools and 1:8 in high schools (Department of Education, Culture and Sports (DECS) 1998).

When the investigative report came out, violation of rules had already become common practice. Supplementary materials which are not in the list of titles approved by the education department were purchased. Overpriced materials were also bought, the prices of which are certified by the NPO and are supposedly based on lower print runs. Worst, ghost deliveries were likewise practiced.

### **3.3 Outdated and Fragmented Laws and Weak Oversight Institutions Governed Philippine Public Sector Procurement**

Prior to the reforms, public procurement was characterized by outdated and fragmented laws and a proliferation of uncoordinated executive issuances (World Bank 2003). The basic regulation that governed the procurement of infrastructure projects was Presidential Decree (PD) 1594, a law passed in 1978 during the dictatorship and which remained unchallenged for more than 20 years. A partial survey revealed at least 40 legislative enactments, Executive Orders (EO),

Administrative Orders (AO), PDs and issuances from government agencies. The numerous executive issuances were promulgated in order to plug loopholes in the system.

Uncoordinated and overlapping directives were the result. Oftentimes, a variety of procedures and requirements has been prescribed which later has been found to be inconsistent with each other. The Commission on Audit (COA) rules were likewise not always made consistent with most recent changes.

This labyrinth naturally led to ambiguity and uncertainty. Without an oversight body to regulate and monitor procurement activities, procuring entities, on whose shoulders the primary responsibility for the implementation and execution of laws and rules rest, performed their duties based on their own knowledge, understanding and interpretation of the laws and rules.

More problematic, procurement at the Local Government Unit (LGU) level was subject to province or municipality specific regulation. Since the passage of the Local Government Code in 1991, primarily focused on decentralization, procurement rules were designed individually by each province and municipality. There was absence of check and balance, in that the local chief executive (such as the provincial governor or the city mayor) sat as the chairman of the bidding committee responsible for bid evaluation. The influence of the local chief executive in the bidding was so far reaching that effectively whoever he/she favours could win the contract.

The legal mess that governed public procurement was likewise matched by weak oversight and regulatory institutions. The COA is an independent agency created by the constitution to audit government revenue and expenditures. Although the COA has also been an important source of information on malfeasance committed by corrupt government officials, the extent of connivance of some government auditors with corrupt practices in other government agencies is likewise an issue.

The Office of the Ombudsman is the lead agency to enforce public accountability. It has the power to investigate and prosecute violators of antigraft laws. However, the rate of sanction is very low. The Office of the Ombudsman reports that in 1997, only 16 percent of reported corruption cases were advanced for prosecution, and at best less than 2 percent resulted in conviction (cited in World Bank 2000:40). It likewise lacked resources to perform its duties. In 2002, the Office of the Ombudsman had only 32 full-time prosecutors handling more than 2,000 cases at the Antigraft Court; had 37 field investigators to watch over a bureau-

cracy of 1.5 million public officials and employees; had no training programs for prosecutors and investigators; and had no supervisory/monitoring/management system of cases and prosecutors' performance (Marcelo 2004).

#### **4 Reforming Public Procurement in the Philippines: Building Institutions**

In 1999, the government, with the help of the donor community and the civil society, started reforming its procurement system.<sup>5</sup> At a time when the highest office of the land was rocked by a serious corruption scandal resulting in the impeachment of the President, anti-corruption efforts were very much supported. In 2003, the Government Procurement Reform Act (GPRA) was passed and was hailed by politicians of the new administration as a successful first step in fighting corruption. The potential savings that the government was not able to realize in the old procurement system was the primary 'selling point' for the passage of the law.

North (1990) argues that institutional changes come from the perceptions of players in political and economic organizations that they could do better by altering the existing institutional framework at some margin. Thus, institutional change occurs when organizations deem it profitable or beneficial. Modifications occur because individuals perceive that they can do better by restructuring exchanges. This was true for the then soon-to-be impeached President who thought that by supporting a legislation that is suppose to address corruption in government procurement, the society's furor over his own corruption activities would be dissipated. This was likewise the case for the later sworn in President who needed to show her strong conviction to fight malfeasance in the public sector, amidst doubts about the constitutionality of her ascent to power. The legislators both in the Lower and Upper Houses saw themselves becoming more popular among the then very vigilant population by throwing their support for the reforms.

While the President and the legislators played an important part in the passage of the new procurement law, the backbone of the procurement reforms, it was the Department of Budget and Management (DBM) which took the lead in the

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<sup>5</sup> A huge amount of information in relation to the passage of the law was taken from Campos and Syquia (2006), the most detailed and comprehensive documentation of the reform efforts in its early years.

reforms.<sup>6</sup> It first secured technical assistance from the Canadian International Development Agency (CIDA) to help the Government Procurement Service (GPS), an office under its supervision, develop an electronic procurement system.

Further, to rationalize the procurement system by having an all-encompassing law passed by the legislature, DBM sought technical assistance from the United States Agency for International Development (USAID) to undertake an extensive analysis of the problem and then, based on the analysis, to prepare a draft bill that would address the system's weaknesses. Submitted in August 1999, the study revealed that opportunities for corruption in government procurement stem from three factors: 1) excessively strict pre-qualification process for prospective bidders; 2) excessive use of discretion in selecting the winning bidder; and 3) lack of transparency that accompanies the bidding process. The draft bill proposed a solution that emphasized deterrence and prevention.

Technical Working Group (TWG) discussions were conducted in August to October 2000 resulting in the following: 1) a new EO 262, amending the previous EO 302 for the procurement of goods, supplies and materials, and its accompanying Implementing Rules and Regulations (IRR), and 2) the revised IRR of PD 1594 for infrastructure contracts. The new IRR of PD 1594 took effect in August 2000, and EO 262 became effective in December 2000.

In addition to these outputs, the TWG likewise produced a draft bill, which the DBM requested the then President to certify as "urgent". In October 2000, the public furor over the President's activities – mostly related to corruption and abuse of power – was beginning to build steam. His staff saw the bill as one way of helping contain the growing discontent. Unfortunately, by the time the bill passed the Lower House and got to the Senate, the senators were already gearing up for the President's impeachment trial. Despite this disappointment, the reform coalition headed by DBM realized that anti-corruption was an issue that could be used strategically to move a bill forward when the public was very vigilant about corruption-related issues.

In May 2001, a new President was sworn in, rising on a platform of good

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<sup>6</sup> In the process, the DBM sought the support of the other major spending government departments, such as the Departments of Public Works and Highways, Education, Health, Defense, among others. It first convened an Inter-Agency Workshop to discuss possible reforms in procurement that may be pushed. The workshop concluded that the procurement process embodies the principles of transparency, accountability, equity, effectiveness, efficiency and economy.



governance and anti-corruption with the support of many of the civil society organizations (CSOs) that clamoured for the previous President's impeachment. In her July 2001 State of the Nation Address, the new President stressed the urgent need for good governance and, considering the inability of the bill to pass the 11<sup>th</sup> Congress, set it as a top priority for her administration. As Alston (1996) explains, institutional change can arise from either a change in the demands of the constituents or a change in the power of the suppliers of institutions. As a result of a new election, or in the Philippine case the impeachment of a president, another group could gain political power, inducing changes in the institutional structure.

In October 2001, the President signed EO 40<sup>7</sup> claiming it as an early achievement of her administration in the fight against corruption. This is in line with the observation of the World Bank's *Doing Business: How to Reform* (2007) that most reforms take place in the first 15 months of a new government. Thus, for a government recently elected or re-elected, the time to push through ambitious reforms is at the start of its term.

As the previous President was successfully impeached, the outrage of the public against public sector corruption started to dissipate. The reform coalition then formed a non-governmental organization specialized in procurement issues. Procurement Watch Inc. (PWI) was launched in February 2001. Its immediate task was to recreate a semblance of the impeachment ambience that could refocus the public's attention on corruption, at least to an extent sufficient to convince enough legislators to support the needed legislation.

PWI approached key CSOs and engaged vigorously with each to get their "buy in". Additionally, PWI worked on the media to raise the news profile of corruption in government procurement. A media team with considerable experience in public relations, advertising, and political campaigns was brought on board, whose campaign efforts was composed of four components: a) targeted use of AM radio; b) invitation to "60 Minutes"-type TV shows; c) regular but strategic news releases in print media, and d) an advertising campaign complete with streamers, posters, stickers, and give-aways. Central in these

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<sup>7</sup> EO 40 consolidated the new implementing rules and regulations of PD 1594, EO 262 and new rules for contracting consulting services into one document. Additionally, EO 40 mandated that the country's Electronic Procurement System (EPS) shall be the single and centralized electronic portal for all types of procurement.

media exposures is the emphasis on the proposed procurement reform bill as a necessary first step to address the corruption problem in the public sector.

Meantime, the DBM has convinced the Speaker of the Lower House to endorse the bill. In May 2002, the President certified the bill as “urgent” – to address the public emergency borne out of the pervasive malady of graft and corruption that has long plagued the government procurement system, impaired public service efficiency, and stunted national capacity for economic growth.<sup>8</sup>

In October 2002, the bill was brought to the Floor for a vote and passed with an overwhelming majority. At the same time in the Senate, the senator sponsoring the bill gave a speech to the Floor entitled “Building Honest Roads to Progress”. In urging his colleagues to certify the bill, he explained that the estimated 20 percent of procurement funds being wasted because of corruption (PHP 21 billion, using 2002 figures) can finance 520 million textbooks for public school children, the construction of 63,000 new classrooms, or the pavement of 1,500 kilometers of farm-to-market roads (as mentioned in Syquia 2003). In December 2002, the Senate passed its version of the bill. The Consolidated Bill was eventually approved by both Houses. And on January 2003, the President signed the Consolidated Procurement Reform Bill into law as RA 9184 or Government Procurement Reform Act (GPRA).

The reform coalition was successful in using anti-corruption as an issue to strategically move the bill forward in the legislature. Anti-corruption is a platform that everybody supported. Nobody could be against it. Or at least, nobody would admit to be against it. In both Houses, apart from the original sponsors of the bill, a large number of legislators signed up as the bills’ co-sponsors.

## **5 The Government Procurement Reform Act: Reducing Opportunities for Corruption, Breaking Barriers to Entry, and Lessening the Likelihood of Collusion**

While reducing opportunities for corruption may result in lower transaction costs in procurement, breaking barriers to entry as well as lessening the likelihood of collusion are two other institutional backbones that are clearly imbedded in the new law, as can be seen from an examination of the GPRA and its IRR.

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<sup>8</sup> Correspondence of President Gloria Macapagal-Arroyo to Speaker Jose C. de Venecia, Jr. dated May 27, 2002 as quoted in Campos and Syquia (2006).

In order to attract more competition, the law requires that all procurement opportunities be advertised in a national newspaper and be posted in established websites, among which is the Government Electronic Procurement System (GEPS). Prior to the reforms, bidding was sometimes limited to only a few by posting advertisements in local newspapers of limited circulation. Chua (2002) has documented cases wherein announcements of procurement opportunities have been printed on early editions of newspapers or special print runs or where all copies of the newspaper carrying the advertisement have been bought by either the corrupted procurement official or the favoured supplier/contractor to deliberately limit information dissemination.

Further, the GEPS has a feature of automatically advising registered suppliers of procurement opportunities that match their products or services. This shift to maximum information dissemination should make collusion more difficult and hinder bid orchestration. Further, as more participate, the likelihood of responsive bids being received increases. Additionally, to avoid tailor-fitting specifications of the required goods, the GPRA prohibits reference to brand names.

To simplify the process and avoid unnecessary delays, the GPRA streamlined prequalification into a simple eligibility screening using transparent and non-discretionary criteria. In the old system, prior to bidding and during the pre-procurement stage, each document submitted by each prospective bidder was checked and underwent a detailed validation procedure, which took time and resulted in an excessively long procurement cycle. With the new law, detailed verification and validation of submitted documents are done only in the post-qualification stage for the bidder with the Lowest Calculated Bid. Further, due to its computerized facilities, the GEPS and the DPWH require interested suppliers and contractors to submit their eligibility requirements only once a year.

In order to enhance transparency, several new features are in place. First: all necessary information about the procurement opportunity is made public in the advertisements and the bidding documents, including the Approved Budget of the Contract (ABC). In the old system, this figure was kept confidential presenting the government official and the bidder/s an opportunity to collude in the revelation of this inside information. Likewise, there was an observed high tendency of failed biddings due to all bids being higher than the allowable ceiling.

Second: all activities by the Bids and Awards Committee (BAC) from the pre-bid conference to the contract award are open to the public. CSO representatives,

who are knowledgeable about the nature of procurement and the law, participate in the bidding activities as observers. They prepare a report of their observations which they may submit to the Office of the Ombudsman in cases where prescribed bidding procedures are not followed.

Third: members of the BAC, its Secretariat and the TWG are prohibited from entertaining any form of communication from bidders.

Fourth: the new procedure for the opening of bids has several transparency-enhancing features which are primarily directed against bid rigging. All sealed bids are opened in public during the bid opening in the presence of all bidders and observers. Further, no previously-submitted sealed bid may be destroyed or retrieved. This helps ensure that documents have not been altered and allows manipulations to be detected at an early stage.

Fifth: to render complex procedures transparent and clear to potential suppliers and contractors, particular efforts to disseminate information on rules, regulations and procedures are undertaken. Additionally, comprehensive procurement manuals have been drawn up and are easily accessible on the Internet.

In order to minimize discretion, the GPRA specifies that the Lowest Calculated and Responsive Bid be determined using an objective, quantifiable and non-discretionary criteria during the bid evaluation. In contrast, the old system allowed trade-offs between price and quantity. Worse, it was likewise vague on the difference between minor and major deviations. The new law, on the other hand, pegs the technical requirements to a minimum and bidders compete on the basis of price alone. This system then removes the discretionary power of the BAC in deciding between a relatively high-quality high-priced bid and a relatively low-quality low-priced bid.

When the bid evaluation involves quality-based evaluation, as in the case of procurement of consulting services, the extreme scores (both lowest and highest) given by evaluators for each proposal are not taken into consideration in determining the mean scores of the proposals. This removes the possible distortion in quality ranking by limiting the possibility that a bribed member of the BAC can affect the result of the evaluation.

In order to promote consistency of rules, the GPRA covers all government-funded procurement activities of all branches of the government across the country. Thus, interested suppliers or contractors face the same rules and procedures when bidding on locally-funded contracts. In order to foster the development of uniform procurement practice and policies, the Government

Procurement Policy Board (GPPB), a central procurement authority, has been established to supervise the individual procuring entities, monitor compliance with the regulatory framework, set and harmonize policies, and recommend reforms.

But like in any change of policy, there would be winners as well as losers. In a compromise deal to pass the procurement bill, the reform coalition had to accept a legislative insertion that gave preference to provincial bidders in the procurement of provincial projects. In cases where the lowest bid is submitted by a bidder not coming from the concerned province, the lowest bidder among the provincial bidders is given the right to match this lowest bid. This special provision, however, will only be effective for the first five years of the law.

## **6 Figures Suggest Gains Are Being Made from the Reforms**

Four years after the passage of the GPRA, reform measures continue to be put in place (World Bank 2005). Trainings are on-going to familiarize the government procurement personnel on the law, its rules and the corresponding bidding documents. PWI continues to train other CSOs in making them qualified observers and works with the Office of the Ombudsman for the handling and processing of various information and reports coming from the observers. Some government departments, notably the DepEd, has tapped CSOs in monitoring procured goods delivery.

Nonetheless, gains are clearly being made at this early stage. The first major gain is namely the passage of a comprehensive law. As Asian Development Bank/Organization for Economic Cooperation and Development (ADB/OECD) (2006) explains, “a clear and comprehensive regulatory framework for the conduct of public procurement is a fundamental prerequisite for curbing corruption in public contracting”. The establishment of rules in parliamentary law protects the framework from short-lived changes. Further, rules laid down as guidelines or written up in manuals are normally not legally binding.

Secondly, competitive bidding, as is now known by all involved in procurement, is the rule and not the exception. The experience of the DepEd provides an inspiring picture of what may be achieved from embracing competition. Apart from being an active member of the reform coalition, DepEd likewise sought the World Bank’s assistance in 1998 to address the problem of extremely low textbook-pupil ratios in the form of a USD 44 million loan under the Social Expenditure Management Project (SEMP) to procure textbooks (World Bank

2004). The project delivered over 42 million textbooks to schools improving the textbook-pupil ratios to between 1:1 to 1:2 in core subjects. It improved the procurement and delivery of textbooks through the introduction of competitive bidding procedures resulting in significant cost savings. The average price of textbooks plummeted by 50 percent (to PHP 35 for grade school and PHP 60 for high school) in the first and second phase of the loan agreement, generating savings of USD 23 million for a third phase.

Reduction in prices is likewise reported by the GEPS, which it claims to be the result of posting procurement opportunities on the website.

*Table 1 Posting procurement opportunities on the website*

Savings (%)	Goods
53	Various drugs / medicines
43	Equipment for electrification projects
42	Printing of letterheads
33	IT equipment and supply/delivery of construction materials
25	Supplies/material and services
19	Construction supplies, IT equipment
17	Electrical/mechanical supplies and equipment
15	Various office supplies/equipment
15	Office supplies/materials
11	Vehicles and supplies/materials

*Source: Government Electronic Procurement System 2006.*

This claim is supported by several other indicators from the GEPS. Since it is a requirement to be registered at the GEPS for interested suppliers to be advised of procurement opportunities matching their offered goods/services and to eventually be able to participate in the bidding of the required goods/services, then figures showing the number of registered firms should give one an idea of the size of the market of potential suppliers. The more firms register, the stiffer the potential competition among them may be.

*Table 2 New registered suppliers*

Year	Number of New Registered Suppliers
2001	854
2002	1,894
2003	1,875
2004	6,553
2005	5,264

Source: *Government Electronic Procurement System 2006*.

Similarly, the DPWH has reported an extremely large increase in the number of bidders joining the bidding for infrastructure projects. In one case, this figure had risen from 10 to 95 eligible bidders (Campos and Taningco 2001).

More participation is observed not only among the private sector, but likewise within the government. As more and more offices of the government are trained to familiarize themselves with the new law, and more particularly with the use of the GEPS, more and more procurement opportunities are advertised/posted at the website.

*Table 3 Procurement opportunities advertised/posted*

Year	Number of Advertisements Posted
2001	2,064
2002	10,016
2003	20,817
2004	42,945
2005	86,496

Source: *Government Electronic Procurement System 2006*.

Meantime, other government departments are likewise reporting shorter periods of procurement. The DPWH says that the procurement cycle for infrastructure projects has been cut down by as much as five (5) months because of the shift from the tedious pre-qualification to the simple eligibility screening (Campos and Taningco 2001). Further, because of the computerization of eligibility check, screening of bidders takes only as much as 12 minutes. Additionally, according to the DepEd, the procurement cycle, which used to be 24 months from bid

opening to final delivery, has been cut down to 12 months.

Apart from much lower prices and shorter procurement cycles, the DepEd likewise points out that better technical specifications and random monitoring of CSOs at printing presses and warehouses and at delivery points improved the physical quality of textbooks and avoided ghost deliveries.

The statistics enumerated above support the claim that much could be gained from procurement reforms. While one may argue that the reduced prices, stiffer potential competition, enhanced transparency, etc. may well have been caused by another factor, a look at new legislations passed around the time of the GPRA reveals that no other policy change may have led to the same results.

Survey results are reflecting these gains as well. There has been a marked easing in the perception of corruption in procurement. SWS reports that the proportion of managers saying that most or almost all companies in their sector give bribes to win public contracts has fallen to 46 percent from 2004's 52 percent and a high of 57 percent in 2002 (Social Weather Stations 2006). Zooming in to specific government departments, the DepEd seems to be doing well not only in the reforms, it is likewise able to communicate its gains to the public. While it suffered from a rating of -9 in Net Sincerity in Fighting Corruption in 2000, it enjoyed an impressive +65 in 2001 and has since then stayed in the positive territory.

## **7 Concluding Remarks**

Prior to the reforms, various sources reported extremely huge costs of exchange in procurement, partly due to rent-seeking behaviour. The absence of a clear and comprehensive procurement law and weak oversight institutions were contributory to this situation. Realizing the losses it was incurring, the government initialized institutional change by reforming the system of procurement and successfully passing the GPRA in the respective legislative bodies. International organizations like ADB, OECD and World Bank assisted the government by making sure that the new procurement law would match international standards. Thus, the government acted due to internal pressure but on the basis of already existing frameworks being advocated by international actors.

Although the law has been changed, it is expected that it will take time for the old norms to be replaced. Though still scant, some figures are showing that gains are already being made due to policy change. The instalment of a comprehensive framework led to competitive bidding, lower prices and a shorter



procurement cycle. The question if the procurement law will lead to a significant reduction of corruption can only be answered with time. Thus, it would be advisable to conduct a systemic analysis of how much of the potential benefits are indeed been realized. The Government Electronic Procurement System, being the central procurement portal, should be the best starting point. The Department of Education and the Department of Public Works and Highways, once perceived to be run by corrupt officials, should be interesting case studies. Such information would be very encouraging to the rest of the public sector in embracing the reforms' implementation, to the donor community in continuing its support, and to the general public in playing its role as observers and monitors in the procurement process.

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