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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

PHILIPPINES

PROGRAM ASSISTANCE APPROVAL DOCUMENT
(PAAD)

RURAL PRODUCTIVITY SUPPORT PROGRAM

(492-0383)

NOVEMBER 1984

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PHILIPPINES
RURAL PRODUCTIVITY SUPPORT PROGRAM

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	2. Country		Philippines	
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\$ 47,500,000		10. Appropriation Budget Plan Code		
11. Type Funding	12. Local Currency Arrangement	13. Estimated Delivery Period	14. Transaction Eligibility Date	
<input type="checkbox"/> Loan <input type="checkbox"/> Grant <input checked="" type="checkbox"/> Informal <input type="checkbox"/> Formal <input type="checkbox"/> None		12/84		
15. Commodities Financed				

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash \$47,500,000		\$47,500,000	
		Other	

18. Summary Description
 The Philippine economy is in its most serious crisis since World War II. Poor development policy selection and execution during the 1960s and 1970s, international oil price increases, and the recent worldwide recession weakened the economy. The crisis was precipitated in August 1983 with the assassination of former Senator Aquino. This led to massive capital flight and the declaration of a commercial bank debt payment moratorium, as the country's foreign exchange reserves dissipated.

In addition, budgetary capital outlays had to be significantly reduced due to tight fiscal and monetary policy. This has delayed the completion of many investment projects including those assisted by the U.S. and the multilateral development banks - i.e. the IBRD and ADB. Therefore, the economic and social benefits of these activities will be delayed while the costs for completing the activities escalate.

The objective of the AID proposed \$47.5 million Economic Support Fund program assistance is to carry out U.S. commitments entered into under the 1983 amendment to the 1947 Military Bases Agreement, and to provide both foreign exchange support to the GOP and budget support to the Rural Productivity Support Program (RPSP). Upon transfer of the dollar assistance, the GOP will make an equivalent amount of pesos available for the RPSP, which will consist of development projects of the IBRD, ADB and A.I.D. selected on the basis of mutually agreed criteria. This amount will be in addition to other resources available for the Program from

19. Clearances		20. Action	
REG/DP, JWestley	Date	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED	
REG/GC, STisa			
AA/PFC, RADERHAM	12/12/84	Authorized Signature Date	
M/EM, ES QWENS			
GC, HFry		12/19/84	
		Title Counselor, A.I.D.	

18. Summary Description (Con't)

the GOP and from the proceeds of loans and grants made by the IBRD, ADB and A.I.D. for projects within the Program.

The purpose of furnishing this additional peso support is to maintain a satisfactory pace of implementation for the projects included in the EPSP which have been delayed due to the funding cutbacks in the national budget. The GOP will monitor performance within the EPSP during the 1985 budget cycle and report on progress toward achievement of Program objectives. A.I.D.'s purpose in furnishing budget support for the EPSP is focused on progress of the Program as a whole rather than on any individual activities in the Program.

Prior to disbursement of dollars for the Program, the GOP will certify that funds are available for the fiscal year 1985 budget for the EPSP and provide a list of projects included in the Program. Prior to release of pesos from the special account, the GOP will provide A.I.D. with a certification from the Office of Budget and Management that Advances of Allotment have been issued with respect to projects in the Program.

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I. SUMMARY AND RECOMMENDATION

A. Recommendation

USAID Philippines recommends authorization of an Economic Support Fund (ESF) grant of \$47,500,000. These funds will be disbursed after compliance with the conditions precedent whereby the Government of the Philippines (GOP) has initiated a process of increasing its counterpart funding level to the mutually agreed-upon group of development projects contained in a Rural Productivity Support Program (RPSP).

B. Grantee

The Grantee will be the Government of the Philippines acting through the Economic Support Fund Council. The Economic Support Fund Council was formerly the Management Advisory Committee which oversaw ESF resources.

C. Program Summary

The Philippine economy is in its most serious crisis since World War II. Poor development policy selection and execution during the 1960s and 70s placed the economy in a position such that it could not adjust rapidly enough to the oil price increase shocks of 1973 and 1979, and the deep worldwide economic recession of 1981 and 1982. The economy was overburdened with: import-dependent and inefficient industries protected by high tariffs, extensive external debt, and artificially low interest and exchange rates. The GOP recognized the country's problems and started on a program of structural reform in 1980; however, it was an insufficient effort. With confidence in the economic management on the wane, the assassination of former Senator Aquino in August 1983 precipitated a high degree of political uncertainty which led to massive capital flight. The foreign exchange reserves of the country dissipated and the GOP had to declare a commercial bank debt payment moratorium in October 1983. Inflation accelerated as foreign exchange was limited and goods became scarce, while the GOP engaged in monetary and fiscal policy reform.

Over the past year, the International Monetary Fund (IMF) and a Commercial Bank Advisory Committee negotiated a financial restructuring plan and loan package with the GOP to meet its balance of payments needs which have been estimated to total some \$3.9 billion over 1984 and 1985. Further, monetary policy performance and budget deficit targets were set. With the October 1984 implementation of a prior action program and the IMF's acceptance of a Letter of Intent for a new Stand-by Agreement, it appears that the country is finally back on a recovery path. However, there has been a significant reduction of over 50 percent in the real value of budgeted capital outlays. This will delay the completion of many investment projects, including those assisted by the U.S. and multilateral donor agencies such as the IBRD and ADB. Therefore, the economic and social benefits of these activities will be delayed at the very time they are needed most.

The objective of AID's proposed Economic Support Fund program assistance is to provide budget support to the GOP. The additional support will be directed to a group of foreign-assisted projects selected for inclusion in the Rural Productivity Support Program (RPSP). Currently the 1985 budgeted level for all foreign assisted projects is approximately the equivalent of \$322.7 million. This is at least \$100 million below the level of funding requested by the various implementing entities. With additional budget support provided to projects in the RPSP, the GOP will be able to maintain their pace of implementation which is being slowed due to the funding cutbacks in the country's national budget.

The support will be accomplished by transferring \$47.5 million to the Treasury of the GOP in exchange for the GOP depositing an equivalent amount of pesos in a Special Account in a duly authorized bank. Release of these pesos to the general fund account of the GOP Treasury will be approved by AID when the GOP, through the Office of Budget and Management (OBM), issues Advices of Allotment (AAs)--the GOP obligational authority--for the agreed-upon RPSP funding level. Based upon the list of projects for RPSP, the funding level would be approximately the equivalent of \$196.6 million. This level includes the regularly budgeted GOP counterpart (at the equivalent of \$56.4 million), budgeted donor grant and loan proceeds (at \$92.7 million), and the additional GOP counterpart (equivalent to \$47.5 million) that will be made available as a result of these Economic Support Funds.

The GOP will monitor performance within the RPSP during the 1985 budget cycle. The additional counterpart resources made available as a result of the ESF dollar transfer will be shifted by the GOP among RPSP activities based on project implementation progress such that the entire amount of RPSP resources - regular and additional GOP counterpart pesos, and grant and loan proceeds - are expended during the 1985 budget cycle.

D. Conditions, Covenants and Negotiating Status

The conditions and covenants proposed for the grant are described in Section III.D. Essentially, in addition to the standard conditions precedent, a Certification of Funds Availability (CFA), which commits the GOP to make available all peso counterpart and grant/loan proceeds associated with RPSP during 1985, will be required prior to dollar disbursement. Our concurrence in the release of pesos from the Special Account will require: a certification from the National Accounting Office (NAO) of OBM that Advices of Allotment (AAs) authorizing obligations have been issued for all peso counterpart, loan/grant proceeds, and ESF related funds for the RPSP; a certification that any public sector corporation or parastatal included under RPSP has agreed to limit fund uses to the agreed-upon purposes and that this is auditable by the GOP; and, a detailed implementation plan.

The basic proposed covenants are that: 1) no changes will be made to the agreed-upon list of projects in the Program without good reason and without the approval of AID; 2) the GOP will not amend, cancel or otherwise change the AAs for projects in the RPSP to free GOP resources from the RPSP for other purposes; and, 3) that quarterly reports on the physical and financial status of the Program's implementation will be provided to AID with a closeout report no later than six (6) months following the end of the Program.

The options under AID's Program Assistance have been discussed extensively since mid-1983 with the GOP's Economic Support Fund Council's Sub Committee on Program Negotiations. There is agreement on the priority need for budget support to maintain a satisfactory level of implementation for the select group of rural development-oriented projects which would be beyond the rate possible with Philippine Government resources alone. The Program Assistance Initial Proposal (PAIP) was shared, discussed and modified in collaboration with the GOP. Negotiations have continued since the April 1984 PAIP approval in order to agree on the final project selection criteria, the basis from which additionality would be measured, and the implementing and monitoring mechanisms. We have promised a best effort to obtain AID/W Program Authorization in time for finalizing the Program Agreement so that the dollar disbursement will occur prior to the end of the 1984 calendar year.

II. THE CURRENT ECONOMIC SITUATION

A. Overview

1. Past Economic Performance

Philippine economic performance over the past several years has been characterized by a progressive deterioration, eventually leading to the present crisis. The country's balance of payments deficit widened from \$54 million (0.2 percent of GNP) in 1978 to well over \$2.0 billion in 1983 (more than 5 percent of GNP) due to worsening external terms of trade, a substantial increase in interest payments on external loans, and, particularly in 1983, a sharp deceleration in capital inflows. The 1981-1982 worldwide recession adversely impacted the domestic economy.

Real GNP growth decelerated from almost 7.0 percent annually during 1977-1979 to only 2.6 percent per year during 1980-1983, (1.4 percent in 1983), and a decline of 5.5 percent during the first half of 1984. The growth of the industrial and commercial sectors declined markedly because of domestic recessionary conditions. Moreover, agricultural production was severely affected by unfavorable weather conditions since the start of the eighties. Investment growth was similarly restrained by the poor business climate which was highlighted by the financial crisis in early 1981, and the economic and political turmoil in 1983. With population growing at 2.5 percent per annum there has been virtually no increase in the peso per capita income since 1979.

The GOP budget deficit rose sharply in 1981 and 1982 due to countercyclical spending and an unimproved tax collection effort. Inflation remained at double-digit levels during the 1979-1983 period because of the budget deficits, higher domestic petroleum product prices, and a declining peso exchange rate.

2. Reasons for the Current Crisis

The origins of the current crisis may be traced back to policy decisions as early as the mid-60's when the Philippines chose to follow an import substitution policy which favored the large scale urban-industrial sector over both the agricultural, and rural medium and small scale industrial sectors. Despite the structural problems resulting from this choice, continued good growth was made possible by a favorable international environment before 1973 and by the ready availability of commercial foreign capital thereafter. The GOP started taking certain steps toward structural reform but these measures were put in place rather too late and on too limited a scale to counteract the drying up of cheap sources of foreign capital and the relative inefficiency of the productive assets this capital had financed.

The gradual shift from a natural resources, export-driven growth to an import substitution and debt-driven growth also introduced several additional features to the country's economic affairs in more recent years. The most pronounced of these was the substantial acceleration of public sector investment in both infrastructure and directly productive activities. Second, commercial bank lending, justified principally by GOP guarantees, was part of the same spending activity and ultimately resulted in government take-overs or bail-outs. Third, the eagerness of foreign banks to lend and the equal eagerness on the part of the public and private sectors to borrow have weakened whatever push had been initiated toward a change in development strategy. Fourth, there has been a substantial increase in monopoly power not only in the public and private industrial sector but also in cash crops and related processing activities. Fifth, there has been pervasive disenchantment with the government's management of the economy. One consequence of this growing disenchantment has been the well recognized flight of capital, both financial and human.

These factors, combined with the worsening external environment during 1981-82, have brought the Philippines to its present crisis. The assassination of former Senator Aquino in August of 1983 only precipitated and worsened the situation. The Government had to declare a commercial bank debt moratorium as foreign exchange reserves were depleted and the peso was effectively devalued. By the end of 1983, business activity slackened and unemployment rose. The budget had to be slashed to keep it within deficit limits as revenues declined. The Government entered into negotiations with the IMF and an Advisory Committee of the commercial banks on an economic recovery program.

3. Prospects

Prospects for the Philippine economy in the foreseeable future remain bleak. Government forecasts a 5.0 percent decline in GNP for 1984, and 1.5 percent and 3 percent real increases in GNP for 1985 and 1986, respectively. Inflation is forecast at 50 percent, 25 percent and 18 percent, respectively, for 1984, 1985 and 1986. There seems to be a consensus that growth for the rest of the 80's will be much below that experienced in the 70's, averaging at best 3 to 4 percent per annum in the next five years. Even these reduced rates presuppose a modicum of basic social stability and significant structural reforms which may be difficult to implement due to resistance from those benefitting from the status quo.

B. Recent Economic Developments

1. Output and Spending

The present year can only be described as grim. GNP dropped by 5.5 percent in real terms during the first semester of 1984 relative to the same period in 1983. This decline was brought about by a 3.7 percent contraction in Gross Domestic Product and a further decrease in net factor income from abroad. In September, the GOP estimated that the real rate of decline in GNP for the whole of 1984 would be 5.0 percent.

Industry registered an output decline of 9.0 percent during the first semester of 1984 with construction activity being reduced by 16.2 percent and manufacturing production going down by 6.3 percent. While the utilities subsector managed to post a 4.7 percent real increase in the first semester, it is also expected to experience a decline of at least 2 percent for the whole year. The manufacturing industries most affected by the crisis thus far were the capital and intermediate goods categories, i.e., transport equipment, chemicals and chemical products, non-electrical machinery, basic metals, and leather and leather products. The service sector is estimated to post a 3 percent decline during 1984.

Although real per capita GNP declined by 7.6 percent during the first semester relative to the year-ago level, real personal consumption expenditures still increased by 1.6 percent. This has been attributed to people trying to maintain old living standards and to short term bursts in speculative spending for consumer goods. In addition, gross domestic investment contracted markedly by 34.5 percent during the first semester.

With the scaling back of production and with a rising number of firms shutting down operations, the country's unemployment problem is expected to worsen, inevitably leading to a further decline in real incomes. The GOP reported an unemployment rate of 6.3 percent during the first quarter of 1984 compared to 5.9 percent in 1983. However, the definition used by the GOP understates unemployment in the standard sense of people without full time employment seeking jobs. Independent estimates of unemployment run as high as 30 percent. The Ministry of Labor and Employment estimates over 90,000 workers laid off during the first six months of 1984, 1,284 establishments closing shop or retrenching, and 182 companies experiencing reduction in work time.

2. Prices

Inflation continues at the highest rate experienced since the early post-war period. The estimated average annual inflation rate for the first semester of 1984, as measured by the Consumer Price Index for the Philippines (1978=100), was 40.3 percent. Even higher rates were yielded by other indices. As of the end of September, the inflation rate was 63.4 percent on a year-to-year basis. The price increases appear to be broadly distributed between traded and nontraded goods, a reflection of the general inflationary influences stemming in large part from the excess liquidity which began to emerge toward the end of 1983.

Given the long experience of the Philippines with relatively low rates of inflation, these developments appear to have changed behavioral patterns and expectations. As already mentioned, this was evidenced during the first half of the year by increased commodity hoarding and consequent shortages, particularly of essential foods and other consumer goods governed by price control regulations. It was also apparent in reduced demand for financial instruments, whose yields became sharply negative in real terms, and in greater pressure on the value of the peso in the parallel foreign exchange market.

The GOP has recently floated the peso and imposed new domestic taxes on petroleum products. These developments are certain to result in new price adjustments. However, they should be minimal as liquidity is fairly tight now. This is already evident in the narrowing down of the differential between the official and the parallel market peso-dollar exchange rates from as much as 30 percent shortly after the June 1984 devaluation to a negligible level in mid-October (however, some of this must be attributed to informal pressures on the parallel market dealers to hold down their rate). Another manifestation of things to come is the drop in market prices for some consumer foods, e.g. poultry and livestock products, below previously established ceilings.

3. Financial Sector Situation

During the first half of the year, monetary policy was slightly contractionary. Open market operations through: issuance of Central Bank Certificates of Indebtedness (CBCIs) and Central Bank bills at market rates of interest, increased reserve repurchase transactions, and lower rediscounts had initial success in mopping up excess liquidity during the first quarter of 1984. In the succeeding quarter, however, the intended tightness in monetary policy was diluted by Central Bank accommodations to several hard-pressed financial institutions and by the expansion of net domestic credits to the National Government. Meanwhile, liquidity rose significantly in the third quarter when emergency advances were made by the Central Bank to banks hit by massive deposit withdrawals. By early October, however, the Central Bank seemed to have better control over liquidity.

Interest rates have been on the uptrend, reflecting the general tightening of monetary conditions in the economy. The average Manila Reference Rate rose from 16.8 percent in the first quarter of 1984 to 21.4 percent in the second quarter. Treasury bills (91 days) rose 10 percentage points to 26.6 percent over the same period. Average time deposit rates likewise increased 3 percentage points to 19.4 percent. Only savings deposit rates experienced a drop from 9.8 percent to 9.7 percent. Interbank lending rates rose to 41.3 percent, an increase of 32.6 percent over the level posted during the immediately preceding quarter. The average loan rate for all maturities reached the level of 25.1 percent from 22 percent as of the immediately preceding quarter. Nevertheless, real interest rates have continued to drop as inflation has accelerated.

4. External Sector

On the basis of actual foreign exchange payments during the first semester, the balance of payments yielded an overall surplus of \$70 million. Actual payments, however, excluded arrears amounting to \$228 million. Adjusted for this, the balance of payments in the first semester resulted in an overall deficit of \$158 million, representing an improvement from the \$1.14 billion deficit in the same period last year. The merchandise trade balance remained negative, although at \$286 million it was much below the \$1.3 billion trade deficit in the first semester of 1983. The improvement has been primarily due to a 23 percent decline in imports.

In the services account, the net outflow amounted to \$561 million, 2.5 times larger than the net outflow in the comparable period last year. The increase in the net outflow was due to declines in overseas workers' remittances, income from tourism, and investment abroad. The current account deficit was offset by a net inflow of \$482 million in the non-monetary capital account.

Pending agreement on the restructuring of the country's commercial, bilateral and multilateral foreign obligations, extension of the debt moratorium has been requested and granted four times thus far, the last extension being granted on October 15, 1984. As of end-June, 1984, total foreign exchange liabilities were recorded at \$24.8 billion, up by 0.1 percent from the end-1983 level, and higher by 3.1 percent than the outstanding level on October 17, 1983 when the debt moratorium began.

The Central Bank tried to maintain a minimum level of gross reserves equivalent to two months' import requirements. Nonetheless there was a 30.2 percent decrease in gross reserves by the end of June to a level of \$632 million. This represents a little over one month's imports at current payment rates. Indications are that reserves had fallen even further by the end of September and are less than one month's needs.

The official exchange rate of the peso to the dollar was pegged at P14 to \$1.00 from October, 1983 until June 6, 1984 when another devaluation was effected at an exchange rate of P18 to \$1.00. With the imposition of a 10 percent excise tax on sales of foreign exchange for non-priority imports, the effective exchange rate for this purpose was P19.80. Meanwhile, parallel market dollar selling exchange rates rose to as much as P28 to \$1.00 early in 1984 as businesses were allowed to source their foreign exchange requirements from this market. Government intervention seemed apparent in late February to early April as parallel market operations were temporarily stopped (where feasible) and eventually resumed at controlled dollar buying rates of P16 to P17 per dollar. Despite further interventions in parallel market operations, buying rates have fluctuated between P18 and P22 since mid-April.

In October of this year, the GOP announced a free float of the peso. Initially, it appeared to be nothing more than a gradual devaluation starting at an official rate of P18.12 per dollar on October 2 and moving upward to P20.00 by the end of October. After announcing acceptance by the IMF of the GOP's Letter of Intent for a new Stand-by arrangement, the GOP appears to be venturing more towards a flexible exchange rate. Special taxes are being removed which had created a multiple rate system. The Central Bank (CB) issued several new regulations which allowed commercial banks to engage in foreign exchange trading and stopped the CB's allocation system.

C. External Sector Outlook

After a year of negotiations with the IMF, an economic adjustment program has been formulated that seems acceptable to the IMF, the GOP, and the Commercial Bank Advisory Committee. The near term focus of the GOP effort will be on stabilization: fiscal and monetary restraint, the establishment of a market exchange rate mechanism, and the identification of foreign exchange resources. Much of this effort will be directed at addressing the deficit projected in the external accounts of the country. The magnitude and nature of external financing required has been estimated by the GOP, IMF and Bank Advisory Committee. In fact, sources have been identified to fill most of these requirements - the ESF related portion of the RPSP being one of them. The current balance of payments deficit is estimated at \$3.9 billion for 1984 and 1985, excluding arrearages. Please see Table 1 below for details.

Table 1: Philippine Balance of Payments 1983-85
(In millions of U.S. Dollars)

	<u>1983</u>	<u>1984</u>	<u>1985</u>
Trade Balance	-2482	-487	137
Export FOB	5005	5300	5830
Imports ^{1/}	-7487	-5787	-5693
Services (Net)	- 747	-1291	-1612
Receipts	3120	2455	2764
Payments ^{2/}	-3867	-3746	-4376
Transfers (Net)	472	250	378
Receipts	483	252	380
Payments	-11	-2	-2
Current Account	-2757	-1528	-1097
Capital Transactions	683	-714	-516
Balance of Payments	-2074	-2242	-1613

Source: Central Bank.

^{1/} Residuals based on the current account targets.

^{2/} Payments include interest payments on exceptional financing.

However, in addition to the BOP deficits shown above there are other financing needs to clear up arrearages estimated at \$1.3 billion. The savings from commercial bank and Paris Club rescheduling is expected to finance \$2.1 billion of the total. Therefore, during these two years the financing gap is estimated to be \$3.1 billion.

The estimated financing requirements are shown in Table 2 below:

Table 2: Philippines Financing Requirements, 1984-85
(In billions of U.S. Dollars)

	<u>Total 1984/5</u>
1. Overall balance of payments deficit before exceptional financing (From Table 1)	-3.9
2. Additional financing needs Repayment of pre-December 31, 1983 arrears and other debt service payments	-1.3
3. Overall balance of payments needs after settling arrears (1 + 2)	-5.2
4. Rescheduling Savings Commercial Banks Paris Club	2.1 (1.4) (0.7)
5. Financing gap to be filled by new money (=3-4)	-3.1

Commercial banks are expected to raise \$925 million in new loans to finance a part of this requirement. The rest needs to be sourced from multilateral/bilateral extra-ordinary financing. World Bank disbursements are liberally estimated at \$611 million consisting mainly of monies from the structural adjustment loans, the Agricultural Inputs Program, and proposed Agricultural Credit and Export Development Fund Projects. The Asian Development Bank is expected to provide \$303 million, mainly from its Fertilizer Inputs Program, and Special Adjustment and Advanced Loan Disbursement Programs.

Among the bilateral donors, the US is expected to make available \$770 million in Eximbank and CCC credits which do not include ESF disbursements. Japan may put in \$340 million through the Overseas Economic Cooperation Fund and GOJ-assisted projects but problems with the 1984 level appears to be jeopardizing the 1985 level. Other bilateral donors, notably Australia, South Korea and the People's Republic of China, are expected to contribute \$350 million

Table 3: Possible Sources of Financing
(In millions of U.S. Dollars)

	<u>1984</u>	<u>1985</u>	<u>TOTAL</u>
A. Commercial Banks	-	925	925
B. Government and Development Banks	984	1,036	2,020
- 1) World Bank	234	377	611
- 2) ADB	203	100	303
- 3) Japan	170	170	340
- 4) Other	156	149	305
- 5) U.S. Related	221	240	461
- a) EXIM	25	40	65
- b) CCC	196	200	396
C. Government-Short Term	355	-	355
1. US-EXIM	310	-	310
2. AUS-EFIC	45	-	45
D. Grand Total	<u>1,339</u>	<u>1,961</u>	<u>3,300</u>

in short, medium and long term loans. Total funds potentially available for 1984 and 1985 amount to \$3.3 billion. This is about \$200 million above the estimated financing required. However, the estimates must be considered preliminary and not all of the funding is sure to materialize. Further, this does not consider the need to rebuild Central Bank international reserves, which as previously indicated were equivalent to only one month imports when the standard level is three months. (See Table 3 above.)

This program of \$47.5 million and potential other ESF releases during 1985 may provide a total of about \$130 million to help ease the tight foreign exchange situation. Further, there is a possibility of a \$50 million PL 480 Title I program in 1985. Of even greater importance to the longer term development of the country is how the GOP handles its fiscal policy and controls its budget deficit. This is discussed below.

D. Budgetary Problems

1. Recent Budgetary Developments

After 1982 the GOP made substantial adjustments in both its expenditure and revenue efforts to improve its overall budget program. This was necessary to correct for its countercyclical budgets during 1981 and 1982 which had huge deficits reaching P14.4 billion or 4.3 percent of GNP. Total GOP expenditures, including net lending and debt servicing, declined as a proportion of GNP from 16.2 percent in 1982 to 14.7 percent in 1983. This was largely achieved through a reduction in and delaying of capital investments, particularly equity contributions to government corporations, and firmer control over expenditure releases. The end result has been a significantly lower overall budgetary deficit of P6.5 million (1.7% of GNP) in 1983.

At the same time, GOP revenue performance improved to 12.4 percent of GNP in 1983 from the previous year's 11.4 percent due primarily to the introduction of various discretionary tax measures. The new measures consisted of an additional import surcharge, increased excise taxes and export levies. However, these measures placed heavy reliance on taxes that can be quickly implemented but which do not address the basic structural problems afflicting the tax system. In fact, domestic-based tax receipts as a proportion of GNP had been declining since 1980 and this represents one of the major challenges to increasing GOP revenues. To a large extent, poor domestic tax collections indicate that tax administration has not improved and that some existing tax measures have been ineffective in increasing revenues because of the various special exemptions granted.

The GOP's budgetary target in 1984 is to limit the overall deficit to P7.7 billion or 1.5 percent of GNP. To attain this, expenditure cuts were programmed for infrastructure projects and equity contributions, reducing 1984 outlays in these areas by 24 percent and 30 percent respectively, from their 1983 levels. This, of course, represents substantial cuts in real terms with inflation running over 40 percent. Cuts of 9 percent were also made in maintenance and other operating expenditures, but the margin for further reductions here was limited as it would affect the productivity of the capital stock. Total GOP expenditures for the year were thus projected to drop to a much lower 11.3 percent of GNP.

However, it became apparent as 1984 progressed that further measures were required to achieve the established budgetary objective. Trade related revenues were falling short of expectations due to the general economic downturn, and the GOP knew it would be required under the IMF agreement to remove special taxes

which resulted in a multiple exchange rate structure. Moreover, new claims on budgetary resources occurred: 1) the newly formulated self-reliant productivity program (Sariling Sikap) was introduced with a budgetary requirement of P1.8 billion; 2) a wage increase for public employees was granted in May with a budget claim of P0.8 billion; and, 3) several public financial institutions are expected to make large payments for previously extended guarantees and will need large budget transfers estimated to be in the neighborhood of P6.0 billion. Likewise, the recent calamities (two severe typhoons and a volcano eruption) required added expenditures for infrastructure rehabilitation and social services.

Initially, to generate more revenues the import surcharge was raised from 5 percent to 8 percent in April and to 10 percent in June, while new taxes on foreign exchange purchases and on export receipts were imposed. However, as part of the prior actions for the IMF agreement in October, the tax on export receipts has been removed, and the foreign exchange transaction tax and import surcharge are being reduced to 1 percent and 5 percent, respectively. As alternative measures, higher specific taxes on cigarettes, liquor and oil products, and a uniform 15 percent tax on deposit interest income were imposed while many tax exemptions, including those to GOP corporations were lifted. Increased GOP collections of business and sales taxes have also been targetted as an additional revenue-generating effort. Nonetheless, the most recent GOP data has indicated that the cash budget deficit for 1984 would still reach around P10.2 billion or 1.9 percent of GNP because of carried over expenditure commitments from prior years.

2. 1985 GOP Budget

The 1985 fiscal budget is expected to be more stringent than in previous years as the GOP has indicated that it will adopt austerity measures as part of its Letter of Intent to the IMF to keep the cash deficit down to only 1 percent of GNP (about P6.6 billion). The budget program of P67.3 billion is equivalent to only around 10 percent of projected GNP although total cash budget disbursements may reach P75.5 billion (11.5 percent of GNP) because of expenditures due from prior years. This budget is nominally 14.4 percent higher than the 1984 level and reflects increases of: 18 percent in current operating expenses, only 4 percent in capital investments, and 7 percent in debt servicing. Revenues are expected to grow by 18 percent to P68.9 billion, mainly through large increases in indirect taxation, higher GOP fees and charges, and improved collections of business taxes. The recently-introduced higher taxes on non-essential commodities (e.g. liquor and cigarette) and petroleum products are expected to raise P8 billion during 1985. Other new tax measures are projected to result in an additional P2.5 billion in revenues.

As in the previous two years, the share of capital expenditures in the total budget will continue to decline (from 27 percent in 1983 to 18 percent in 1985) as a result of lower GOP appropriations for infrastructure projects and corporate equity. Specifically, the budget program for GOP infrastructure projects (being implemented by the Ministries of Public Works and Highways, and Transportation and Communications) has dropped 44 percent to P3.6 billion in 1985 from its 1983 actual level of P6.4 billion.

Equity contributions to public corporations in 1985 are projected to be 42 percent less than 1983's P4.3 billion. In real terms, these cuts are quite staggering considering that 1985 prices are expected to be over 80 percent greater than their 1983 levels. It is inevitable then that all GOP entities will be hard-pressed for funds. Some parastatals (e.g., National Power Corporation) implementing development or investment projects may be able to increase their internal cash generations and offset a part of the reduction. These entities are those mostly involved with public utilities or goods produced in the urban areas. However, activities in the rural areas have not been faring as well during the crisis, thus, rural investment expenditures are expected to bear the brunt of the budget cutbacks.

3. Budgetary Resource Gap

Vigorous budget-cutting and austerity measures have characterized the GOP's fiscal programs in 1983-85. This is reflected by drastic cuts in budget levels requested by Ministries and GOP entities that affect both the current operating expenditures and the investment program (capital or development budget). Total budgetary funding requests to OBM by the operating entities exceeded appropriations by P16 billion in 1983, P30 billion in 1984 and, reflecting a little more realism, P 24 billion in 1985. Regarding the GOP's investment or development program alone the gap between requested funding and budgeted levels has been P5, P15 and P 18 billion, respectively, in 1983, 84 and 85.

However, the actual or final funding shortfall in the development budget has been even larger because reallocations of resources away from the development projects were necessary during the year to cover both inflation and devaluation impacts elsewhere in the budget, and reduced levels in deficit financing to meet IMF interim targets. This has increased the development program resource gap by another P7 billion in 1983 and P3 billion in 1984, for a total of P12 billion in 1983 and P18 billion in 1984. (The latter is obtained by subtracting the final budgeted level after reserves and reallocations were made from the requested funding level of the implementing agencies.) See Table 4 below:

Table 4

National Government Budget, CY 1983-85
(In millions of Pesos)

	1983			1984			1985	
	Budgetary Request ^{1/}	Original Program ^{2/}	Revised Program ^{3/}	Budgetary Request	Original Program	Revised Program	Budgetary Request	Original Program
Current Operating Expenditures	49.8	41.1	36.6	55.3	41.5	43.1	57.0	50.8
Capital Outlays	26.5	21.6	14.4	29.4	14.5	11.6	29.8	12.1
Infrastructure (MPWH/MOTC)	8.3	8.6	6.3	9.2	5.4	4.8	4.9	3.6
Corporate Equity	11.2	6.9	4.3	12.4	4.5	3.0	10.2	2.5
Other Capital Outlays	7.0	6.1	3.8	7.8	4.4	3.8	14.7	6.0
Debt Amortization	4.8	2.4	2.4	5.4	3.6	4.1	4.5	4.4
Total	81.1	65.0	53.4	90.1	59.5	58.8	91.4	67.3

^{1/} Refers to budgetary requests of ministries and public corporations prior to OBM review.

^{2/} Approved GOP budget on an obligation basis for 1983 and 1984 and Proposed Budget for 1985.

^{3/} Revised GOP budget after reallocations and the imposition of budget reserves.

Source: OBM

While such cuts are understandable given the current economic situation and competing demands for scarce GOP resources, the lower final funding level involves substantial economic and social costs. Budgetary constraint has led to serious delays in project implementation, postponing expected economic and social benefits to a future period and increasing the carrying costs of the loans as interest payments are extended over a longer period of time. Disbursement problems and delays in fund releases have contributed to cost overrun, especially given the unprecedented high inflation rates currently being experienced. This constraint has also curtailed the initiation of new projects, seriously hampering the GOP's ability to pursue development programs as targetted in the Philippine Five-Year (1983-87) Plan.

The current economic crisis has forced the GOP to rethink its own development strategy and revise its Five-Year Plan to set new realistic targets and refocus development efforts to the rural and agricultural areas. Now that the rural sector has the priority attention of the GOP, however, there are too few domestic resources available to support a meaningful development program. Many rural-based projects of the GOP are on reduced implementation schedules or have been shelved because of a shortage of budgetary funding.

4. Budget Program for Foreign-Assisted Projects

In particular the GOP development budget program for foreign donor-assisted projects was subjected to a substantial 27 percent reduction in the peso value of funding between 1983 and 1985 (some P2 billion in nominal terms). The dollar equivalent of this reduction was over 50 percent because of the rapid depreciation of the peso. In 1983 the budget for foreign assisted projects was equivalent to over \$660 million. This stood at only \$323 million in 1985.

The budget for these projects consists of GOP provisions for equity contributions to government corporations and regular peso counterpart and loan proceeds from donors for line ministries. The decreasing peso budget program is attributed to the reduction in the provisions for GOP budgeted counterpart funds for these projects. The level was P5.07 billion in 1983 and only P3.03 billion in 1985. The actual requested funding level was at least P2.0 billion higher in 1985 which is currently equal to about \$100 million. As a result of the peso counterpart funding cutbacks, the proportion of loan proceeds (excluding those provided public corporations which are not shown in the budget) to the total program for foreign-assisted projects has increased from 32 percent in 1983 to 44 percent in 1985 although in dollar terms they have declined 50 percent. See Table 5 below:

Table 5

Budgetary Programs for ODA Foreign-Assisted Projects*
(In millions of Pesos)

	<u>1983</u>	<u>% Dist'n.</u>	<u>1984</u>	<u>% Dist'n.</u>	<u>1985</u>	<u>% Dist'n.</u>
A. By Funding Source						
GOP Counterpart	5066	68.2	3218	61.4	3026	55.8
Loan Proceeds*	2365	31.8	2026	38.6	2399	44.2
TOTAL	7431	100.0	5244	100.0	5425	100.0
B. By Budget Type						
Current Oper. Exp.	859	11.6	771	14.7	969	17.9
Capital Outlays	6572	88.4	4473	85.3	4456	82.1
TOTAL	7431	100.0	5244	100.0	5425	100.0
C. By Sector						
Infra/Util.	5233	70.4	3511	67.0	3317	61.1
Agriculture	1106	14.9	709	13.5	818	15.1
Energy	66	0.9	37	0.7	42	0.8
Industry	18	0.2	30	0.6	41	0.8
Social Services	842	11.3	849	16.2	1049	19.3
Others	166	2.2	108	2.1	158	2.9
TOTAL	7431	100.0	5244	100.0	5425	100.0

* excludes loan proceeds of government corporations for which data are not on the budget.

Source: OBM

Hardest hit by the cutbacks are foreign-assisted infrastructure and utilities projects, comprising over 60 percent of the total program. The total 1985 budgetary provisions are only P3.3 billion. This is 37 percent lower than the 1983 level of P5.2 billion. The budget program for agriculture projects, accounting for 15 percent of the total program, has also declined by P200 million or 26 percent. On the other hand, increases have been programmed in the remaining 25 percent of the 1985 budget program for social services and industrial projects. Such increases are due partly to planned implementation of new projects and partly to a higher priority being accorded the existing projects.

Recognizing the difficulties, the major multilateral banks have designed Special Action Programs (SAP) to accelerate budget disbursements for several of the major on-going projects they support. The SAPs provide additional foreign exchange financing of local currency expenditures in these bank-assisted projects whose implementation is being impeded mainly by a shortage of local currency resources. However, these programs took the banks beyond their normal limits of local cost financing and they are reluctant to go further as their Boards may not approve. The AID Mission also has examined ways to keep the momentum going in many of the activities it supports. In particular, we have looked to accelerate grant funding drawdown in the projects because these funds do not increase the budget deficit and they can be disbursed outside the appropriated level under certain circumstances. Nevertheless, planned implementation of our projects has definitely slowed down as a result of budget cuts.

III. PROGRAM DESCRIPTION

A. U.S. Interests and Program Objective

The United States has important political, economic and strategic interests in the Philippines, the military facilities at Olongapo and Angeles City being the most prominent. In recognition of these interests the U.S. Government (USG) has fostered one of our country's longest uninterrupted development assistance programs in the Philippines. In addition, with the 1947 Military Bases Agreement (MBA) amendments in 1978 and in 1983, the U.S. Government pledged its best efforts to seek special economic and military assistance totaling, respectively, \$450 million for the 1980-84 period and \$900 million for the 1985-89 period. The former amount included \$200 million in economic aid which has been appropriated by Congress over the years in the form of Economic Support Funds. These funds have been obligated by the U.S. Government to support various development activities in the Philippines. The more recent MBA amendment includes \$475 million of ESF of which it was agreed up to 50 percent could be of a program assistance nature. The USG sought \$95 million to be appropriated by the Congress in FY 1985.

As described in Section II and other documents, the Philippines is going through its worst economic crisis since the end of World War II. This document and those cited in the bibliography at Annex B, have identified and discussed two basic problems resulting from this crisis:

- 1) the GOP lacks sufficient budgetary resources to continue the implementation of foreign assisted and other development projects at or near their originally planned pace; and,
- 2) the availability of foreign exchange is insufficient to meet balance of payment and Central Bank reserve build-up needs in 1984 and 1985, even with an IMF Stand-by Agreement and a rescheduling of public and private external debt.

Given our interests in the country and its current severe economic difficulties, we propose to assist the Government of the Philippines in a way that is consistent the USAID/Philippine Country Development Strategy Statement and the Philippines' Five Year Development Plan. We propose an Economic Support Fund program assistance grant of \$47.5 million for budget support purposes as described hereunder.

The objective is to provide foreign exchange and peso budget support to the GOP so that it can maintain a satisfactory pace of implementation for selected foreign assisted projects which have been slowed due to the country's current budget difficulties. The projects selected will be consistent with the Mission's strategy in the Philippines of poverty alleviation through greater productive employment in rural areas. The projects and the associated funding will form the Rural Productivity Support Program (RPSP). RPSP will be executed in accordance with AID Handbook 4. The transfer of the RPSP-related dollar resources will occur in a manner that will help the GOP meet its external financial requirements as assessed by the IMF and others.

B. Concept and Design

1. Concept

In order to accomplish this objective the USG will transfer to the GOP \$47.5 million and the GOP will release an equivalent amount of pesos in the form of counterpart contributions to selected foreign assisted projects of multilateral donor organizations (i.e., the IBRD and ADB) and the USAID. The dollars will be available as "free" foreign exchange to the Philippine Government. Additionality will be measured against the amount of GOP counterpart pesos, and grant and loan proceeds for this group of selected projects provided in the national budget as approved by the Philippine Legislature - the Batasang Pambansa. The additional peso counterpart funds will be allocated by the GOP to the projects included in this budget support program on the basis of needs during the 1985 budget year. The GOP may reallocate these additional pesos from slower to faster moving activities among the preapproved projects in RPSP during the 1985 budget year to ensure that they are expended within that time frame.

2. Design

Based on the above concept, the design of this budget support program is as follows:

- a. A group of multilateral donor organization and USAID projects will be selected according to mutually agreed upon criteria which ensure their compatibility with AID priorities. These criteria are:
 - i. a strong relationship with the Mission's Country Development Strategy Statement of improving productivity in rural areas and stimulating productive rural employment,
 - ii. projects already under implementation whose benefits will be realized quickly once additional resources are provided, and
 - iii. projects with a high probability that they can expend promptly the additional counterpart made available to them by the GOP.
- b. The proposed list of projects meeting these criteria that to be included in the RPSP is provided below. These projects are grouped together in the RPSP for identification and for GOP tracking and reporting.

List of Projects in the
Rural Productivity Support Program

Loan No. Projects By Donor Agency

I. Asian Development Bank (16 Projects)

491/597	Third Road Improvement Project
528/529	Palawan Integrated Area Dev.
548	Smallholder Livestock Dev.
417/466	Second Laguna de Bay Irrig.
677	Philippine Aquaculture Dev.
406	Bukidnon Irrigation
580	Third Davao del Norte Irrig.
417	Bicol River Basin Integrated Area Development
676	Phil. Forestry Development
531	Technical & Vocational Educ.
285	Second Davao Irrigation
363	Second Agusan Irrigation
341	Allah River
350	Tago River
371	Laguna de Bay Fishpen Dev.
604	Agro-Processing & Mktg.

II. International Bank For Reconstruction and Development (22 Projects)

2040	Agricultural Support Services
1786	Sixth Education - Fishery Training
1815	Rainfed Agricultural Dev.
IDA 923	Population II
1772	Samar Integrated Area Dev.
2030	Seventh Educ. Sector (PRODED)
2206	First Rural Water Supply & Sanitation
1626	National Extension Project
1890	Magat Range Management Pilot
1506	Smallholder Tree-Farming and Forestry Project
2156	National Fisheries Dev.
2200	Vocational Training
1860	Rural Road Improvement
2169	Small & Medium Industries Development Project
1809	Philippine Medium-Scale Irrigation
1567	Magat River Multipurpose II
1639	Magat River Multipurpose III
2173	Communal Irrigation
1414	NISIP I
1526	NISIP II
1367	Jalaur Irrigation

III. U.S. Agency for International Development (10 Projects)

492-T-065	Small Farmer Systems III
492-T-068	Rainfed Resources Development
492-T-066	Eastern Visayas Farming Systems
492-U-059	Barangay Water
492-U-070	Primary Health Care Financing
492-T-067	Local Resources Management
492-W-052	Non-Conventional Energy Resources
492-T-071	Small & Medium Enterprise Dev.
492-Q-063	Population III
492-H-057	Bicol Integrated Health, Nutrition and Population

- c. For this selected group of projects in RPSP, budgeted GOP counterpart, and grant and loan proceeds total P1.13 million (\$56.4 million equivalent at P20=\$1) and \$92.7 million, respectively. The latter amount excludes loan proceeds for projects implemented by government corporations because the proceeds are not appropriated in the budget. This is summarized below in Table 6. When the peso equivalent value of the \$47.5 million from this PAAD is added to these amounts the total minimum GOP financial commitment for the program is approximately \$196.6 million.

Table 6

<u>RPSP Funding Related to Project List</u>				
<u>(millions of U.S. dollars)</u>				
<u>Donor</u>	<u>Budgeted GOP Counterpart</u>	<u>Grant/Loan Proceeds</u>	<u>1/</u>	<u>Total</u>
	<u>56.4</u>	<u>92.7</u>		<u>149.1</u>
ADB	21.0	27.0		48.0
IBRD	29.7	51.8		81.5
USAID	5.7	13.8		19.5

1/ Loan proceeds for government corporation are not appropriated in the GOP budget. The proceeds were shown in the budget at a peso 14 to dollar 1 exchange rate.

- d. Allocations may be shifted from slow moving to faster moving projects during the 1985 budget cycle to ensure that the agreed-upon total disbursement occurs.
- e. The GOP will monitor the implementation of the RPSP and report quarterly (within three months after the close of each quarter) on its progress. The reports will contain at least the following information:
 - i. The status of program implementation covering physical progress over and above what had originally been planned and funded in the budget for the time period in question in terms of the percentage completion of the activities.
 - ii. The summarized status of program implementation covering financial progress of the entire program. This would be accomplished by summarizing program expenditures of GOP counterpart funds and loan/grant proceeds by recipient and relating the expenditures to the funding levels provided under the AAs. Although loan proceeds for activities of public corporations are not part of the RPSP, a memorandum item in the report will indicate the rate of utilization.
 - iii. Specific examples of any projects completed ahead of schedule due to the availability of the additional counterpart, or other anecdotal information which indicates improved rates of project implementation.
- f. A final closeout report will be provided within six months of the end of the budget year in the same format as discussed above. The report will provide a more definitive indication of the achievement of the RPSP objective and contain a Commission on Audit (COA) certified financial statement on the status of funds expended under the auspices of the RPSP. This will indicate the level of disbursement related to the AAs under the RPSP for all GOP counterpart and grant/loan proceeds during the 1985 budget cycle.

C. Implementation Procedures

1. Fund Generation

- a. A Certification of Funds Available (CFA) shall be issued by the OBM to cover 1985 budget requirements of all peso counterpart and grant/loan proceeds associated with RPSP. The CFA will be supported by work and financial plans (WFPS) which provide the budgetary requirements and narrative of the work to be performed in the ensuing year on a quarterly basis to justify the release of Advices of Allotment (AAs) and quarterly Cash Disbursement Ceilings (CDCs).

- b. Upon receipt of the CFA by USAID and the satisfaction of all other conditions precedent to dollar disbursement, the USG through USAID shall remit the ESF dollar proceeds to the BTR.
- c. The BTR shall deposit the peso equivalent of these ESF dollar proceeds in a BTR "Special" Account at the Philippine National Bank (PNB) main office to be labeled the "RPSF Fund Account".
- d. On or before January 15, 1985 the comprehensive (on an annual basis) AAs, as certified by the OBM under the CFA, shall be issued by the OBM:
 - i.) AAs will be issued in favor of the implementing agencies (IAs) to cover funds intended for non-corporate government agencies.
 - ii.) AAs will be issued in favor of the BTR to cover funds intended for government corporations.
- e. The peso proceeds of the ESF component of the RPSF shall be transferred from the Special Account to the general fund of BTR upon receipt and approval of the following documents by USAID:
 - i.) OBM certification that appropriate AAs have been issued in accordance with Para 1.d. above.
 - ii.) A certification from OBM that any public corporation or such other parastatal agreeing to participate in the RPSF has certified to OBM:
 1. To utilize its originally budgeted equity contribution as indicated in the RPSF;
 2. To utilize any additional equity provided through RPSF for the projects in the RPSF;
 3. That the counterpart will not be used to substitute for the use of loan proceeds;
 4. That funds received through the RPSF will be auditable by the GOP.
 - iii.) BTR request to USAID for the transfer of pesos in the Special Account to the general fund.

2. Fund Disbursement

- a. On the basis of a BTR certification of the availability of the peso proceeds the OBM shall issue notices of CDCs in favor of IAs to cover funds intended for non-corporate government agencies and in favor of the BTR to cover funds intended for government corporations.

Note: The RPSF fund will be exempted from LOI 1408 which restricts expenditures in relation to CDCs and limits releases of CDCs and Allotments.

- b. All peso proceeds intended for government corporations shall be released by the BTR as part of the national government equity contribution to said agencies.

3. Fund Liquidation

- a. As per standard operating procedures of the GOP each IA shall submit quarterly a COA-certified disbursement report, a physical accomplishment report, and a projected disbursement/physical accomplishment report to OBM within ten (10) days of the end of each quarter. OBM will collate and analyze these reports. The analyses will focus on project accomplishments against the projections made in the WFPS or projected disbursement/physical accomplishment reports previously submitted. OBM will present its analyses to the Inter-Agency Technical Working Committee (IATWC) which will review same and recommend to the Economic Support Fund Council (ESFC) appropriate RPSF fund reallocations that will ensure attainment of GOP and Program objectives (expending of program funds). This process will take approximately two months from the end of each quarter.
- b. Summary status reports of Program physical and financial progress will be submitted by the ESFC to USAID within three months of the end of the each quarter.
- c. A final Program closeout report will be submitted by the ESFC to USAID within six (6) months of the end of the budget year. This report is to be audited and certified by COA.

4. Organization

- a. The Inter-Agency Technical Working Committee (IATWC) shall:
 - i.) be headed by an officially designated representative of the Office of Budget and Management (OBM).
 - ii.) be composed of officially designated representatives from the Ministry of Finance (MOF), Bureau of Treasury (BTR), National Economic Development Authority (NEDA), Commission on Audit (COA), and the ESF Secretariat.

- iii.) recommend the policies and procedures to govern the fund.
 - iv.) in the members' respective capacities, draft position papers, legal issuances, memorandum, etc., to enact/implement said policies and procedures.
 - v.) review the performance of past fund beneficiaries based on the evaluation of the Office of Budget and Management.
 - vi.) recommend future fund recipients.
 - vii.) monitor fund utilization, including physical progress of project beneficiaries.
 - viii.) upon Program completion, conduct an evaluation, the results of which shall be the basis of an improved fund management system for the succeeding program assistance package, if any of a similar nature.
- b. The Secretariat shall:
- i.) also act as the coordinating body between and among the IATWC, ESFC, the President, USAID, OBM, BTR, and the implementing agencies.
 - ii.) exercise fund management functions.
- c. The ESF Council:
- i.) has oversight responsibilities over RPSP.
 - ii.) shall endorse to the President all policies and procedures which shall govern the utilization of the fund.
 - iii.) shall exercise fund management functions.
- d. The President:
- i.) shall approve fund utilization guidelines.

D. Conditions and Covenants

The following are the non-standard conditions and covenants that the Mission proposes for the RPSP:

- 1. Conditions Precedent to Dollar Disbursement
 - a. The GOP shall submit to AID a duly authorized Certification of Funds Available (CFA) for the 1985 budget that includes all peso counterpart and grant/loan proceeds associated with RPSP.

Note: The CFA is needed because we are transferring dollars in 1984, prior to the January 1, beginning of the GOP 1985 fiscal year in which the additional pesos are needed. The CFA commits the GOP to make available the prescribed funds in the RPSP.

- b. The GOP shall formally submit to AID the list of rural based projects, and the budgeted funding data, consistent with the agreed-upon criteria that will form the basis of the RPSP.
- c. The GOP will formally submit an implementation plan satisfactory to USAID that explains how the GOP will monitor and report on the implementation of RPSP. The plan should detail the organization of the monitoring, implementing and reporting functions, the responsibilities of each involved office, and the timing of actions.

2. Conditions Precedent to Peso Release from the Special Account

- a. A certification from OBM's National Accounting Office that Advices of Allotment have been issued for all originally budgeted and additional peso counterpart and grant/loan proceeds for the RPSP as defined by the project list submitted in 1.b above.
- b. A certification from the GOP that any public corporation or such other parastatal agreeing to participate in the RPSP has entered into a written agreement with OBM: i) to utilize its originally budgeted equity contributions as indicated in the RPSP; ii) to utilize any additional equity provided through RPSP for the projects in the RPSP; iii) that the counterpart will not be used to substitute for the use of loan proceeds; iv) and, that funds received through the RPSP will be auditable by the GOP.

3. Covenants

- a. No changes will be made to the agreed-upon list of projects in the Rural Productivity Support Program without the approval of AID.
- b. The GOP will not reduce, cancel or otherwise change the obligation authorities issued by OBM for projects in the RPSP to free resources from the RPSP for other purposes.
- c. That quarterly reports on the status of the RPSP will be provided within three months of the quarter's end except in the case of the final report which may be within six months of the end of the budget cycle.

- d. The GOP will inform the donor and implementing agencies of the eligibility of the selected projects for receiving additional GOP counterpart peso related to the projects inclusion in the RPSP which was created with the assistance of the USG.
- e. The GOP agrees to ensure that the funding for the RPSP will be used solely for projects included in RPSP and that the additional counterpart will not be used to substitute for the use of budgeted loan proceeds.

IV ANNEXES

- A. List of Abbreviations/Acronyms
- B. Bibliography of Papers on the Philippine Economy
- C. Description of GOP Budget System
- D. OBM Certification of Funds Available
- E. PAIP Approval
- F. Statutory Checklists (available in ASIA/PD, cc to GC)

List of Abbreviations/Acronyms

A/A	Advice of Allotment
ADB	Asian Development Bank
BOI	Board of Investments
BTR	Bureau of Treasury
BTS	Budget Technical Service
CB	Central Bank
CBCI	Central Bank Certificate of Indebtedness
CCC	Commodity Credit Corporation
CDC	Cash Disbursement Ceiling
COA	Commission on Audit
CPI	Consumer Price Index
EFIC	Export Finance Insurance Corporation
ESF	Economic Support Fund
EXIM	Export Import Bank
FOA	Forward Obligation Authority
GAA	General Appropriations Act
GDP	Gross Domestic Product
GNP	Gross National Product
GOJ	Government of Japan
GOP	Government of the Philippines
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
MOLE	Ministry of Labor and Employment
MOTC	Ministry of Transportation and Communications
MPWH	Ministry of Public Works and Highways
MRR	Manila Reference Rate
NAO	National Accounting Office
NEDA	National Economic and Development Authority
NPC	National Power Corporation
OBM	Office of Budget and Management
OECF	Overseas Economic Cooperation Fund
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Initial Proposal
RPSP	Rural Productivity Support Program
SAL	Structural Adjustment Loan
SAP	Special Action Program
SEC	Securities and Exchange Commission
USC	U.S. Government

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DESCRIPTION OF GOP BUDGET SYSTEM

Overview of Program Funding

The GOP budget is a total resource budget, wherein, under the terms of Presidential Decree 1177 (PD 1177) all the resources and commitments of the government are to be considered at one time. It is the responsibility of the Office of Budget and Management (OBM) to prepare the budget documents after the overall levels have been established by the Development Budget Coordination Committee (DBCC). The national budget as presented and adopted must be balanced: planned deficits are not permitted. The gap between planned revenues and planned expenditures including capital outlays, must be met through a financing program from identified sources.

The GOP operates on a January 1 to December 31 calendar year. The year is broken into four quarters to control releases and promote an orderly pattern of disbursements which does not outstrip receipts. The GOP operates on the basis of obligations in that commitments are treated as expenditures (but not necessarily as disbursements) when incurred. It is very difficult, at any point in time, to calculate the cash position of the national government or any individual program or project. The obligation aspect of the budget is regulated by the Advice of Allotment (AA), while cash control is covered by the Cash Disbursement Ceiling (CDC).

The three initial stages of the budget cycle, i.e. preparation, authorization and execution, require approximately 3 years to complete. The budget call precedes the beginning of the calendar year by up to 14 months and close out activities may take six to eight months beyond the year end (infrastructure projects may take six to seven years). If the accountability stage is included, one or two additional years will be needed.

The GOP uses a zero based budget approach to force consideration of priorities of all elements of the national government, and to achieve a balance as the planned expenditures usually exceed available revenues.

The budget document is comprised of an annual operating budget, an infrastructure budget, and a regional budget. It also contains a "Key Budgetary Inclusion (KBI)" designation in order to highlight priority expenditures of the government, such as foreign exchange loan proceeds and peso counterpart funding for foreign assisted projects. The KBIs also facilitate the availability and release of funds as they establish and list mandatory obligations of the agencies.

The GOP budget process cycle has four stages; as follows:

- (1) Budget Preparation
- (2) Budget Authorization
- (3) Budget Execution
- (4) Budget Accountability

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(1) Budget Preparation (Fiscal Year 1985 Appropriation)

Submission (November or December 1983)

Budget Preparation is that stage of the overall cycle when OBM requests ministries, local government units, and government-controlled authorities and corporations to estimate the revenues, expenditures, and expected accomplishments for the fiscal year commencing twelve to fourteen months hence.

The National Budget Call is prepared by the DBCC and issued to the various agencies/ministries by OBM.

Internal Review (January 84 - April 84)

Once completed, the forms are submitted to OBM where analysis is conducted by its various offices. These forms are subject to a coordinated review which includes regional considerations, income estimates, organizational changes, personnel needs, workload measures, past performance, etc. This provides OBM with the background necessary to question the submissions of the ministries/agencies during the technical hearings.

The Budget Technical Hearing Panel, chaired by the Budget Minister establishes tentative ceilings to use in reworking initial estimates.

Executive Review (April 84 - July 84)

The most critical review is conducted by the Executive Review Board (ERB), a high-level inter-ministerial panel which has final authority in determining the allocation of resources to meet agency demands. The ERB makes the final decisions on appropriations, obligations, etc. to each agency. OBM reflects these changes in a final budget submitted to the President and to the Batasang Pambansa (BP) together with the President's Budget message. This submission of the General Appropriation Bill is referred to the Committee on Appropriation.

(2) Legislative Review and Authorization (July 84 - September 84)

The initial budget review is conducted by the Committee on Appropriation (chaired by the Budget Minister) who reports the bill to the BP floor. Here the budget may be debated and modified. Once it is approved and sent to the President, he may "line-item veto", veto the act, submit for reconsideration or permit it to become law with or without his signature. This, then is the authorized General Appropriation Act (GAA) for the ensuing fiscal year.

Appropriations

Appropriations provide the basis to expend funds for a specified purpose, and are very important in the GOP system of budgetary control. Accordingly, ministries carefully word the appropriation language during budget preparation so as to provide a clear, but to the maximum extent possible, flexible purpose for the funds. The appropriation language must set forth the authority, specific purpose, activities, amounts and sources of funds for the programs/projects, together with any other special limitations or special provisions governing the use of such funds.

(3 and 4) Budget Execution and Accountability

The Budget Execution phase begins with the preparation by individual ministries/agencies of the work and Financial Plans (WFPs) for each program/project/activity in the approved budget, which provides the basis for determining the quarterly cash needs.

Prior to the beginning of the year, notices of approved agency WFPs are released by OBM Budget Operations. These notices indicate the total available allotment broken into expenditure classes. At the same time OBM provides a summary of the obligational authority by ministry. This forms the basis for the issuance of Advices of Allotment. A/As are the first fundamental budget execution document since they represent the initial obligational authority to operating entities. The ministries are then informed of the Cash Disbursement Ceilings. This is the second fundamental budget document whose purpose is to control disbursement authorizations.

Advice of Allotment

The A/A is the control device for the obligation authority established by the GAA. It specifies the amount which can be obligated by contract, purchase order, etc. The A/A in no event will be greater than the amount of the specific appropriation. When issued on a quarterly basis, it has the tendency to reduce flexibility and generate forced savings. Furthermore, all A/As, except those issued to the Ministry of Public Works and Highways (MPWH) and the Ministry of Transportation Communications for infrastructure projects, are valid only for one year.

Cash Disbursement Ceiling

The CDC on the other hand, is the control tool for both cash outflows and receipts of cash from designated sources (including foreign donors) prior to disbursement. CDCs are issued on a quarterly basis. CDCs issued in the first three quarters are valid through the end of the year, while those issued in the 4th quarter are valid through the end of the 1st quarter of the following year. New CDCs may be issued after the 1st quarter of the following year to pay unliquidated accounts payable emanating from valid obligations.

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Reports and Reviews

Monthly and quarterly reports of receipts, expenditures and accomplishments are required by OBM's National Accounting office. These reports are used to confirm A/As and CDCs and to more effectively monitor the savings generated.

Furthermore, all agencies are required to submit a balance sheet as of the end of the year indicating the outstanding obligations or accounts payable against each A/A. This report which is due one month after year end is used to review cash needs and revalidate CDCs.

In addition, a formal mid-year review is required by law. This review is used to make necessary financial adjustments.

Accountability

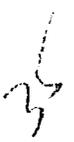
The above describes the GOP budget and reporting system. This system includes traditional controls inherent in an accounting system and is augmented by audits conducted by the Commission on Audit (COA) which reports directly to the President.

Exceptions

While the above pertains to all government activities as mandated by PD 1177, other Presidential Decrees, Letter of Instructions (LOIs) and Joint Circulars (specially Joint Circular 5-82 and 5-82A), the system has not been fully operationalized for government-controlled Corporations.

The main exceptions for corporations are:

- (i) Loan funded expenditures are not budgeted for in the GAA.
- (ii) Counterpart funds for foreign assisted projects are identified as a lower priority through the use of a different KBI and are described in the GAA as equity. Furthermore, once the money is made available to the corporation it becomes fungible with the corporation's other sources.
- (iii) Reporting is not required on a monthly or quarterly basis. In addition, it is unclear if COA has the same audit right.



CERTIFICATION OF FUNDS AVAILABLE

MINISTRY : OFFICE OF THE PRIME MINISTER

Pursuant to Paragraph 1.0 of Letter of Instructions No. 880 dated June 21, 1979 and National Budget Circular No. 341 dated February 16, 1981, this is to certify that funds in the amount of ___ BILLION ___ MILLION ___ THOUSAND PESOS (approximately pesos 3.6 billion) are to be set aside during the budget year 1985 under appropriate obligational authority by the Office of Budget and Management for the activities under the Rural Productivity Support Program (RPSP). The final obligational authority for the various components of RPSP shall be issued on the basis of the final amounts and allocations as appropriated in the 1985 General Appropriations Act for Philippine Government counterpart, loan/grant proceeds and peso counterpart proceeds equivalent to ESF dollar proceeds under RPSP.

PROJECT : Rural Productivity Support Program

PROJECT NO./SOURCE :

In Thousand Pesos

<u>Loan Proceeds</u>		<u>peso Counterpart</u>
<u>Peso Cost Financing</u>	<u>Foreign Cost Financing</u>	<u>TOTAL Financing</u>

FY 1985

MANUEL S. ALBA
Minister of the Budget

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No action necessary: 13886
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E.O. 12356: N/A

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SUBJECT: RURAL PRODUCTIVITY SUPPORT PROGRAM (492-0383)

1. PAIP WAS REVIEWED BY APAC APRIL 13 AND BY AA/ASIA APRIL 17. THE PAIP IS APPROVED, AND YOU MAY PREPARE PAAD WITH THE GUIDANCE BELOW. ON SEVERAL POINTS, CONTINUING MISSION-AID/W COMMUNICATION DURING PAAD PREPARATION WILL BE NECESSARY.

2. WE REFINED RPSM CONCEPT DURING AID/W DISCUSSIONS WITH PETER DAVIS AND IN APAC PROCESS TO HAVE THESE CHARACTERISTICS:

- A. AT THE DOLS 95 MILLION LEVEL REQUESTED, ONE HALF OF FY 1985 ESP II ASSISTANCE UNDER U.S. UNDERTAKINGS IN THE 1983 AMENDMENTS TO THE MILITARY BASES AGREEMENTS WILL BE PROVIDED AS PROGRAM ASSISTANCE. (IF FY 1985 ESP EXCEEDS DOLS 95 MILLION, THE 50/50 PROPORTION MAY NEED TO BE ALTERED.)

- B. THIS ASSISTANCE WILL PROVIDE FREE FOREIGN EXCHANGE, HELPING MEET BALANCE OF PAYMENTS PROBLEMS. HOWEVER, OUR PRINCIPAL DEVELOPMENT OBJECTIVE WILL BE TO HELP OVERCOME OBSTACLES TO TIMELY IMPLEMENTATION OF

DONOR-ASSISTED DEVELOPMENT PROJECTS ARISING FROM THE INABILITY OF THE GOP TO INCREASE PESO SUPPORT OF THOSE PROJECTS UNDER THE CURRENT FINANCIAL/ECONOMIC CRISIS.

- C. THE GOP DEVELOPMENT PROGRAM TO BE ASSISTED BY PESOS ATTRIBUTABLE TO AID ASSISTANCE TO THE RPSM WILL BE A PORTION OF THE FOREIGN ASSISTED PROJECTS SUPPORT FUND (FAPSF) WHICH SUPPORTS IBRD, ADB, AND U.S. AID DA PROJECTS SERVING THE LIVELIHOODS, PRODUCTIVITY AND BASIC NEEDS OF RURAL FILIPINOS. THE GOP DEVELOPMENT PROGRAM ULTIMATELY DEFINED MUST BE DISCRETE WITHIN THE GOP BUDGETARY CONTEXT AND MUST HAVE SOURCES OF PESOS OTHER THAN COUNTERPART TO AID ASSISTANCE. PESOS COUNTERPART TO AID ASSISTANCE UNDER RPSM WILL NOT BE DIRECTLY ATTRIBUTED TO SPECIFIC ACTIVITIES UNDERTAKEN UNDER THIS GOP DEVELOPMENT PROGRAM.

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- D. OTHER GOP PESOS WILL BE PUT INTO THE RPSF ENTIRELY FROM GOP REVENUES AND OTHER PESOS WILL BE PROVIDED IN ANTICIPATION OF REIMBURSEMENTS FROM THE DONORS (EITHER AS PROJECT ASSISTANCE REIMBURSEMENTS, AS ADVANCES UNDER PROJECT ASSISTANCE OR THROUGH THE SPECIAL ACTION PROGRAM OF THE IBRD OR SIMILAR SPECIAL DONOR ASSISTANCE).

- E. GOP PESOS COUNTERPART TO AID RPSF DOLLAR ASSISTANCE WILL BE PUT INTO A SPECIAL ACCOUNT FOR ADDITIONAL FUNDING OF THE PPSF OR OTHERWISE TRACED TO THE PPSF AS A PREREQUISITE TO AID DISBURSEMENT OF DOLLARS. (SEPTEL COVERS GUIDANCE ON INTEREST ON SPECIAL ACCOUNTS.)

- F. AID WILL MONITOR EFFECTIVENESS OF THE RPSF BY TRACKING THE ISSUANCE OF CASH DISBURSEMENT CEILINGS (CDC'S) TO IMPLEMENTING AGENCIES FOR ALL RPSF PESOS (WHETHER ATTRIBUTABLE TO AID ESF NON-PROJECT ASSISTANCE, DONOR REIMBURSEMENT OR TO PURELY GOP RESOURCES). WE EXPECT THIS TOTAL TO BE MUCH LARGER THAN THE AMOUNT OF PESOS ATTRIBUTABLE TO AID'S RPSF ASSISTANCE.

- G. THE GOP WILL ALSO GIVE AID COPIES OF GOP REPORTS TO THE IBRD AND ADB OF PROGRESS ON THE PROJECTS SUPPORTED BY THE RPSF WHICH INDICATE RATES OF DRAWDOWN OF IBRD AND ADB LOANS. AID WILL CONTINUE TO TRACK PROGRESS OF ITS DA PROJECTS (INCLUDING TRACKING THAT HOST COUNTRY CONTRIBUTIONS OF AT LEAST 25 PERCENT OF PROJECT COSTS ARE MADE) THROUGH NORMAL MEANS. WE EXPECT THAT THE RATE OF IMPLEMENTATION OF THESE PROJECTS WILL BE GREATER DURING THE PERIOD AFFECTED BY RPSF ASSISTANCE

THAN IMPLEMENTATION RATES PROJECTED IN THE ABSENCE OF RPSF ASSISTANCE. HOWEVER, IT IS RECOGNIZED THAT THESE IMPLEMENTATION RATES WILL NOT HAVE A ONE-TO-ONE RELATIONSHIP WITH THE RATE OF CDC ISSUANCE TO IMPLEMENTING AGENCIES.

3. WE ARE SEEKING THESE PROGRAM CHARACTERISTICS TO ASSURE THAT THE LOCAL CURRENCY COUNTERPART OF OUR ASSISTANCE HAS THE MAXIMUM DEVELOPMENT IMPACT. WE NORMALLY SEEK SUBSTANTIAL DEVELOPMENT POLICY IMPACTS WHEN CONTEMPLATING PROGRAM ASSISTANCE SUCH AS THE RPSF. HOWEVER, THE ORIGINS OF THE ESF PROGRAM IN THE MILITARY BASES AGREEMENTS AMENDMENT PROCESS HAS LIMITED OUR ABILITY TO MAKE A NORMAL POLICY REFORM JUSTIFICATION FOR RPSF.

NEVERTHELESS, THE PAAD SHOULD ANALYZE THE POLICY CONTEXT (MEASURES TO RESTORE INTERNATIONAL CONFIDENCE, TO MOVE TOWARD INTERNATIONAL PAYMENTS BALANCE, TO INCREASE

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RESOURCES FOR RESTORATION OF PRIVATE SECTOR ACTIVITY, TO INCREASE RESOURCES FOR DEVELOPMENT, ETC.) IN WHICH THE RPSP WILL OPERATE. THE PAAD SHOULD ANALYZE THE EXTENT TO WHICH THIS POLICY CONTEXT MAKES POSSIBLE EFFECTIVE USE OF BOTH THE DOLLAR (FOREIGN EXCHANGE AVAILABILITY) AND THE PESO (DEVELOPMENT PROJECT IMPLEMENTATION) ASPECTS OF OUR ASSISTANCE.

4. WE RECOGNIZE THAT OUR CONCEPT OF RPSP DOES NOT INCLUDE SUPPORT FOR PROJECTS WHICH ARE NOT RECEIVING DONOR ASSISTANCE AS PROPOSED IN THE PAIP. WE APPRECIATE THE MAGNITUDE OF THE THE PROBLEM OF SUPPORTING OTHER PARTS OF THE GOP DEVELOPMENT PROGRAM, BUT WE HAVE SPECIAL PROBLEMS JUSTIFYING PROGRAM ASSISTANCE UNDER ESF II. OUR CONGRESSIONAL PRESENTATION OF RPSP AND TESTIMONY ON THE FY 1985 PROGRAM HAVE BEEN BASED ON A SHOWING THAT THE ACTIVITIES TO BE SUPPORTED BY RPSP HAVE ALREADY BEEN EXAMINED BY A DONOR REVIEW PROCESS (IN WHICH THE USG PARTICIPATES) AND FOUND TO MEET DEVELOPMENT ASSISTANCE STANDARDS. WE DO NOT FEEL WE CAN JUSTIFY THE MORE FLEXIBLE PROGRAM ASSISTANCE MODE FOR ACTIVITIES WHICH HAVE NOT MET THIS TEST. OTHER GOP DEVELOPMENT ACTIVITIES CAN BE EXAMINED UNDER PROJECT ASSISTANCE CRITERIA AND, IF QUALIFIED, ASSISTED FROM THE PROJECT SIDE OF ESF II.

5. WE ARE CONTINUING CONSULTATIONS WITH THE OFFICE OF THE INSPECTOR GENERAL AND OTHER AID/W OFFICES ON MONITORING AND ACCOUNTABILITY UNDER RPSP, AND THAT SHOULD BE KEPT IN MIND IN ANY DISCUSSIONS WITH THE GOP.

WE WILL ADVISE OF ANY FURTHER SUGGESTIONS FOR FINAL DESIGN. PLEASE ADVISE US WHETHER THE ABOVE APPROACH IS ACCEPTABLE OR PRESENTS SIGNIFICANT PROBLEMS. DAM

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STATUTORY CHECKLISTS

1. Country Checklist
2. Nonproject Assistance Checklist
3. Standard Item Checklist

3A(1) - COUNTRY CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Security Supporting Assistance and the criteria applicable to Development Assistance. Selection of the appropriate criteria will depend on the funding source for the program.

A. GENERAL CRITERIA FOR COUNTRY

1. FAA Sec. 481. Has it been determined that the government of recipient country has failed to take adequate steps to prevent narcotics drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? No

2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government? No

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3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? No
4. FAA Sec. 620(f); App. Sec. 108. Is recipient country a Communist country? Will assistance be provided to the Democratic Republic of Vietnam, Cambodia, or Laos? No
No
5. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action, of U.S. property? No
6. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the AID Administrator within past year considered denying assistance to such government for this reason? There is an investment guaranty program with the Philippines.
7. FAA Sec. 620(o); Fishermen's Protective Act, Sec. 5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters, The Philippines' has not seized or imposed any penalties on U.S. fishing in international waters.

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a. has any deduction required by Fishermen's Protective Act been made?

b. has complete denial of assistance been considered by AID Administrator?

8. FAA Sec. 620(q); App. Sec. 504. (a) Is the recipient country in default on interest or principal of any AID loan to that country? (b) Is country more than one year in default on interest or principal on U.S. loan made pursuant to program for which funds appropriated under Approp. Act, unless debt was earlier disputed, or appropriate steps taken to cure default? No
No
9. FAA Sec. 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators and Military Assistance Staff (PPC/RC). 10.8% for 1983. \$50 million was spent in 1983 and 1984. \$40 million is scheduled to be spent in 1985.
None. The primary focus of the military is to fight insurgency.
10. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? No

11. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? Payments are current
12. FAA Sec. 620A. Has the country granted sanctuary from prosecution to any individual or group which has committed an act of international terrorism? No
13. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U. S. who is present in such country to carry out economic development programs under the FAA? No
14. FAA Sec. 669. Has the country delivered or received nuclear reprocessing or enrichment equipment, materials or technology, without specified arrangements on safeguards, etc.? No
15. FAA Sec. 670. Has the country delivered or received nuclear reprocessing, equipment, material or technology? Is the country not a "nuclear-weapon state" as defined in Article IX(3) of the Nuclear Non-Proliferation Treaty and on which detonates a nuclear explosive device? No. The Philippines is not a "nuclear weapon state".

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B. FUNDING CRITERIA FOR COUNTRY

1. Security Supporting Assistance Country Criteria

a. FAA Sec. 502B. Has the Department of State made findings which indicate that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, is program in accordance with policy of this Section? No
N/A

b. FAA Sec. 531. Is the Assistance to be furnished to a friendly country, organization, or body eligible to receive assistance? Yes

c. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? N/A

2. Development Assistance Country Criteria N/A

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3A(2) - NONPROJECT
ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Security Supporting Assistance and the criteria applicable to Development Assistance. Selection of the appropriate criteria will depend on the funding source for the program.

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Yes

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. App. Unnumbered; FAA Sec. 653(b)

a. Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the nonproject assistance;

The FY 1985 Congressional Presentation of A.I.D. fully described to the Congress the nature and scope of RPSP. This has not changed since that time.

b. Is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than \$1 million over that figure plus 10%)?

The assistance is within the Philippines' OYB for FY 1985.

2. FAA Sec. 611(a)(1). Prior obligation in excess of \$100,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislative action is required within the Philippines. The national budget, the basic document upon which RPSF relies, has been approved.

4. FAA Sec. 209, 619.

Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance with multilateral plans to the maximum extent appropriate?

No. This assistance is needed to permit the Government of the Philippines to increase its funding of selected projects. Some of these projects are assisted by multilateral organizations but the problem relates to the shortage of local currency, not foreign resources. The assistance is for bilateral purposes only. The Philippines is not a "newly independent country."

5. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

RPSF is designed to provide additional local counterpart to a select group of about 40 U.S. and multilateral organization-assisted projects. All of these projects relate to rural productivity in some manner, e.g. market roads, irrigation systems, fishing training, farming systems, household water supply, small and medium scale industry. Therefore, RPSF may be most closely identified with improving the technical efficiency of industry, agriculture and commerce. However, to the extent projects in RPSF are associated with the other efforts mentioned, it will assist the country in those efforts

6. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).
- The RPSP is a budget support program for local currency and will influence U.S. private trade and investment here to the extent the projects assisted are viewed as improving the investment climate and increasing the rural economy's demand for traded goods
7. FAA Sec. 612(b); Sec. 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.
- This program is being entered into precisely because there is a shortage of local currency. The GOP must commit itself to providing the original funding appropriated in the national budget. In the past, the Government has been unable to do even this as funding shortfalls required expenditure level cutbacks. For this program, all of the originally budgeted currencies will be provided.
8. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?
- No.
9. FY 1985 Continuing Resolution. If assistance is from the population functional account, does the country (or organization) include as part of its population planning programs involuntary abortion?
- N/A
10. FY 1985 Continuing Resolution Sec. 530. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States?
- N/A

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11. FY 1985 Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

N/A

12. FY 1985 Continuing Resolution Sec. 536. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

No

13. FAA 118(c) and (d). Does the project or program comply with the environmental procedures set forth in AID Regulation 16. Does the project or program taken into consideration the problem of the destruction of tropical forests?

Yes

No

3. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Security Supporting Assistance

a. FAA Sec. 531. How will this assistance support promote economic or political stability? Is the country among the 12 countries in which Supporting Assistance may be provided in this fiscal year?

The proposed RPSP will promote economic and political stability by bringing a group of donor-assisted projects in economically disadvantaged rural areas closer to fruition, and by increasing the resources made available to these projects. It is hoped that this will be viewed favorably by portions of the population concerned over the political situation

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| 2. <u>Nonproject Criteria for Development Assistance</u> | N/A |
| 3. <u>Nonproject Criteria for Development Assistance (Loans only)</u> | N/A |
| 4. <u>Additional Criteria for Alliance for Progress</u> | N/A |



3A(3) - STANDARD ITEM CHECKLIST

Listed below are statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by exclusion (as where certain users of funds are permitted, but other uses not).

These items are arranged under the general headings of (A) Procurement and (B) Other Restrictions.

A. PROCUREMENT

- | | |
|--|---|
| 1. <u>FAA Sec. 602.</u> Are there arrangements to permit U.S. small business to participate equitably in the furnishing of goods and services financed? | N/A. RPSF is a budget support program whereby our ESF dollars are transferred to the GOP in exchange for its making additional counterpart available to a select group of projects. |
| 2. <u>FAA Sec. 604(a).</u> Will all commodity procurement financed be from the United States except as otherwise determined by the President or under delegation from him? | N/A |
| 3. <u>FAA Sec. 604(b).</u> Will all commodities in bulk be purchased at prices no higher than the market price prevailing in the United States at time of purchase? | N/A |
| 4. <u>FAA Sec. 604(c).</u> Will all agricultural commodities available for disposition under the Agricultural Trade Development & Assistance Act of 1954, as amended, be procured in the United States unless they are not available in the United States in sufficient quantities to supply emergency requirements of recipients? | N/A |

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5. FAA Sec. 604(d). If the cooperating country discriminates against U.S. marine insurance companies, will agreement require that marine insurance be placed in the United States on commodities financed? N/A

6. FAA Sec. 604(e). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? N/A

7. FAA Sec. 604(f). Are there arrangements whereby a supplier will not receive payment under the commodity import program unless he/she has certified to such information as the Agency by regulation has prescribed? N/A

8. FAA Sec. 608(a). Will U.S. Government excess personal property be utilized wherever practicable in lieu of the procurement of new items? N/A

9. MMA Sec. 901(b).
(a) Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. - flag commercial vessels to the extent that such vessels are available at fair and reasonable rates. N/A



10. International Air Transport.
Fair Competitive Practices Act,
1974

If air transportation of person or property is financed on grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such service is available? N/A

B. OTHER RESTRICTIONS

1. FAA Sec. 620(h). Do arrangements preclude promoting or assisting the foreign aid projects or activities of Communist-Bloc countries, contrary to the best interests of the United States? Yes

2. FAA Sec. 636(i). Is financing prohibited from use, without for purchase, long-term lease, waiver exchange, or guaranty of sale of motor vehicle manufactured outside the United States? N/A

3. Will arrangement preclude the use of financing:

a. FAA Sec. 114. to pay for performance of abortions or involuntary sterilizations or to motivate or coerce persons to practice abortions? to pay for performance of involuntary sterilizations as methods of family planning or to coerce or provide any financial incentive to any person to practice sterilizations? Yes

b. FAA Sec. 620(g). to compensate owners for expropriated nationalized property? Yes

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- c. FAA Sec. 660. to finance police training or other law enforcement assistance, except for narcotics programs? Yes
- d. FAA Sec. 662. for CIA activities? Yes
- e. App. Sec. 103. to pay pension, etc., for military personnel? Yes
- f. App. Sec. 106. to pay U.N. assessments? Yes
- g. App. Sec. 107. to carry out provisions of FAA Sections 209(d) and 251(h)? (transfer to multi-lateral organization for lending). Yes
- h. FY 1985 Continuing Resolution, Sec. 506.
To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? Yes
- i. FY 1985 Continuing Resolution, Sec. 510
To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? No
- j. FY 1985 Continuing Resolution, Sec. 511.
Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? No

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| k. <u>FY 1985 Continuing Resolution, Sec. 516.</u>
To be used for publicity or propaganda purposes within U.S. not authorized by Congress? | Yes |
| 4. <u>FAA Sec. 201(d).</u> If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter. Can the country borrower service the loan on harder than standard development loan terms? | N/A |

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