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Agency for International Development  
Washington, D.C. 20523

PHILIPPINES  
PROGRAM ASSISTANCE APPROVAL DOCUMENT  
(PAAD)

BUDGET SUPPORT PROGRAM  
(BSP)

(492-0404)

June 1986

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CLASSIFICATION:

AID 11-20-1  PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT  PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 492-0404
		2. COUNTRY Philippines
		3. CATEGORY Cash Transfer
		4. DATE
5. TO: Frederick W. Schieck	6. OYB CHANGE NO. N/A	
7. FROM: <i>W. Thomas Oliver</i> W. Thomas Oliver, Acting Deputy Director	8. OYB INCREASE None TO BE TAKEN FROM:	
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$200,000,000.00	10. APPROPRIATION	
11. TYPE FUNDING   12. LOCAL CURRENCY ARRANGEMENT   13. ESTIMATED DELIVERY PERIOD   14. TRANSACTION ELIGIBILITY ( ) LOAN (X) GRANT   (X) INFORMAL ( ) FORMAL ( ) NONE   June 1986   N/A		
15. COMMODITIES FINANCED  N/A		

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local: Peso equivalent of \$200,000,000.00
Cash: \$200,000,000.00	Other:

18. SUMMARY DESCRIPTION

The new GOP administration is facing an immediate budget crisis. Unless ameliorated, it could serve to undermine the policy reform objectives and ultimately the viability of the new government. The objective of the proposed Budget Support Program (BSP) is to provide budget support to the GOP so that it can continue financing basic services in priority sectors of education, health and agriculture, as well as in other priority budget areas mutually agreed upon by A.I.D. and the GOP.

Upon satisfaction of conditions precedent to disbursement AID will disburse to the GOP pesos equivalent to \$200 million for deposit in a special account. Prior to the initial transfer of pesos from the special account to the General Fund, A.I.D. and the GOP will agree on: (1) an implementation plan; (2) the specific priority budget categories based on the budget then in effect for the GOP's 1986 budget year for which disbursements will be reported against BSP and the total amount of pesos to be disbursed in those budget categories for such costs and (3) the estimated disbursements for costs incurred and to be incurred in March, 1986 and in the second and third quarters of the 1986 Budget Year of the GOP in those budget categories. Upon notification from A.I.D. that these conditions have been satisfied, the GOP will transfer the amount of pesos agreed upon in clause (3) above from the special account to the GOP's General Fund. Subsequent transfers of pesos to the General Fund will be made as agreed upon by A.I.D. based on periodic financial reports or revised estimates of expected disbursements in the selected budget categories. Any disbursements for costs incurred in the 1986 budget

19. CLEARANCES	DATE	20. ACTION
RLA: BMiller <i>B Miller</i>	6/23/86	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED
PRO: DD Antonio <i>D Antonio</i>	6/20/86	<i>Frederick W. Schieck</i> AUTHORIZED SIGNATURE June 23, 1986 DATE
CO: B Eckerley <i>B Eckerley</i>	6/20/86	
OD/PE: P Deuster <i>P Deuster</i>	6/20/86	
UCD: K Brown <i>K Brown</i>	6/20/86	
ORAD: D Clark <i>D Clark</i>	6/20/86	
		Director, USAID/Philippines TITLE

Continuation of Summary Description:

year beginning with March 1, 1986 in the identified budget categories may be reported as disbursements under BSP provided such disbursements are not attributed to any other source by the GOP.

The GOP will monitor performance of the BSP and report periodically on progress toward achievement of Program objectives. The focus will be on progress of the Program as a whole rather than on any individual activities in the Program.

## List of Abbreviations/Acronyms

A/A	Advice of Allotment
ADB	Asian Development Bank
AID/W	Agency for International Development/Washington
AIP	Agricultural Sector Inputs Loan
BOP	Balance of Payments
BRE	Budget of Receipts and Expenditures
BSP	Budget Support Program
BTR	Bureau of Treasury
CB	The Central Bank of the Philippines
COA	Commission on Audit
DA	Development Assistance
DBP	Development Bank of the Philippines
DM	Deutsche Mark
DSP	Development Support Program
ESF	Economic Support Fund
ESFS	Economic Support Fund Secretariat
GDP	Gross Domestic Product
GFI	Government Financial Institution
GNP	Gross National Product
GOP	Government of the Philippines
IBRD	International Bank for Reconstruction and Development (World Bank)
IMF	International Monetary Fund
MBA	Military Bases Agreement
MOF	Ministry of Finance
NEDA	National Economic and Development Authority
OBM	Office of Budget and Management
ODA	Official Development Assistance
OECD	Overseas Economic Cooperation Fund

List of Abbreviations/Acronyms (Continued)

₱	Philippine Peso
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Initial Proposal
PL 480	Public Law 480
PNB	Philippine National Bank
PPA	Philippine Program for Policy Action
RAMC	Regional Administrative Management Center
RPSP	Rural Productivity Support Program
SDR	Special Drawing Rights
SPIA	Special Project Implementation Assistance (ADB)
USAID	United States Agency for International Development
USG	United States Government
Y	Japanese Yen

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I. SUMMARY AND RECOMMENDATION

1. Program Title : Budget Support Program (BSP)
2. Grantee : The Republic of the Philippines
3. Grant Amount : \$200 Million (peso equivalent at the rate obtained by the U.S. Disbursing Office, through its agents, from the Central Bank of the Philippines)
4. Funding Source : Economic Support Fund (ESF)
5. Initial Obligation : FY 1986
6. Program Objectives : The primary objective of the BSP is to provide bases related ESF funds as budget support to the GOP. This will assist the GOP in ameliorating its current budget crisis. BSP will contribute to GOP financial and, hence, political stability by providing budget support to the GOP so that it can continue financing basic services in the priority sectors of education, health and agriculture, as well as in other priority budget areas mutually agreed upon by A.I.D. and the GOP.
7. Program Description: A.I.D will provide pesos equivalent to \$200 million to the GOP for budget support. The pesos equivalent to \$200 million will be deposited by the GOP in a Special Account upon satisfaction of Conditions Precedent to Disbursement. Transfer of pesos from this Special Account to the GOP's General Fund will be mutually agreed to between A.I.D. and the GOP based upon the satisfaction of initial and subsequent Conditions Precedent to the Transfers. BSP resources released from the Special Account will be reported against expenditures by the GOP after February 28, 1986 in specific budget categories agreed upon by A.I.D. and the GOP.
8. Estimated Completion Date : Full disbursement by A.I.D. to the GOP for deposit in the Special Account of pesos equivalent to \$200 million in grant ESF is expected to take place in FY 1986.
9. Statutory Requirements : All statutory requirements have been met. See Annex D.
10. Recommendation : That a \$200 million peso equivalent ESF grant be authorized to the GOP based on terms and conditions described in the attached authorization.

## II. NARRATIVE OVERVIEW

The popular new government of President Corazon Aquino faces enormous tasks. It is laboring under intense public expectations of quick results against a myriad of inherited problems. The country is in the midst of a severe recession with 70 percent of the population living in poverty. Foreign debt tops \$26 billion with debt servicing exceeding 37 percent of export earnings, even with debt restructuring. As the result of past misguided policies and crony favoritism, deep structural problems hamstringing the economy. The industrial sector is grossly inefficient, too extensively urban based and excessively capital intensive. The government is overly involved in the economy through regulations, public corporations, financial institutions and acquired assets. Even with measures to reduce expenditures and increase revenues the government is still facing a ₱26.2 billion or \$1.2 billion deficit in its budget.

The new government is developing an economic recovery and development strategy with a strong free market orientation. Its principal focus is rural-based employment-oriented development. The new GOP is deeply committed to implementing fundamental economic reforms. It aims to reduce the role of government, dismantle crony monopolies and privileges, effect trade liberalization, divest public corporations and acquired assets, and maintain sound monetary and fiscal policies.

The objective of the Budget Support Program (BSP) is to help ameliorate the present budget crisis, hence, contributing to the financial viability of the new government and setting the stage for longer term structural adjustments and reforms. BSP will support basic services in such priority sectors as education, health and agriculture. Two-thirds of the population is dependent on agriculture for their livelihood. Deteriorating living standards and past budget cuts have heightened the need to avoid further reduction in basic health and education services.

## III. SETTING

### A. Political Realities

For over twenty years, starting in 1965, Ferdinand Marcos governed the Philippines, first as elected President and then as martial law ruler. Former President Marcos had placed the country under martial rule in 1972 in order to thwart the growing challenge to his rule posed by both democratic political opposition and communist insurgency. The declaration was purportedly in support of a new social order for the country and economic prosperity. However, the act removed public accountability of the government and in time resulted in the neglect of rational economic management in favor of political expediencies and favoritism for cronies. Unfavorable external developments towards the end of the seventies exposed the structural defects of the economy

and the cumulation of effects of years of economic mismanagement. The assassination of former Senator Benigno Aquino, Jr. in August 1983 caused a marked deterioration in political stability.

Against a background of mounting problems, to demonstrate his mandate, Marcos called for a snap presidential election. However, massive irregularities, perpetuated by the Marcos clique, marred the February 7, 1986 elections. While the Batasan Pambansa (Parliament), controlled by his own ruling party, nevertheless proclaimed Marcos the winner, the majority of the people challenged the validity of the results. With Mrs. Corazon C. Aquino, wife of the slain former Senator and presidential contender, as the rallying point, the Filipino people began a determined campaign to oust the former president through civil disobedience. Shortly thereafter, the military declared an open revolt. Under extreme pressures, both from within and outside the country, Marcos fled the country, paving the way for a peaceful transition of government.

The new government of President Corazon C. Aquino assumed office on February 25, 1986, just hours before the final collapse of the Marcos government. It draws wide popular support from both organized and unorganized sectors in the Philippine political spectrum. The new cabinet is a mixture of traditional political oppositionists to the previous government, human rights activists and businessmen who basically represent the economic middle ground. The new government has claimed broad provisional powers, proclaimed a transitional "freedom" constitution, replaced many local government officials, and appointed a commission to draft a new constitution.

Under intense popular expectations, the immediate concern of the new government is to reverse the economic decline of the last two years. It wants to reactivate investment activity and reverse the poor export performance experienced since 1983. While short term recovery measures need to be consistent with requirements for sustainable long-term growth, public expectations for rapidly improved economic conditions make time consuming structural adjustments difficult. The government feels acutely the political necessity to achieve quick and tangible successes in improving conditions, particularly for those in the lowest rungs of the economic strata, who are severely suffering under the present economic crisis. With assistance, the Philippine government should be able to maintain the level of critical public services and response to some of the urgent needs without having to resort to inflationary financing or excessive domestic borrowing which would seriously constrain private investment and, hence, recovery.

## B. Economic Situation

### 1. Historical Perspective

During the 1970s, the Philippines attained economic progress, partly as a result of heavy government spending. Annual growth of real GNP was a respectable 6 percent annually, with the agriculture sector and the industrial

sector expanding by around 5 percent and 10 percent, respectively. Owing largely to credit support, investment in irrigation facilities, and favorable incentives, rice self-sufficiency was achieved. The share of non-traditional manufactured exports to total exports increased from 8 percent in 1970 to 33 percent in 1979, reducing dependency on traditional agricultural exports. Public investment was raised four-fold, thereby expanding infrastructure and social services, although several large investments were of dubious economic value. However, domestic revenue mobilization remained low and the GOP had to rely heavily on foreign borrowings to finance a growing investment-savings gap.

Moreover during the 1970's, structural problems became more serious. The industrial policy was a carryover of the import substitution strategy of the preceding decades. A wide range of protection measures were aimed to promote rapid industrialization and reduce imports. These measures plus an overvalued exchange rate, low interest rates and fiscal incentives skewed investment toward the urban-based and capital intensive industrial sector. They failed to reduce the country's dependence on imports. Instead, they created a modern sector that was inefficient, import-dependent and overly capital-intensive and an agricultural sector that was unable to provide raw materials and local demand essential for expanding rural markets and industrial production.

The previous government's misguided and rent seeking economic policies exacerbated these long-standing structural problems. The policies tended to concentrate economic and political power in the hands of the government and selected individuals (cronies) in the private sector. Increased GOP intervention in the markets for goods and financial assets and monopolistic structures in key sectors of the economy promoted large-scale waste, inefficiency, mismanagement and corruption. As a result, a large segment of the population failed to benefit significantly from the high economic growth of the 1970s.

The country became more and more vulnerable to external shocks. As primarily an exporter of agricultural commodities and a heavily dependent importer of fuel, the Philippines had long been sensitive to changes in international markets. The further growth of an import-dependent industrial sector and the large build-up of foreign debt markedly increased the country's vulnerability.

Ultimately, against a background of global recession and high interest rates in the early 1980s, the Philippine economy weakened considerably. The assassination of former Senator Aquino in August 1983 triggered a loss of business confidence, massive capital flight, and an abrupt decline in foreign commercial credit. Together these precipitated the economic crisis which led to the government calling a moratorium on the amortization of commercial debt in October 1983. The economy has been contracting since.

## 2. Present Economic Problems

The new government has inherited serious interlocking economic problems upon which it is taking immediate action.

### a. Recession, Unemployment, and Poverty

The country is in the midst of a severe recession. Real GNP has declined by 10 percent during the last two years. Per capita GNP in 1985 in real terms was down 15 percent from 1983 and was at the level of ten years ago. The recession has worsened the country's deep-rooted and fundamental employment, income distribution and poverty problems. A fast-growing population is further intensifying these problems. The World Bank estimated that in 1983, 3.6 million families or 39 percent of all families lived in poverty, and the situation has since worsened considerably. Current estimates are that 70 percent of the population lives below the poverty line. Government expenditure cutbacks for basic social services such as health and education have further compounded the recessionary impact on low income groups.

### b. Budget Deficit

The 1986 budget deficit with unchanged policies would have reached as high as ₱39 billion or \$1.9 billion. The government has identified areas for reductions in expenditures and increases in revenues. However, the deficit is still estimated at ₱26 billion or \$1.3 billion. (Section V contains a detailed analysis.)

### c. Foreign Exchange Needs

Debt servicing on the country's \$26 billion foreign debt, even with rescheduling, will consume more than 37 percent of presently depressed export earnings. With little prospect of an early revival in export earnings, foreign exchange availability could be a serious constraint on the country's economic recovery efforts. To maintain adequate reserves, the country will need about \$875 million in new money during the current year. The present foreign reserve level (\$1.6 billion) is adequate over the short run. However, there is a potential crisis if expected financing flows and reschedulings are not realized in a timely fashion. (Section IV.C. contains more information.)

### d. Structural Problems

As discussed previously, the nearly three decades of import-substitution industrial policy, serious economic dislocations brought about by cronyism and misguided policies, and the interventionist activities of the previous regime have created deep-rooted structural problems. The industrial sector is grossly inefficient, overly urban based and excessively capital intensive. Substantial government resources are locked into financial institutions, public corporations and non-performing acquired assets. The rural sector is substantially lagging in development.

### 3. Domestic Economy Outlook for 1986

The prospects for the Philippine economy remains uncertain. There is little sign of recovery. Private investment remains depressed because of weak demand, political uncertainties and high levels of unutilized capacity. The GOP is hoping for a 1.3 percent growth of real GNP for 1986. However, this will only be achieved if a substantial recovery is launched in the second half of the year. If this does not occur, GNP could possibly decline again in 1986, with the consequent further deterioration of employment, incomes and living standards. Hence, the putting into place of the appropriate mix of fiscal, monetary, trade and exchange rate policies for facilitating major economic recovery in the short term, without losing the gains of the past stabilization efforts, is extremely important.

#### C. Philippine Economic Recovery and Development Strategy

The Philippine Government (GOP) is completing the framework for its economic program to achieve near term recovery and sustainable long term growth. The guiding principles of this program are respect for human rights; social justice and poverty alleviation; the recognition of the urgency of growth and greater efficiency; and, a minimum of government intervention. The program has a strong free market orientation with the private sector as the prime mover. Its principal strategy is rural-based employment-oriented development. This strategy is to be implemented by structural reforms, trade liberalization, appropriate monetary and fiscal policies, and employment generating programs such as rural road building and maintenance, reforestation work, communal irrigation improvement and cottage industries.

The GOP is giving priority to agriculture. Agriculture sector growth is to be promoted through market-oriented reforms in agricultural marketing and in the industrial protection system, a flexible exchange rate policy, and strengthening of the rural banking system. The GOP role in the trading of agricultural commodities will be limited to the implementation of normal trading rules and monitoring of performance, and to ensuring a stable supply of basic grains. Selective price support, crop insurance and the reduction of the transactions costs and risks in agricultural lending will promote agricultural investment. The GOP will be formulating an improved agrarian reform program and a coordinated assistance package for small farmers.

In the trade and industry sectors, market-oriented policies will promote industrial efficiency. Reforms in the structure of protection will discourage import-dependent and inefficient industries and encourage exports. Remaining price distortions across sectors will be eliminated, including unwarranted tax and duty exemptions. Further adjustment in the sales tax structure will be undertaken. Small and medium scale industries, particularly those with strong agricultural linkages, will be encouraged.

The objective of monetary policy is to reduce current high real interest rate levels, while being consistent with a flexible exchange rate policy. Policies will also be adjusted to ensure the stability of the financial

system such as asserting the independence of the Central Bank, emphasizing its role as a bank of last resort, and improving its supervision and surveillance.

In the fiscal sector, the GOP has taken steps to reconstruct the 1986 budget to rechannel resources to small-scale, labor-based rural infrastructure projects, to high immediate social impact projects and to wages of public servants to partially restore their severely eroded value. Streamlining of the national budget will also be achieved by raising the cost effectiveness of revenue programs. The GOP has initiated measures to check the further proliferation of public corporations and to enforce financial discipline. Government corporations will no longer be entitled to undue competitive advantages and will be subjected to limits on government support. The GOP is rationalizing the scope and size of the government financial institutions (GFIs) within the framework of the overall financial system to make them more supportive of, rather than competitive with, the private sector.

Finally, the GOP views the international community as playing a vital, catalytic role in the economic program. It is expected that donors will provide and/or assist in obtaining more concessionary aid, private equity investment, trade accommodations and an equitable solution to the external debt problem.

#### IV. RECENT ECONOMIC DEVELOPMENTS

##### A. Domestic Production, Income and Prices

The Philippine economy continued to contract in 1985. Real gross national product (GNP) and real gross domestic product decreased by 3.8 percent and 4.0 percent, respectively. This followed upon the 6.8 percent decline in real GNP between 1983 and 1984. Real GNP in 1985 was 10 percent below the 1983 level. With a population growth of around 2.5 percent per year, per capita real GNP in 1985 (around \$580) was 15 percent below the 1983 level. The 1985 real per capita GNP was at the level of ten years ago.

Table 1. National Income Indicators, 1983-1985  
(Constant 1972 Prices)

<u>Indicator</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>% Change 1984-85</u>
1. Gross Domestic Product (₱ M)	99,920	94,214	90,469	(3.97)
2. Gross National Product (₱ M)	98,619	91,931	88,432	(3.81)
3. Per Capita Income (₱)	1,895	1,723	1,618	(6.12)

Source: National Economic and Development Authority (NEDA)

Investment activity, as measured by gross domestic capital formation, further declined in real terms by 20.7 percent, after a 36.4 percent slide in 1984. The principal factor in the decline in fixed investments was the drop in construction activity by 26.9 percent. The poor investment climate was matched by a continued slack in employment opportunities as reflected by the persistent high unemployment rates (based on prior week) of 11.1 percent during the last quarter of 1985 and 12.0 percent in January 1986. Underemployment rates (based on preceding quarter) were 22.2 percent in the third quarter of 1985 and 18.7 percent in the fourth.

At the sectoral level, only the agriculture, mining and utilities sectors managed to post positive growth rates in 1985. The combined output of the agriculture, fishery and forestry sector posted a real growth of 2.4 percent. On the other hand, the combined output of the industrial sector further declined by 10.2 percent, roughly the same rate of decline as in 1984, despite some positive growth for the mining and the utilities subsectors. The major declines in industry value added were recorded for the construction (27.6 percent) and manufacturing (7.3 percent) activities.

Inflation, as measured by December over December change in the Consumer Price Index (CPI), went down to 5.3 percent in 1985 from the record level of 50.8 percent in 1984. This dramatic reduction in the rate of increase of the general price level was the result of continued fiscal and monetary restraint, the slack in both consumer demand and industrial activity, and the anomalous stability of the peso against the dollar during most of 1985. While there was a momentary sharp increase in the money supply in late 1985, the annualized inflation rate for the first five months of 1986 (May over December) was negative at 1.9 percent.

#### B. Monetary Developments

For most of 1985, the GOP, in compliance with the IMF stand-by agreement, pursued a restrictive monetary policy designed to reduce inflationary pressures and achieve stability in the monetary system. The monetary authorities undertook massive open market operations, offering financial instruments with very high rates of return, and increased reserve requirements. The tight monetary stance was successful in moderating the inflation rate which had reached 64 percent in the previous year. However, the artificially high cost of capital further dampened investment activity and forced a number of business enterprises, especially small-scale industries, out of business.

Total liquidity in the system varied during the year. It increased during the second quarter of 1985 with the bulk of expansion in liquidity coming from external transactions, primarily the improvement in net services receipts. However, contractionary influences, consisting mainly of net flotation of Central Bank bills, low demand for credit and selective lending policies of the banking sector, offset the expansion. Likewise, during the latter part of 1985, money supply increased sharply, apparently because of

excessive pre-election spending. However, prices did not respond to the sharp increase in money supply. Monetary authorities, after the February 1986 revolution, concerned with controlling inflation, again resorted to mopping up the excess liquidity through offering high interest rate bills.

Interest rates had a mixed trend during 1985. Rates on time deposits and promissory notes declined, while the rate on savings deposits increased. Interest rates on Central Bank bills and Treasury bills declined later during the year basically reflecting the relaxation in some of the IMF performance criteria. The financial markets, particularly the capital markets, remained underdeveloped and underutilized as means of mobilizing domestic and foreign savings.

The GOP has not been able to consistently comply with all of the IMF performance criteria in the present stand-by arrangement. In 1985, the GOP failure to meet the March ceiling on net banking system credit to the monitored public sector caused a delay in the release of the second tranche. The GOP was able to comply with the performance indicators in July and December, but not the September ceiling for net domestic borrowing.

Concerning the March 1986 IMF ceilings, the Central Bank exceeded the target for credits to the Philippine National Bank (PNB). Earlier during the year, the GOP had successfully contended with a very high reserve money level caused by excessive pre- and post-election spending. Due to non-compliance on these two performance indicators and the changed economic and political situation, the IMF decided not to release the last tranches of the present stand-by arrangement and to draw up a new economic program with the GOP.

## C. External Sector

### 1. External Trade

The trade balance recorded another deficit in 1985. This deficit, however, was lower than the one in 1984. The lower trade deficit was made possible by a larger decline in imports relative to that for exports. Total exports were valued at \$4.6 billion or 14.2 percent lower than export proceeds in 1984. The decline in export earnings was due mainly to the slump in international prices of the country's export products. Traditional exports were the biggest losers during the year. Exports of coconut products declined by 37 percent or by about \$268.8 million, while sugar and sugar by-products were 33.7 percent lower than in 1984. Exports of forest products, abaca, tobacco, mineral and petroleum products all declined during the year. Meanwhile, imports declined from \$6.07 billion in 1984 to \$5.12 billion in 1985, or by about 15.7 percent.

## 2. Balance of Payments

In 1985, the country's BOP deficit, excluding exceptional financing and the effects of rescheduling, stood at about \$1.8 billion (5.5 percent of current GNP), a significant 22 percent increase from the preceding year's deficit. A substantial net outflow in long-term and short-term loan repayments largely contributed to the BOP shortfall. On the other hand, the current account deficit declined to only \$400 million, roughly one-third of the 1984 level, owing primarily to increased remittances from abroad and a reduced merchandise trade deficit. The latter, however, was the effect of a sharp drop in imports rather than higher exports.

## 3. Foreign Debt Situation

Total external debt as of December 1985 stood at \$26.2 billion, or 3.3 percent higher than the level in 1984. This level is almost double the level before the second oil shock in 1979. The total debt is equivalent to four-fifths of current GNP in 1985. Short-term debt grew rapidly through the late 1970s from a level equivalent to 4.9 percent of GNP in 1977 to 10.2 percent of GNP in 1982. With rescheduling agreements with creditors, short-term debt in 1985 represented 26.3 percent of GNP.

The bulk of total external debt consists of borrowings from international commercial banks and other financial institutions (58.2 percent); followed by debt from suppliers and bilateral sources (23.3 percent); and from multilateral institutions (17.1 percent). Almost half of total external debt was incurred by the public non-banking sector, while the Central Bank and the commercial banking system accounted for 33.8 percent of the total.

Accompanying the rapid build-up in external debt, the total annual debt services payments rose from \$1.3 billion in 1979 to \$3.4 billion in 1984 and about \$4.2 billion in 1985. The figures for 1984 and 1985 represent full obligations before accounting for debt rescheduling. Without rescheduling, the debt service ratio would have been 53.2 percent in 1985, or more than double the ratio in 1979. After rescheduling, the ratio was 34.6 percent in 1985. For 1986, without rescheduling, the full debt obligations, maturing obligations plus interest payments, would be about \$4.0 billion, giving a debt-service ratio of 50 percent. After rescheduling the amount totals about \$3.0 billion, equivalent to 37.3 percent of projected exports and service earnings.

## 4. Foreign Exchange Developments

Throughout 1985, the peso exhibited a surprisingly stable trend against the dollar. During the year, the peso depreciated only by 11.4 percent as compared to about 50.3 percent in 1984. The exchange rate averaged P18.607 per dollar. The almost anomalous strength of the peso was attributed to weak import demand and the apparent continued manipulation of the foreign

Table 2. Balance of Payments, 1984-1986 1/  
(In Million US Dollars)

	<u>1984</u>	<u>1985</u> <u>2/</u>	<u>1986</u> <u>3/</u>
Merchandise Trade	(679)	(482)	(350)
Exports	5,391	4,629	4,800
Imports	6,070	5,111	5,150
Non-Merchandise Trade	(975)	111	(189)
Inflow	2,626	3,288	3,224
Outflow	3,601	3,177	3,413
Transfers, Net	386	379	406
Current Account	(1,268)	8	(133)
Long-Term Loans	(271)	(1,026)	953
Inflow	730	428	896
Outflow	1,001	1,454	1,849
Direct Investments, Net	6	(9)	90
Short-Term Capital, Net	18	(1,526)	0
Errors and Omissions, Net	(94)	638	0
Gold Monetization	169	221	212
Revaluation Adjustment	(15)	(88)	(36)
Capital Account	(187)	(1,790)	(687)
Unremittable Arrears/Adjustments	-	-	-
Overall Balance	(1,455)	(1,782)	(820)
Change in Net Int'l Reserves	446	991	1,408
Change in Nonmonetary Arrears			
Increases ( )/Decrease	(646)	1,798	-
Exceptional Financing	(1,255)	(3,873)	(2,228)
Unremittable Arrears/ Adjustments	-	(698)	-

1/ Before exceptional financing

2/ Revised (as of April 1986)

3/ Projections

Source: Central Bank of the Philippines

exchange rate by the GOP through heavy involvement in dollar trading by government banks and in the operations of the informal market.

During the second quarter of 1985, the remaining restrictions on foreign exchange trading operations were supposedly removed. However, even with these liberalization measures, the peso maintained its strength against the dollar. Domestic interest rates, while on a downtrend, still remained relatively high. This further constrained import demand and maintained the pace of industrial activity. High domestic interest rates likewise appeared to have discouraged foreign exchange speculation by the private commercial banks and the public. Towards the last quarter of 1985, the peso, however, showed signs of depreciation in response to speculation reactivated by the coming election.

After the new government assumed office in late February, the peso strengthened significantly on account of renewed business confidence. With the return of political stability and in response to the offering of high interest bills, many commercial banks in the early weeks of March unloaded their excess dollar holdings. The Central Bank was able to take advantage of the "dollar glut" to add to its reserves through large dollar purchases. Throughout April the Central Bank was almost the sole dollar buyer in the face of limited commercial bank purchases. After a lull, operations of the "Binondo Central Bank", the parallel market operation, appear to have resumed. Speculative pressure, which was insignificant in March, increased slightly in April the rates offered in the parallel market. However, by late April, the rate differential had narrowed to 10-20 centavos in favor of the interbank rates.

## V. ANALYSIS OF GOVERNMENT BUDGETARY PROBLEMS

### A. 1985 Budgetary Developments

The budget deficit in 1985 reached ₱11.1 billion or almost 2.0 percent of current GNP. (See Table 3). This level was about 70 percent above the target originally agreed upon with the IMF for the year. The gap occurred despite severe austerity measures that reduced expenditures in real terms for government recurrent costs (i.e., for personnel services and maintenance) by 12 percent and capital investments by 50 percent between 1983 and 1985. However, total GOP spending remained high because of substantially larger than planned interest payments and assistance to government financial institutions (GFIs) for their debt service. Together, these payments rose from less than 10 percent of expenditures in 1983 to one third of the total in 1985.

GOP revenue collections in 1985 were below expectations. The main cause was the sharp contraction in domestic economic activities, highlighted by a significant drop in imports. Some one-third of GOP tax collections in previous years came from import duties alone. Likewise, there was an 80 percent shortfall in export tax receipts due to the removal of the foreign

Table 3. National Government Cash Budget Operations, 1985-1986

	1 9 8 5		1 9 8 6				
	Original Program 1/	Actual	Original Program 2/	Actual (as of 5/7/86)	Projected w/ Unchanged Policies 3/	Adjustments 4/	Revised Budget 5/
Revenues (exclusive of ESF)	75.1	67.8	78.7	24.8	76.1	7.1	83.2
Tax	68.3	61.2	72.5	n.a.	69.0	7.1	76.1
Non-Tax (exclusive of ESF)	6.8	6.6	8.2	n.a.	7.1	-	7.1
Expenditures	82.9	80.1	87.6	34.0	115.3	(5.9)	109.4
Current operating of which:	55.3	55.3	62.0	n.a.	67.3	(1.5)	65.8
Personnel services	21.2	22.9	26.6		25.6	(1.6)	24.0
Maintenance and other operating expenses	17.4	13.2	20.0		18.9	2.1	21.0
Interest payments	12.6	14.7	14.9		18.3	(1.4)	16.9
Capital Outlays	11.3	8.8	13.8	n.a.	13.9	3.1	17.0
Equity and Net Lending	16.3	16.0	11.8	n.a.	34.1	(7.5)	26.6
Deficit (exclusive of ESF)	7.8	12.3	8.9	9.2	39.2	13.0	26.2
Deficit (inclusive of ESF) 6/	6.6	11.1	6.9	9.2	35.0	13.0	22.0

1/ Budget program for 1985 as set in November 1984.

2/ Budget program for 1986 as approved by the Batasan Pambansa in October 1985.

3/ Based on most recent budgetary developments, assuming unchanged policies, i.e. no drastic expenditure cuts or new revenue measures.

4/ New budgetary measures expected to be adopted by the new GOP.

5/ The new GOP's budget program after the adoption of adjustment measures.

6/ Contributions of ESF program as budget support were P1.2 billion in 1985, and estimated to be P2.0 billion in the 1986 original program and P4.2 billion in the 1986 revised program.

Source: Office of Budget and Management  
Bureau of Treasury

exchange transactions tax, the decline in the prices and volumes of major export products, and the general reduction in the export tax rates.

## B. 1986 Prospects

The new GOP has inherited a very serious fiscal deficit problem. The previous regime's election-related expenditures and revenue shortfalls during the first four months of 1986 have seriously aggravated the existing deficit problem. While the GOP's original 1986 budget target had been to limit the overall deficit to P6.9 billion or 1.0 percent of GNP for the year, the estimated budget deficit for the first four months alone has already reached P9.20 billion. Based on this trend, and in the absence of any substantial expenditure reductions or new revenue sources, the new GOP estimated that the total deficit for 1986 would have reached P39.2 billion, or more than five times the original deficit target. With presently proposed adjustments, the GOP plans to reduce the deficit to P26.2 billion.

## C. Major Problems

### 1. Revenue Side

Under unchanged policy conditions, GOP revenue collections for 1986 would be as much as P2.6 billion below the original target. The shortfall is traced primarily to the decline in crude oil prices which have affected the receipts from import duties and specific taxes on fuel, to the confusion in the implementation of the new sales turnover tax system, and to continuing large revenue leakages.

While the GOP has the opportunity to achieve tax revenue benefits from lower crude oil prices, the need to alleviate the high cost of energy borne by a population with eroded incomes and to make energy costs of the domestic industries at par with the neighboring oil-importing countries limits the government's leeway. The confusion in the implementation of the new sales tax rates was exacerbated by the past government's announcements that certain industries and products were exempted. There were rampant collection leakages, including tax exemptions to certain sectors, as the previous government provided favors to special interest groups. These leakages, combined with inefficient tax collection, are partly responsible for the country's relatively low tax effort, i.e., only around 12 percent of GNP during the past years compared to 15 percent in other Southeast Asian countries.

### 2. Expenditures

The new GOP estimates that, without substantial reductions, total GOP expenditures, including net lending, would escalate to P115.3 billion, or some 32 percent higher than the original program of P87.6 billion. Disbursements during the first quarter of the year accounted for nearly 30 percent of the original budget, with large amounts having been used for unbudgetted

election-related expenses. The siphoning off of excess liquidity resulting from election spending through sales of Treasury Bills has increased the required level of interest payments in the budget. In addition, the financial problems of the public corporations are much more serious than was previously known as discussed below. About 40 percent of total 1986 expenditures are payments for GOP interest expenses, equity and net lending to public corporations.

Moreover, GOP expenditures have to remain high because of the need to stimulate the economy, reorganize the government structure and meet increased funding demand for major priority programs. These involve increased outlays for infrastructure maintenance, agriculture, and the delivery of basic social services such as education and primary health care. There is also need to restore the sharply eroded income of civil servants, including teachers and soldiers, to boost morale and quality of government services.

### 3. Public Enterprises

The financing requirements of public corporations, including government financial institutions, has been a major drain on the GOP budget. In 1985, GOP equity contributions and net lending to public enterprises amounted to ₱16.0 billion, or 20 percent of total budgetary expenditures. The GFIs accounted for roughly 70 percent of the budgetary assistance provided public enterprises during the year.

For 1986, the original program of ₱11.8 billion for equity contributions and net lending to these corporations would have trebled to ₱34.1 billion if no expenditure cutbacks were imposed. The budgetary requirements of GFIs would have increased from ₱7.0 billion to ₱22.9 billion, while those for non-financial public corporations would have more than doubled from ₱4.8 billion to ₱11.2 billion. The larger budgetary needs of these institutions stem mainly from recently identified debt servicing problems which they can not meet through their own internal resources. Furthermore, the GFIs have absorbed the losses and debts of several large corporations whose loans with foreign creditors have been guaranteed by the Phillipine Government.

## D. Deficit Reduction Measures

### 1. Revenue

To reduce the budget deficit, the GOP has developed a package of new measures that will increase revenues by ₱7.1 billion. This package includes a compromise tax settlement scheme, the removal of exemption privileges, adjustments in petroleum product prices, an increase in the tax rates for cigarettes and beer, and improved valuation of duties. These measures are expected to increase collections by ₱3.8 billion. In addition, improved collection efficiency of the Bureau of Internal Revenue is anticipated to yield ₱3.3 billion. With these measures, total revenues for 1986 are now estimated to reach ₱83.2 billion or 23 percent higher than the previous year's level.

## 2. Expenditures

An intensive review of budgetary expenditures planned for the rest of 1986 has enabled the GOP to identify areas where cuts can be made and savings are possible. For instance, outlays for personnel services and for local governments have been reduced by ₱1.6 billion and ₱0.6 billion, respectively, with the elimination of duplicative and unnecessary governmental activities. Interest payments have also decreased by ₱1.4 billion as a result of declines in both domestic and international rates and a lower exchange rate than was previously assumed.

However, further reductions in expenditures have to be balanced against the need to provide budgetary resources to stimulate growth through greater capital expenditures, provide increased funding to the agriculture and social services sectors, prevent the further deterioration of the existing capital stock, and upgrade compensation of government employees. After a thorough review of all on-going projects, particularly foreign-assisted ones, the GOP is now planning to increase capital outlays by some ₱3.1 billion to a level of ₱17.0 billion in 1986. The actual amount spent for capital investments in 1985 was ₱8.8 billion. Maintenance and operating expenses will also be increased to ₱21.0 billion from the original provision of ₱18.9 billion. This is almost 60 percent higher than the actual 1985 level and reverses the decline in the share of these expenses in the budget since 1981.

After considering the financial flows and activities of GFIs and other public corporations, the GOP has determined that budgetary support for these institutions in 1986 could be reduced by some ₱7.5 billion without unduly affecting their operations. By trimming down on their operating expenses and pursuing a more aggressive program of selling their marketable investments and non-performing assets, GFIs could survive with ₱6.5 billion less. Similar cost-cutting measures and greater emphasis on internal cash generation would reduce by ₱1.0 billion the needs of the other public enterprises. These parastatals would also focus their capital outlays only in such critical areas such as plant rehabilitation, divestiture of unrelated subsidiaries and implementation of foreign-assisted projects.

## 3. Revised Deficit Level

Such cutbacks would reduce total GOP expenditures in 1986 to ₱109.4 billion, or ₱5.9 billion lower than projections without policy changes. Combined with increased revenues amounting to ₱7.1 billion, the expenditures reductions would lower the 1986 overall budget deficit to ₱26.2 billion. Inflows from this program amounting to ₱4.2 billion would reduce the gap to a still hefty but more manageable ₱22.0 billion (around 3.4 percent of GNP).

## E. Financing Requirements

The gross financing requirements of the GOP for the year are ₱36.9 billion. See Table 4. This includes ₱26.2 billion for the budget plus ₱9.0 billion for debt amortization due in 1986 and ₱1.7 billion to build up cash

balances. The GOP needs ₱6.5 billion for the amortization of the foreign debt. This high level is the consequence of recent years' peso devaluations, the cumulating expirations of loan grace periods and the final redemption of dollar-denominated Treasury Bills issued in 1982. The ₱2.5 billion required for domestic debt amortization is for the net redemption of Treasury Bills and repayments of advances to the Central Bank.

The GOP has relied on money creation and domestic borrowing for financing past years' deficits because of sharp drops in external funding. The latter has been mainly due to lower disbursement levels of official development assistance. Of the GOP's actual gross financing requirements (including debt amortization) of ₱19.5 billion in 1985, domestic borrowings provided ₱15.8 billion or 81 percent.

GOP borrowings from domestic sources during the past two years have primarily been through the sales of high yielding Treasury Bills. The outstanding stock of Treasury Bills by end-1985 (₱31.2 billion) is five times its end-1983 level (₱6.1 billion), resulting in a corresponding three-fold increase in GOP expenditures for interest payments in the last two years. The economy has also experienced substantial inflation in 1983 and 1984 due partly to excessive liquidity caused by money creation to support government expenditures.

Despite the planned efforts to increase revenues and to substantially cut expenditures in the coming months, the new GOP will still have a large deficit to finance for the rest of the year. The GOP recognizes the inflationary dangers of financing this gap through money creation. From recent years' experience, it also recognizes the adverse impact of large domestic borrowing on domestic interest rates and on the credit supply for the private sector. Hence, it is reluctant to rely heavily on this approach. The GOP is determined to limit domestic borrowings in 1986 to ₱10.0 billion or 1.5 percent of GNP. As a result, the remaining balance of gross financing requirements amounting to ₱26.9 billion or \$1,281 million will have to come from foreign sources.

#### F. Foreign Assistance

Based on indications of commitments from various donors during the recent Consultative Group meeting in Tokyo, a good portion of the GOP's required level of assistance for budgetary support will be met. There are already firm commitments from the international community for on-going projects for which 1986 disbursements are expected to amount to \$701 million (including \$200 million from this program). The GOP is seeking confirmation for what it considers to be indicative commitments involving \$416 million in disbursements plus new commitments to cover another \$146 million. The GOP's financing needs for the budget and the status of commitments from various external sources are provided in the Tables 4 and 5.

Table 4. Financing of the 1986 GOP Budget

I. Budget Deficit (exclusive of \$200 M ESF)		¥26.2 B
II. Debt Amortization		9.0 B
a. Foreign	¥6.5 B	
b. Domestic	2.5 B	
III. Change in Cash Balance		<u>1.7 B</u>
IV. Gross Financing Requirements		¥36.9 B
V. Domestic Borrowing		<u>10.0 B</u>
VI. Balance for External Assistance Dollar Equivalent (¥21/\$1)		¥26.9 B \$1,281 M
VII. Status of External Assistance		
Expected disbursements from:		
a. Firm Commitments (including \$200 M ESF)		\$ 701 M
b. Indicative Commitments		416 M
c. Uncovered Balance		<u>164 M</u>
TOTAL		\$1,281 M

Source: Ministry of Finance

Table 5. 1986 External Assistance for Budgetary Support:  
Firm Commitments and Expected Disbursements  
(US\$ Million)

	<u>Firm Commitments</u>	<u>Expected 1986 Disbursements</u>
I. Multilateral Institutions	<u>720.1</u>	<u>283.0</u>
A. Asian Development Bank	<u>247.1</u>	<u>105.0</u>
1. On-going Projects	130.0 <sup>a</sup> / L	40.0
2. Special Project Implementation Assistance (SPIA)	100.0 L	60.0
3. Agricultural Inputs Program	17.1 L	5.0
B. World Bank	<u>473.0</u>	<u>178.0</u>
1. On-going Projects	247.0 <sup>b</sup> / L	120.0 <sup>c</sup> /
2. Agricultural Sector/Inputs Loan	75.0 L	53.0
3. MWSS	69.0 L	-
4. Rural Roads	82.0 L	5.0
II. Bilateral Sources	<u>573.2</u>	<u>418.1</u>
A. United States	<u>250.0</u>	<u>234.0</u>
1. Economic Support Fund	200.0 G	200.0
2. PL 480 Title I	50.0 L	34.0
B. Japan	<u>305.1</u>	<u>166.0</u>
1. 8th OECF Commodity Loan	115.0 <sup>d</sup> / L	115.0
2. OECF Project Loan (On-going Projects)	190.1 L	51.0
C. Germany	<u>9.8</u>	<u>9.8</u>
1. Commodity Loan	9.8 <sup>e</sup> / L	9.8
D. Australia	<u>8.3</u>	<u>8.3</u>
1. Previous grant Assistance	8.3 G	8.3
Sub-Total	1,293.3	701.1

Footnotes to Table V.3.:

- a/ With counterpart funds to be generated by SPIA loan, expected disbursement from existing loans is estimated at \$130 million of which \$40 million or nearly 30 percent shall be for projects of line agencies of the national government requiring direct budget support.
- b/ With adequate counterpart fund support, \$300 million are expected to be disbursed for 1986 against all existing World Bank loans to the Philippines. This includes \$53 million for Agricultural Sector Inputs Loan (AIP) leaving a balance of \$247 million for projects both of public corporations and line agencies.
- c/ Nearly 50 percent of expected disbursement of \$247 million is for projects of line agencies requiring direct budget support.
- d/ Original commitment was made in May 1984 for Y35.0 billion. Amount unutilized as of December 31, 1985 was Y19.6 billion available for 1986 of which Y4.68 billion was disbursed from January to April of 1986. At average exchange rate of Y184.6/U.S. dollar for this period, the 1986 disbursements would be equivalent to \$25.4 million. This plus the undisbursed amount of Y14.9 billion equivalent to \$89.6 million (converted at current exchange rate of Y166.75/U.S. dollar) will add up to \$115.0 million for 1986.
- e/ Original commitment made in August 1984 was for DM 30 million. Amount unutilized as of December 31, 1985 was DM 22.7 million available for 1986 of which DM 13.105 million was already disbursed from January to April of 1986. At average exchange rate of DM 2.39/U.S. dollar for this period, the 1986 disbursement would be \$5.48 million. This disbursement plus the undisbursed amount of DM 9.6 million equivalent to \$4.34 million (converted at current exchange rate of DM 2.21/U.S. dollar) will add up to \$9.8 million.

Source: Ministry of Finance

The donor community has responded quite positively to the request of the new GOP for assistance. Of the \$701 million of the expected 1986 disbursements for budgetary support, the U. S. will provide \$234 million; the multilateral institutions (ADB and World Bank), \$283 million; Japan, \$166 million; and other countries, \$18 million. The U.S government support will be in the form of ESF grant and a PL 480 Title I loan. The ADB is providing a new \$100 million loan for budget support to their projects, of which \$60 million is expected to be disbursed this year. Further, both the World Bank and ADB are planning to convert part of the loan proceeds of their on-going projects into direct budget support. The Japanese government is also planning to reallocate the unutilized balance of the OECF 8th Commodity Loan and of some other on-going projects into purely budgetary assistance to the GOP.

## VI. POLICY DIALOGUE FRAMEWORK AND AGENDA

### A. Objectives

The promotion of sustained, broad-based, private enterprise driven economic development requires policy reform directed at three major objectives: recovery from the current recession, liberalization and deregulation, and structural adjustment. The number one priority of the new GOP and the Mission is a return to positive economic growth, particularly in agriculture and in light industries which have high job creating potential. The second priority is to increase incentives for private sector investment and production through substantial deregulation and liberalization. The third priority is major structural reforms that will undo much of the cumulative damage of such policies as import-substitution, capital and urban biased financial and investment policies, overvalued exchange rates, monopolies and rent-seeking regulations, etc. However, an essential step to achieving these objectives is the reduction and financing of the GOP budget deficit, i.e., safeguarding financial and economic stability while maintaining basic services of the government.

### B. Key Reforms

Over the past two years, the IMF, the World Bank and the USG have urged on the GOP a series of reforms designed to address the structural and policy distortions which contributed greatly to the current economic crisis. Following is a list of reforms which have been negotiated, or which are under negotiation with the GOP:

#### 1. Macro Level

- Removal of foreign exchange controls;
- Allowing the market to set the value of the peso, i.e., flexible exchange rate;

- Cancellation of monopoly powers in such areas as sugar, coconuts, meat imports and chemicals;
- Liberalization of exports;
- Liberalization of imports;
- Restructuring or dissolution of major government financial institutions and divestiture of their acquired assets;
- Substantial reorganization and privatization program for the public corporations and their subsidiaries;
- Use of market-oriented interest rates in government credit programs;
- Streamlining of regulations on investment; and
- Improvement in government tax policies.

## 2. Sector Level

- Curtailment of the National Food Authority's involvement in grain imports and retail stores;
- Elimination of controls and public sector involvement in fertilizers;
- Reduction of taxes on pesticides;
- Elimination of price controls on food grains;
- Streamlining of the government price stabilization programs, especially for rice and corn;
- Free market pricing for all major agricultural inputs; and
- Free market pricing for all major agricultural outputs.

## C. Review of the Past

The above objectives and reforms are not new. The previous GOP administration had initiated a Structural Adjustment Program in 1979 to correct the import substitution and capital-intensive biases of postwar trade and industrialization policies. However, the reform measures, adopted to counteract the drying up of cheap foreign capital and the sluggishness of the world economy, were limited in scale and were ineffective in correcting industrial inefficiency. The 1983 economic crisis further delayed and reduced the benefits of these structural reforms.

The 1983 crisis necessitated stabilization measures that included slower monetary growth, budget deficit reduction and a more flexible exchange rate. To support GOP implementation of these measures, the IMF approved the GOP's request for an 18-month Standby Credit Arrangement in late 1984. The last two tranches of this Standby Arrangement were not drawn. Instead, a new Standby Arrangement is being formulated that will be more responsive to the current situation.

Prior to the change in administration, the GOP prepared a comprehensive policy program, the Philippine Program for Policy Action (PPA), for the Ad Hoc Consultative Group Meeting in June 1985. The PPA contained six major areas of policy reform: (a) stabilization program; (b) financial sector rehabilitation, mainly of government financial institutions; (c) improvement in the management of public corporations; (d) public sector domestic resource mobilization and prioritization of public investment projects; (e) agricultural sector policy reforms; and (f) continued implementation of the Structural Adjustment Program. However, the PPA did not contain a coherent strategy for policy reform and lacked an implementation plan. It seemed to have been merely a consolidated statement of various requirements of the IMF Standby and the World Bank's various policy initiatives. It lacked future policy intentions and commitments. The previous administration did not achieve substantial progress in policy reforms according to both what it had set out to do and what the donors had wanted it to do.

#### D. Present Administration

Under the new administration, indications are for a more promising implementation of policy reforms. The GOP has conducted a systematic assessment of present Philippine economic problems and has outlined a philosophy and framework for its economic program. The GOP is in the process of preparing detailed action plans to implement policy reforms. The new GOP administration is also characterized by candor and a willingness to discuss with the international community policy reforms.

The new GOP has already undertaken a number of measures to effect policy reform. For example, in the agriculture sector, it is dismantling the trading monopolies. It has opened the domestic market to all sugar traders; liberalized copra exportation and importation of meat, wheat and soybean; and reduced the roles of the Philippine Coconut Authority, the Fertilizer and Pesticides Authority and the National Food Authority. The Philippine Sugar Commission has been abolished. The monopoly position of the United Coconut Oil Mills has been eliminated and the decree giving monopoly control over coconut chemicals to a crony-owned company has been suspended. The GOP is attacking the sugar industry problems. It is developing programs to diversify sugarlands into other crops and to rationalize the capacity in the sugar industry through mothballing sugar mills. It is considering the utilization of 12,000 hectares of foreclosed sugarlands in Negros by sugar workers and rebel returnees.

In trade and industry, the GOP is continuing the trade liberalization program, although selectively. On March 24, 1986, the Central Bank lifted all import restrictions on 171 items including flour, wheat, soybean, feedgrains and alcoholic beverages. On April 30, import controls were removed for another 143 items, including hydrogen peroxide, waste paper, basic iron and steel products, cotton staple fiber and man-made fibers, synthetic resins and resin products, paper and paperboard, fish and fish preparations, and fabrics and textiles. On June 6, import controls were also lifted on 437 items in the unclassified and non-essential consumer goods category. All in all, the GOP has liberalized a total of about 751 items since March.

The GOP has initiated reform of the public corporate sector, rehabilitation of the Government Financial Institutions and privatization of acquired assets. The GOP has asserted audit jurisdiction over all government-owned and/or controlled corporations and their subsidiaries. The Government Corporate Monitoring Committee has power to closely monitor the financial operations of the 15 major non-financial corporations. The Presidential Commission on Reorganization will be submitting restructuring proposals for the entire public machinery within the next few months. With regard to the GFIs, the GOP has initiated the valuation and disposition of non-performing assets, especially those of the Philippine National Bank (PNB) and the Development of the Philippines (DBP). DBP, in particular, plans to immediately sell at least P1 billion of its non-performing assets, mostly hotels, textile mills, real properties, and shareholdings in banks.

These examples strongly confirm the new GOP's policy reform intentions. While consensus on some reforms is still lacking within the cabinet, the general shape of the GOP economic program and reform agenda is quite clear. Moreover, the GOP is currently negotiating a new Standby Arrangement with the IMF and projects with the World Bank designed to encourage rationalization of the public corporate sector and divestiture of public corporations. These negotiations, plus those with bilaterals including with USAID, should lead to further formal GOP policy commitments. USAID, as other donors are, is committed to and ready to work with the GOP in the formulation and implementation of these policy reforms.

## VII. SECTOR JUSTIFICATIONS

The new government is properly giving priority attention to increasing agricultural production, to encouraging new investment in rural-based small and medium industries, and to improving the delivery of basic education and health services. However, the need for drastic expenditure cuts may undermine the GOP's capacity to meet these objectives. Therefore, this program will provide budget support to the GOP so that it can continue financing basic services in these three priority sectors, as well as in other priority budget areas mutually agreed upon by A.I.D. and the GOP. This support will not be in addition to presently budgetted levels, but will ensure that a good proportion of those levels will be actually realized in the face of the grave fiscal crisis.

#### A. Agriculture and Rural Infrastructure

Agriculture currently provides direct employment to half of the country's labor force. It generates over 27 percent of GNP and accounts for one-third of the country's total export earnings. Underemployment among farm families is high. At least 1.6 million of 10 million people in the agricultural labor force are landless laborers. About three-fourths of the country's poorest families live in rural areas. During the past two years, annual growth in agricultural output was only 1 percent compared to 5 percent during the 1970's. This is mainly because farm production, particularly of key export crops, has been adversely affected by world market developments, inappropriate government pricing and marketing policies, shrinking government budget and investment allocations, and productivity problems. Extension services, marketing systems, financial services, and provision and maintenance of rural infrastructure have generally been inadequate.

The current economic crisis has stifled many rural development programs, including infrastructure investment. Declining financial support for new investment and maintenance has resulted in inadequate facilities to meet development needs and a marked deterioration in the physical condition of existing facilities. The previous regime's emphasis on large capital investments, such as power, industrial plants and government buildings, contributed to the smaller resource allocations for agriculture and local infrastructure.

The agriculture sector presently accounts for only about 7 percent of the total government budget. For 1986, the former administration's budget for agriculture was ₱3.8 billion which was lower than 1985's ₱4.6 billion. This was largely the result of a sharp reduction in new irrigation and rural development projects. Almost half of the sector's expenditures are for recurrent costs. It is essential that there be little, if any, further reduction in resource allocations for this critical sector.

#### B. Health

In the health sector, a significant drop in the crude death rate has occurred over the past three decades, owing to the decline in communicable and parasitic diseases. Respiratory and diarrheal diseases, however, are still the leading causes of death among children. Infants under one year of age account for about 25 percent of deaths in all age groups. Mortality is generally lower in urban than in rural areas. The difference in life expectancies among regions is of up to seven. Estimated infant mortality rates based on a 1985 survey range from 35 per 1000 live births in Central Luzon to 94 per 1000 in Mindanao. Widely prevalent are respiratory ailments (including tuberculosis), diarrheal diseases, measles and malaria. The tuberculosis problem in the country is of particular concern, because little progress has been made in reducing its prevalence. It is a disease which affects not only maternal and child health but also labor force productivity. In 1986 alone, the Ministry of Health requires \$10 million to purchase TB

drugs for identified cases, which, if untreated, will continue to spread the disease. Another area of immediate concern is the nutritional status of pre-school children which appears to have declined in recent years. While 17 percent of children below seven years of age were severely and moderately underweight for their age in 1982, estimates for 1984 place the figure at 22 percent, or back up to the 1978 level.

### C. Education

When juxtaposed against other countries, the Philippine education system looks deceptively successful with a literacy rate level above the average for the region. However, although the quantity of education in terms of number of students and schools has certainly increased in recent years, it is not at all certain that the quality of Philippine education has kept pace. Growth rates from 1960-1980 for literacy in the Philippines in comparison to other countries in the region indicate that educational quality in the Philippines has eroded. During this period, Philippine literacy rates improved from 72 percent to 75 percent. This is only a 4 percent improvement over 20 years while the rest of the region averaged nearly 30 percent (ranging from the Philippine low of 4.2 percent to the Chinese high of 60.5 percent).

Budgetary constraints on public expenditures for education, along with high population growth and the uneven income distribution, are the major factors believed contributing to the apparent erosion of educational quality. Other factors include unresolved regional disparities, a lack of internal efficiency, the effects of bilingual education, insufficient and inadequate classroom space, and uneven and inconsistent allocations of resources to the various types and levels of education.

More specifically, the GOP outlays for education in real terms has declined sharply during the past two decades. While the education sector accounted for over 30 percent of the total GOP budget expenditures in the 1960s, its share has since fallen to around 15-17 percent in recent years. The smaller allocations have led to low salary levels for teachers and non-academic personnel, poor maintenance of schools and state universities, and drastic shortages of classrooms, school instructional materials and supplies, particularly in the rural areas. These have adversely affected the quality of the country's education system and the morale of teaching personnel.

### D. Budget Requirements

Under the original 1986 budget, current year appropriations for the three priority sectors (i.e., agriculture, education and health) amounted to some ₱13.2 billion, or around 15 percent of the national budget. With the new GOPs thrusts and priorities for economic recovery, about ₱1.2 billion in reallocated funds has been added on to the original appropriations.

Agricultural services has a budget of ₱1.9 billion. With the exclusion of budgetary accounts for GOP counterpart for foreign-assisted projects, debt

service payments, scholarships and other similar expenditures, the adjusted agriculture budget would be about P1.1 billion. The adjusted agriculture budget covers major expenditure categories such as general administration and support services of the Ministry of Agriculture and Food, agricultural services administration for line agencies, support for food production programs including fisheries/aquatic resources development. The largest expenditure item falls under agricultural and fishery extension services.

The new programmed budget (with reallocation) for health services for 1986 is around P3.5 billion. With the corresponding adjustments, the sector budget would be around P2.2 billion. Expenditures for operation and maintenance for basic health services account for over half of the adjusted sector budget. Other major expenditure categories include purchase of drugs and medicines, support for primary health care services, treatment of tuberculosis and other communicable diseases, and research, training and control of tropical diseases.

For education, the reprogrammed budget for the sector is about P9.2 billion. After adjustments, the sector budget under this program amounts to P6.4 billion. The major budget categories are expenditures for general administration and support services of the Ministry of Education, Culture and Sports and for improvement and maintenance of services for basic education.

## VIII. THE PROGRAM

### A. Program Rationale and Objectives

The United States has important political, economic and strategic interests in the Philippines. In recognition of these interests, the U.S. Government (USG) has fostered one of its longest, uninterrupted development assistance programs anywhere in the world here in the Philippines. Additionally, in connection with the 1947 Military Bases Agreement (MBA) amendment in 1979 and review in 1983, the U.S. Government agreed to seek, on a best efforts basis, special economic and military assistance totaling \$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 was appropriated by Congress over the years in the form of Economic Support Funds (ESF). These funds were obligated by the U.S. Government to support various development activities in the Philippines. In connection with the 1983 review of the MBA, the Executive Branch of the U.S. Government agreed to make a best efforts undertaking to obtain appropriations of \$475 million of ESF for the 1985-89 period. \$140.0 million of this amount was appropriated by Congress in FY1985 and obligated to the GOP under various projects and programs and an additional \$119.625 million has been appropriated for FY1986.

On May 14, 1986, the Government of the Philippines through the Ministry of Finance formally requested A.I.D.'s concurrence in the use of ESF resources for budget support purposes (See Annex A). In light of important U.S.

strategic interests here and the U.S. government's desire to be responsive to a genuine and critical need of the new government as it faces severe tests in formulating and implementing its economic recovery program, USAID has agreed that the FY1986 ESF appropriation and prior year ESF deobligations of uncommitted ESF funds provided in prior years be used for program rather than project assistance. Congress has raised no objections to this decision (Please see Annex B).

As described in Section V and other documents, the new GOP administration is facing an immediate budget crisis which could undermine its policy reform objectives and ultimately its viability. Revenue shortfalls and excessive pre-and post-election spending by the previous administration have decimated the GOP's 1986 budget. The GOP's budget deficit for the entire 1986 CY was originally forecast to be P6.9 billion. However, the GOP's budget deficit for the first quarter of 1986 has already reached an estimated pesos 10.0 billion. It is now estimated that with unchanged policies the GOP budget deficit for CY 1986 will be approximately P39 billion or \$1.9 billion. Even with GOP planned revenue increasing and expenditure decreasing measures, it is estimated that the deficit will still be P26.2 billion. Budget support is needed urgently to ameliorate this crisis.

Given U.S. interests, as stated above, and the severe economic difficulties now being experienced by the new government, A.I.D. proposes to assist the GOP in a manner consistent with the objectives of the USAID/Philippines Country Development Strategy Statement and the Government's Program for Economic Recovery and Development. A.I.D. proposes an ESF program assistance grant of \$200.0 million for peso budget support to the GOP. This Budget Support Program (BSP) will contribute to GOP financial and, hence, political stability by providing resources which will help the GOP finance basic services in priority sectors such as education, health and agriculture. The Budget Support Program (BSP) will be executed in accordance with A.I.D. Handbook 4.

#### B. Program Funding

Funding for BSP will be sourced from current and prior year ESF resources. \$119.625 million of current FY resources are available for the program. \$12.5 million deobligated from the Rural Energy and Clark Access Road projects in September 1985 will be reobligated for this purpose. \$67.875 million will be deobligated from existing ESF project agreements for reobligation to this program. This action has significantly reduced the ESF project pipeline. However, sufficient funds have been left to cover cash needs to complete on-going subproject construction (including change orders, escalation, and construction management services costs), design and feasibility study services and to fund new subprojects and, thus, will serve as a bridge to FY1987 ESF appropriations. This assumes that the GOP will want to continue with a rural infrastructure development program. Listed below are the project agreements which have been amended and the amounts involved.

<u>PROJECT</u>	<u>OBLIGATION</u>	<u>DEOBLIGATION</u>
Municipal Development Fund	55.0	19.0
Regional Development (Inc. Schools and Roads)	121.5	34.575 <sup>1/</sup>
Markets	21.0	11.8
Rural Energy	6.0	2.5
Total	203.5	67.875

<sup>1/</sup> Following the deobligation of dols. 34.575 million from the Regional Development Fund, the USAID intends to make the remaining project funds available on a nationwide basis for eligible activities over the remaining life of the project.

### C. Program Description

BSP will assist the GOP finance peso expenditures in selected priority budget categories. Priority will be given to the education, agriculture and health sectors. However, other budget categories will be given consideration based upon mutually agreed to priorities. This approach will provide flexibility to allocate and/or reallocate scarce budget resources as budget priorities become clear.

BSP pesos will be included in the base level of expenditures in the identified priority budget categories. Additionality will not be a requirement of BSP. USAID and the GOP will agree on the minimum peso amount to be spent in total by the GOP for the budget categories eligible for assistance. This minimum amount will be large enough to cover the amount of disbursements reported against BSP pesos as well as budget items in those categories that may have dubious economic development impact. In the latter case, these doubtful budget items will be attributed to resources other than those made available under BSP for these budget categories.

Upon satisfaction of BSP conditions precedent to the disbursement of pesos to the GOP, USAID will provide to the GOP pesos equivalent to \$200.0 million for deposit in a GOP-owned special account. Accordingly, the pesos equivalent to \$200.0 million will be fully disbursed during

FY1986. Upon satisfaction of subsequent conditions precedent to the transfer of pesos from the Special Account, pesos held in the account will be transferred by the GOP to its General Fund. (Please see Section X for the CPs and covenants proposed for the BSP).

The GOP will provide quarterly reports which will indicate the financial progress of the program as a whole. Reporting will be required on GOP budget expenditures for the programs eligible to receive BSP resources and will indicate total disbursements for costs incurred in the GOP's 1986 budget year on or after March 1, 1986 for the agreed upon budget categories. The final report of disbursements audited by the Commission on Audit (COA) will be due by September 30, 1987, in accordance with established COA auditing procedures and reporting requirements (See Section IX for a discussion of reporting requirements).

#### D. Program Restrictions

BSP will not finance National Defense, equity to government corporations and consumer subsidy budget expenditures. In addition, BSP will not finance expenditures for the Foreign Assisted Projects including those participating in RPSP and DSP (Please see paragraph E below).

Section 531(c) of the Foreign Assistance Act of 1961, as amended, prohibits the use of ESF for military or paramilitary purposes. The exclusion of budget support to finance government corporation equity, including government owned financial institutions, is in keeping with the Mission's dialogue with the previous and present GOP Administrations on the need to reduce and eventually eliminate budget transfers to these entities. As highlighted in Section V.C.3 above, they are a major source of the current budget deficit. Consumer subsidies is an area that has caused major distortions in the economy and contributed significantly to the current economic crisis. The multilateral development banks and the U.S. government have conducted intense policy discussions with the previous regime on this subject and that dialogue continues with the new administration. Foreign-assisted projects will be excluded to avoid the possibility of double-counting.

#### E. Relationship to other Mission Programs

##### 1. RPSP and DSP

The BSP is the third Program Assistance effort utilizing bases related ESF. The U.S. government provided in December 1984 \$47.5 million in ESF under the Rural Productivity Support Program (RPSP) grant, and in December 1985, \$45 million in ESF under the Development Support Program (DSP) grant. Both programs were designed to provide balance of payment and budget support to the Philippines. The dollar transfers were free foreign exchange. The equivalent pesos generated by the RPSP and DSP grants were to provide additional GOP resources during the 1985 and 1986

calendar years, respectively, to selected A.I.D., World Bank and ADB projects whose implementation has been hampered by the critical lack of peso counterpart. However, due to severe budgetary problems in 1985, actual GOP disbursements for projects in the RPSP were below the expected levels, leaving an unexpended peso balance at the end of 1985. The pesos generated under DSP in December 1985 amounting to pesos 853.8 million are in a special account of the Philippine Bureau of the Treasury, awaiting satisfaction of conditions precedent governing their transfer to the GOP's General Fund. Recognizing the existing budgetary difficulties confronting the new government, the Mission advised AID/W of its intention to amend these programs to eliminate the additionality requirement and permit the remaining RPSP pesos and the DSP pesos to be utilized to supply the regular GOP counterpart resources for selected projects in CY1986 and, if necessary, in CY1987. AID/W has authorized the Mission to amend the RPSP Agreement to reflect these changes. Also, the Mission has the authority to amend the DSP Agreement to reflect these changes.

The GOP is committed to reporting GOP budget expenditures in FY 1986 for these projects against RPSP and DSP generated pesos. As discussed in Section VIII.C., the Mission will mutually agree with the GOP on the priority budget categories eligible for BSP assistance. To avoid the possibility of double-counting, the Mission will mutually agree with the GOP to eliminate these projects from BSP eligibility.

## 2. PL 480 Title I

The FY1985 PL480 Title I Program will generate pesos equivalent to approximately \$38 million. The FY1986 PL480 Title I Program is projected to generate pesos equivalent to approximately \$33.25 million. Consistent with the need of the GOP to secure funding for basic budget needs of agencies responsible for activities in the agriculture sector, the local currency generations will be used for selected budget support purposes. It has been mutually agreed to between A.I.D. and the GOP that the proceeds from the 1985 Agreement can be used for agricultural research and extension, rural infrastructure construction, rice buffer stock operations, and private grain trading. Priority for the 1986 Agreement will be given to budget support for the operating costs of the Ministry of Agriculture and Food, the Ministry of Natural Resources, the National Irrigation Administration and the National Food Authority (excluding rice and corn procurement and equity). The provision of budget support for these organizations will result in the continuation of services essential for the agriculture sector.

IX. IMPLEMENTATION PROCEDURES

A. Implementation Process

1. Peso Disbursement

Upon satisfaction of Conditions Precedent to Disbursement of pesos to the GOP, USAID will disburse to the GOP pesos equivalent to \$200 million. The amount of pesos to be disbursed will be determined on the basis of the rate or rates of exchange obtained by the U.S. Regional Administrative Management Center (RAMC), Bangkok, through its agents, from the Central Bank of the Philippines in acquiring the pesos to be disbursed.

2. Creation of the Special Account

The GOP will immediately deposit the peso disbursements equivalent to the \$200 million into a GOP owned non-interest bearing Special Account, to be labelled "BSP Fund Account."

3. Transfer of Pesos from the Special Account to the General Fund

a. Initial Transfer of Pesos from the Special Account

Prior to the initial transfer of Pesos from the BSP Fund Account to the GOP's General Fund Account, the GOP will, except as A.I.D. may otherwise agree in writing, furnish A.I.D., in form and substance satisfactory to A.I.D.: (1) A copy of an implementation plan specifying the responsibilities and interrelationships of the entities involved in the implementation of BSP; (2) A statement of the budget categories and eligible programs within those budget categories, based on the budget then in effect for the GOP's 1986 budget year, against which disbursements for costs incurred or to be incurred in the GOP's 1986 budget year on or after March 1, 1986 will be reported for purposes of BSP and a statement of the total amount of pesos agreed to be disbursed in that period in those budget categories for such costs; and (3) A statement of estimated disbursements through the end of the third quarter of the 1986 Budget Year for costs incurred and to be incurred that the GOP and A.I.D. agree is reasonable or reasonably anticipated for the budget categories specified in clause 3.a.(2) above for March 1986 (to the extent disbursements for such costs incurred can be estimated for such period) and for the second and third quarters.

Upon receipt by the GOP of notification from A.I.D. that the above conditions and any other agreed upon requirements have been satisfied, pesos in the GOP's BSP Fund Account will be transferred to the GOP's General Fund Account.

b. Subsequent Transfer of Pesos from the Special Account

The statement described in clause 3.a.(3) above can be amended by the GOP from time to time at any time before the first quarterly report is due (See Paragraph 4 below). Upon receipt by the GOP of notification from A.I.D. that such an amended statement is satisfactory, additional pesos will be transferred from the BSP Fund Account to the General Fund Account in the amount by which the amended statement of estimated disbursements for March, 1986 and for the second and third quarters of 1986 exceeds the amounts previously transferred from the BSP Fund Account to the General Fund Account.

The GOP is required to furnish A.I.D. unaudited quarterly reports of disbursements for costs incurred in the agreed upon budget categories. These reports are due by the end of the following quarter and may be amended from time to time at any time prior to the end of the quarter. Upon receipt by the GOP of notification from A.I.D. that the report is in form and substance satisfactory to A.I.D., the GOP will transfer pesos contained in the BSP Fund Account to its General Fund Account in an amount which when added to (1) the amount by which the cumulative amount of pesos previously transferred from the BSP Fund Account exceeds the amount that the report shows to have been disbursed as of the end of the reported on period for costs incurred on or after March 1, 1986 in the agreed-upon budget categories, equals (2) the amount of pesos that A.I.D. and the GOP mutually agree is reasonable or reasonably anticipated to be disbursed during the two fiscal quarters following the reported period.

The transfer of pesos from the BSP Fund Account to the General Fund Account will continue in the foregoing manner until all pesos in the BSP Fund Account have been transferred. The BSP Fund Account may then be closed.

4. Monitoring/Reporting

As stated above in Section IX.A.3.b., the implementation of BSP will be monitored through quarterly reports (which may be amended), which will be due by the end of the following quarter, and will contain at least the following information:

- Cumulative disbursements through the end of the period reported upon for costs incurred for March, 1986 (to the extent this information is reasonably available) and for the period on or after April 1, 1986, in the agreed upon budget categories.

A final Commission on Audit (COA) audited report will be provided by September 30, 1987 in the same format as discussed above. The GOP will also furnish with this final report a certification, in form and substance satisfactory to A.I.D., that an amount at least equal to the amount of pesos released from the BSP Fund Account has not been reported against other resources available to the GOP for disbursements for such costs.

B. Implementing Entities

1. The Office of Budget and Management (OBM) through its Fiscal Planning Services and National Accounting Offices will:

- a. With the agreement of A.I.D., determine the budget categories eligible for BSP and the total amount to be disbursed.
- b. Together with the National Economic and Development Authority (NEDA), represent the GOP in dealing with A.I.D. regarding BSP.
- c. Prepare and submit to A.I.D. statements of estimated costs incurred and estimated costs to be incurred for the GOP's 1986 Budget Year for the priority budget categories for which disbursements will be reported against.
- d. Submit unaudited quarterly reports and a final audited report to A.I.D.
- e. Coordinate with other concerned/involved GOP instrumentalities in effectively implementing BSP.

2. The Bureau of Treasury will:

- a. Deposit the peso disbursement equivalent to the grant in a non-interest-bearing Special Account.
- b. Transfer BSP pesos from the Special Account to the General Fund in accordance with the BSP Agreement CPs.

3. The National Economic and Development Authority (NEDA), together with OBM, will represent the GOP in dealing with A.I.D. with regard to BSP.

X. CONDITIONS AND COVENANTS

The following are the conditions and covenants proposed for BSP:

A. Conditions Precedent to Disbursement

Prior to the disbursement of pesos by A.I.D. under the Grant Agreement, or to the issuance of documentation pursuant to which disbursement will be made, the GOP shall, except as A.I.D. and the GOP may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

a. An opinion of counsel acceptable to A.I.D. that the BSP Grant Agreement has been duly authorized and/or ratified by, and executed on behalf of, the GOP and that it constitutes a valid and legally binding obligation of the GOP in accordance with all of its terms; and

b. A statement of the name of the person holding or acting in the office of the GOP specified in the relevant Section of the Grant Agreement, and of any additional representatives, together with a specimen signature of each person specified in such statement.

B. Transfer of Pesos from the BSP Fund Account to the General Fund Account

1. Restriction on Transfer of Pesos from the BSP Fund Account to the General Fund Account. Except as A.I.D. may otherwise agree in writing, pesos held in the BSP Fund Account may not be transferred except as provided in this paragraph B.

2. Condition Precedent to Initial Transfer of Pesos from the BSP Fund Account. Prior to the initial transfer of pesos from the BSP Fund Account to the GOP's General Fund Account, the GOP shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

a. A copy of an implementation plan specifying the responsibilities and interrelationships of the entities involved in the implementation of BSP;

b. A statement of the budget categories and eligible programs within those budget categories based on the budget then in effect for the GOP's 1986 Budget Year, against which disbursements in the GOP's 1986 Budget Year for costs incurred or to be incurred in the GOP's 1986 Budget Year on or after March 1, 1986 will be reported for purposes of BSP and a statement of the total amount of pesos agreed to be disbursed in that period in those budget categories for such costs; and

c. A statement of estimated disbursements through the end of the third quarter of the GOP's 1986 Budget Year for costs incurred and to be incurred that the GOP and A.I.D. agree is reasonable or reasonably anticipated for the budget categories specified in Paragraph B.2.b. above for March, 1986 (to the extent disbursements for such costs incurred can be estimated for such period) and for the second and third quarters of the 1986 Budget Year of the GOP.

3. Initial Transfer of Pesos. Upon receipt by the Grantee of notification from A.I.D. that the conditions precedent to initial transfer of pesos from the BSP Fund Account specified in Paragraph B.2 above have been satisfied, pesos in the BSP Fund Account shall be transferred by the GOP to the GOP's General Fund Account in the amount specified in the statement provided under Paragraph B.2.c. above.

4. Subsequent Transfer of Pesos from the BSP Fund Account.

a. The statement furnished to A.I.D. by the GOP pursuant to Paragraph B.2.b. may be amended by the GOP from time to time at any time prior to the date by which the first report under Paragraph C.2.a. is required to be delivered to A.I.D. Upon receipt by the GOP of notification from A.I.D. that any such amended statement provided to A.I.D. by the GOP is in form and substance satisfactory to A.I.D., the amount of pesos by which (i) the amount shown in such amended statement of estimated disbursements through the end of the third quarter of the GOP's 1986 Budget Year for costs incurred and to be incurred that the GOP and A.I.D. agree is reasonable or reasonably anticipated for the budget categories specified in Paragraph B.2.b. for March, 1986 (to the extent disbursements for such costs incurred can be estimated for such period) and for the second and third quarters of the 1986 Budget Year of the GOP exceeds (ii) the aggregate amount of pesos previously transferred from the BSP Fund Account to the GOP's General Fund Account, shall be transferred by the GOP to the GOP's General Fund Account.

b. Upon receipt by the GOP of notification from A.I.D. that a report or amended report provided in accordance with Paragraph C.2.a. below for any quarter is in form and substance satisfactory to A.I.D., an amount of pesos shall be transferred by the GOP from the BSP Fund Account to the GOP's General Fund Account, which when added to (i) the amount by which the cumulative amount of pesos previously transferred from the BSP Fund Account to the GOP's General Fund Account under this Agreement exceeds the amount that said report shows to have been disbursed as of the end of such quarter for costs incurred in the GOP's 1986 Budget Year on or after March 1, 1986 in the budget categories agreed upon in accordance with Paragraph B.2.b. above, equals (ii) the amount of pesos that the GOP and A.I.D. agree is reasonably anticipated to be disbursed through the end of the second fiscal quarter following the fiscal quarter through the end of which the report covered for costs incurred and to be

incurred for the budget categories specified in Paragraph B.2.b. during the two fiscal quarters following the fiscal quarter through the end of which the report covered. Transfer of pesos from the BSP Fund Account to the GOP's General Fund Account shall continue in the foregoing manner until all pesos in the BSP Fund Account have been transferred.

C. Special Covenants of the GOP

1. Disbursements in Selected Budget Categories. Except as A.I.D. may otherwise agree in writing, the GOP agrees to disburse in the GOP's 1986 Budget Year at least the amount of pesos to be agreed upon in accordance with Paragraph B.2.b. in the agreed upon budget categories for costs incurred in the GOP's 1986 Budget Year on or after March 1, 1986.

2. Reports

a. Unaudited Quarterly Reports. The GOP agrees to furnish A.I.D. unaudited quarterly reports, which may be amended, by the end of the following quarter, of cumulative disbursements through the end of the period reported upon for costs incurred in the GOP's 1986 Budget Year for March, 1986 (to the extent information for such period is reasonably available) and for the period on or after March 1, 1986, in the budget categories agreed upon in accordance with Paragraph B.2.b.

b. Audited Final Report. The GOP agrees to furnish A.I.D. a final report by September 30, 1987 audited by the Commission on Audit on disbursements through the end of the GOP's 1986 Budget Year for costs incurred in the GOP's 1986 Budget Year for March, 1986 (to the extent information for such period is reasonably available) and for the period on or after March 1, 1986, in the budget categories agreed upon in accordance with Paragraph B.2.b. The GOP shall also furnish with this final report a certification, in form and substance satisfactory to A.I.D., that an amount at least equal to the amount of pesos released from the BSP Fund Account to the GOP's General Fund Account has not been reported against other resources available to the GOP for disbursements for such costs.

5-170



REPUBLIKA NG PILIPINAS  
MINISTRI NG PANANALAPI  
MAYNILA

Annex A

May 14, 1986

Mr. Frederick W. Schieck  
Director, U.S. Agency for International Development  
Ramon Magsaysay Center  
1680 Roxas Boulevard, Manila

Dear Director Schieck:

As you are well aware, the Government of the Philippines (GOP) is in the throes of a major budget crisis. Our latest budget review with the IMF in late April indicated that the budget deficit for the current fiscal year could reach a level as high as P35 billion. We hope to reduce this deficit by increasing revenues and reducing expenditures, where possible. However, we will need to finance the remaining deficit and we hope to do so primarily through donor resource transfers to keep inflation and interest rates at levels which will be conducive for economic recovery. Accordingly, during my discussions with the AID Administrator Peter McPherson in early March 1986, I expressed interest, on behalf of the GOP, in seeking U.S. government permission to utilize ESF for budgetary support in fiscal year 1986.

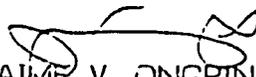
I would now like to formally request AID concurrence to the use of \$200 million in Economic Support Fund (ESF) resources for budget support purposes. This amount would be made available from prior and current year resources. Prior year ESF resources include the following: (a) reobligation of the \$12.5 million deobligated from the Rural Energy and Clark Access Road Projects in 1985; and (b) deobligation and reobligation of \$67.875 million from the U.S. dollar pipeline for existing ESF projects (please see attached table). Current year ESF resources available for obligation totals \$119.625 million. All together, available prior and current year ESF resources total \$200 million.

The deobligation and reobligation of the \$67.875 million from ESF projects is based on a careful analysis of all ongoing ESF projects and takes into full consideration project cash needs to complete ongoing subproject construction (including change orders, escalation and construction management services costs), design and feasibility study services.

I understand that the reprogramming of the ESF resources is subject to approval of the U.S. Congress and therefore would appreciate your consideration of this request at the earliest opportunity.

I look forward to your reply.

Sincerely yours,

  
JAIIME V. ONGPIN  
Minister of Finance

**ACTION TAKEN**  
Name \_\_\_\_\_  
Type \_\_\_\_\_  
Date \_\_\_\_\_  
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JVC:edr

Economic Support Fund  
 \$200.0 M Budget Support Program  
Financing Source

Deobligated Amounts From Prior Year Resources

<u>Project</u>	<u>Amount</u>
Clark Access Highway Project	\$ 0.5M
Rural Energy Project	<u>12.0M</u>
	\$ 12.5M

Additional Deobligation From Prior Year Resources

<u>Project</u>	<u>Amount</u>
Municipal Development Program	\$ 19.0M
Regional Development Program (including Elementary Schools and Local Roads Project)	\$ 34.575M
Public Markets Project	\$ 11.8M
Rural Energy Project	<u>\$ 2.5M</u>
	\$ 67.875M

Current Year Resources

ESF allocation for Fiscal Year 1986 appropriated by U. S. Congress to the Philippines	\$119.625M
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Total:	<u>\$200.000M</u> =====
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CN: 03980  
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**ACTION COPY**

Action Taken: \_\_\_\_\_  
No action necessary: \_\_\_\_\_  
Date: \_\_\_\_\_ Units: \_\_\_\_\_

AIDAC

E.O. 12356: N/A

TAGS:

SUBJECT: FY 1986 BUDGET ALLOWANCE - PHILIPPINES

REF: MANILA 18143

1. BA FOR BPC QESA-86-27492-KG-13 (637-50-492-00-69-61) HAS BEEN DECREASED BY DOLS. 3,300,000 FROM PROJECT 492-0343, PROJECT DESIGN. FUNDS REALLOCATED TO BUDGET SUPPORT PROGRAM NEW BUDGET ALLOWANCE TOTAL 0 - ADVICE OF BUDGET ALLOWANCE AMENDMENT NO. 1 FOLLOWS.

2. BA FOR EPC QESA-86-37492-KG-31 (637-63-492-00-50-61) HAS BEEN ESTABLISHED AT DOLS -119,625,000 FOR CASH GRANT 492-0404, BUDGET SUPPORT PROGRAM. CN EXPIRED 5/31/86. FUNDS NOT AUTHORIZED FOR OBLIGATION UNTIL PAAD HAS BEEN AUTHORIZED. APPROPRIATION SYMBOL 72-1161037. FUNDS ALLOWANCED TO AA/ANE NON PROJ GRANT AGREEMENT 492-K-603

3 - THE BUDGET ALLOWANCES FOR THE FY85 DEOBS OF DOLS 12,500,000 AND FY86 DEOBS OF DOLS. 67,875,000 WILL FOLLOW SEPTEL UPON RECEIPT OF THE ESF REAPPORTIONMENT -

4 - MISSION AUTHORIZED TO DEOBLIGATE DOLS. 67,875,000 FROM PRJ. 0374, REGIONAL DEVELOPMENT FUND AS DEOBLIGATION CN EXPIRED 5/31/86. SHULTZ

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UNCLASSIFIED

STATE 188503

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UNCLASSIFIED

STATE 137230

ACT: AID-6 INFO: AMB DCM AA ECON ADE CHRON/11

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LOC: 61-62 313  
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CHRG: AID  
DIST: AID

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Action Taken \_\_\_\_\_  
No action necessary \_\_\_\_\_  
Date \_\_\_\_\_ Inits \_\_\_\_\_

AIDAC

F.O. 12356: NA/  
TAGS:

SUBJECT: 492-0404, BUDGET SUPPORT PROGRA - PHILIPPINES

REF: MNILA 18143

1. MISSION IS AUTHORIZED TO DEOBLIGATE DOLS. 67,875,000 FROM PROJECT 0374, REGIONAL DEVELOPMENT FUND, AS DEORLIGATION CONGRESSIONAL NOTIFICATION EXPIRED WITHOUT OBJECTION 5/31/86

2 - PLEASE PROVIDE IMMEDIATE CABLE STATI THAT THE CONTROLLER CERTIFIS THAT THE DEOBLIGATIC ILL BE REFLECTEE ON THE JUNE 30 U-101 REPORT. CABLE SHOUG RE SLUGGED FOR FM/CAD AND INFO TO ANE/DP/F.

3 - FOLLOWING IS STATUS OF DOLS 200,000,000 ESF GRANT FUND FOR SUBJECT PROJECT: (\$000)

116,325 APPORTIONED AND AVAILABLE FOR OBLIGATION  
3.300 APPORTIONED FOR PROJECT DESIGN - TRANSFER OF FUNDS TO PROJECT 0404 BEING CLEARED BY OMB  
12,500 FY85 DEOBS AWAITING REAPORTIONMENT IN OMB  
67,875 AWAITING NOTIFICATION FROM MISSION THAT FUNDS HAVE BEEN DEOBLIGATED - APPORTIONMENT REQUEST IN OMB - URGENT THAT FUNDS BE DEORLIGATED ASAP FOR REAPORTIONMNT - SHULTZ

PT  
#7280

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UNCLASSIFIED

STATE 137230

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JUN 16 8 30 AM '86  
STATE DEPT

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ACT: AID-6 INFO: AMR DCM AA ECON ADR CHRON/11/86

Annex C

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RR RUEHML  
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TO AMEMBASSY MANILA 5714  
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CN: 01922  
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DIST: AID

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AIDAC

Action Taken: \_\_\_\_\_

No action necessary: \_\_\_\_\_

Date: \_\_\_\_\_ Init: \_\_\_\_\_

E.O. 12356: N/A  
TAGS: N/A

SUBJECT: BUDGET SUPPORT PROGRAM (492-0404) - PAIP  
APPROVAL

RECEIVED  
JUN 2 11 02 AM '86  
USAD, MANILA

1. AA/ANE APPROVES THE PROGRAM ASSISTANCE INITIAL PROPOSAL (PAIP) FOR THE BUDET SUPPORT PROGRAM AND HERERY REDELEGATES AD HOC AUTHORITY TO THE MISSION DIRECTOR, USAID/PHILIPPINES TO APPROVE THE PAAD AND TO AUTHORIZE THIS PROGRAM ASSISTANCE. IN PREPARING THE PAAD AND NEGOTIATING THE PROGRAM ASSISTANCE AGREEMENT YOU SHOULD TAKE INTO ACCOUNT THE CONCERNS IDENTIFIED DURING THE BUREA REVIEW (ANPAC) OF THE PAIP.

2. ANPAC REVIEW MAY 8 ACCEPTED THE PAIP ANALYSIS OF THE PROPOSED ASSISTANCE REQUIREMENT. WE AGREE THAT THERE IS ANURGENT NEED FOR DOLLAR AND LOCAL CURRENCY RESOURCES TO ENABLE THE NEW GOVERNMENT TO DEAL WITH ECONOMIC CRISIS CONDITIONS AND TO MAINTAIN BASIC SERVICES WHILE ADDRESSING FUNDAMENTAL PROREMS IT INHERITED. WE ALSO ACCEPT THAT THIS IS BASES-RELATED ASSISTANCE FOR WHICH POLICY CONDITIONALITY IS NOT APPROPRIATE. EVEN IF THERE WERE TIME TO NEGOTIATE A POLICY AGENDA. IN SUM, WE FOLLOW YOUR GENERAL APPROACH TO THE ASSISTANCE AS ENABLING THE NEW GOVERNMENT TO GET THROUGH A DIFFICULT

TIME AND GIVING IT TIME TO MAKE REFORMS NOW IN PRELIMINARY DESIGN STAGES.

3. HAVING ACCEPTED THAT THERE CANNOT BE SPECIFIC CONDITIONALITY ON THIS PROGRAM, WE DO NOT LOSE SIGHT OF THE NEED FOR MOVING AHEAD TO REFORMS AS SOON AS CONDITIONS PERMIT. WE ALSO SEE THE NEED FOR THE PHILIPPINES TO MAKE SOUND USE OF THE RESOURCES THE DONOR COMMUNITY IS MAKING AVAILABLE TO GET THROUGH THE ECONOMIC CRISIS. OUR FUTURE ASSISTANCE RELATIONSHIP WITH THE PHILIPPINES WILL BE AFFECTED BY THE ABILITY OF THE NEW GOVERNMENT TO MAKE PROGRESS IN THESE DIRECTIONS. THE PAAD SHOULD ANALYZE LIKELY USES OF THESE RESOURCES, AND WE ASK THAT YOU CONTINUE TO KEE US INFORMED OF THE POLICY REFORM AENDA AND PROGRESS OF THE NEW GOVERNMENT. SHULTZ

BT  
#1973

DIV	ACTIVITY
OD	✓
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RIA	✓
PO	✓
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6-9-86	

## 5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable generally to FAA funds, and criteria applicable to individual fund sources: Development Assistance and Economic Support Fund.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481(h)(1); FY 1986 Continuing Resolution Sec. 527. Has it been determined or certified to the Congress by the President that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971) which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? NO
  
2. FAA Sec. 481(h)(4). Has the President determined that the recipient country has not taken adequate steps to prevent (a) the processing, in whole or in part, in such country of narcotic and psychotropic drugs or other controlled substances, (b) the transportation through such country of narcotic and psychotropic drugs or other controlled substances, and (c) the use of such country as a refuge for illegal drug traffickers? NO

3. 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) the debt is not denied or contested by such government? NO
4. 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
5. FAA Sec. 620(a), 620(f), 620D; FY 1986 Continuing Resolution Sec. 512. Is recipient country a Communist country? If so, has the President determined that assistance to the country is important to the national interests of the United States? Will assistance be provided to Angola, Cambodia, Cuba, Iraq, Syria, Vietnam, Libya, or South Yemen? Will assistance be provided to Afghanistan without a certification? The Philippines is not a communist country.
6. 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

7. FAA Sec. 620(1). Has the country failed to enter into an agreement with OPIC?
8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?
- (b) If so, has any deduction required by the Fishermen's Protective Act been made?
9. FAA Sec. 620(q); FY 1986 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill (or continuing resolution) appropriates funds?
- 9A In July, 1985, the Philippines became technically in default because of a brief delay in signing a bilateral loan re-scheduling agreement. At that time, the Secretary of State determined that it was in the U.S. national interest to continue assistance to the Philippines. Subsequently, the bilateral rescheduling agreement was signed ending the default. The Philippines is current in its debt repayment under that agreement.
10. FAA SEC. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)
- 9B NO
- Yes, taken into account by the Administrator at the time of approval of agency OYB.

11. 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
12. 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? (Reference may be made to the Taking into Consideration memo.) The Philippines is in arrears to the United Nations. The cause has been due to the severe economic crisis of the Philippines, and more recently, the current 1986 deficit projected at \$1.1 billion. This has been taken into account by the Administrator at the time of approval of agency OYB.
13. FAA Sec. 620A. Has the government of the recipient country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? NO
14. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? NO

15. 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
16. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) NO to both questions.
17. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported illegally (or attempted to export illegally) from the United States any material, equipment, or technology which would contribute significantly to the ability of such country to manufacture a nuclear explosive device? NO

18. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)

The Philippines is not a member of the non-aligned movement (NAM).

19. FY 1986 Continuing Resolution Sec. 541.

Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

NO to all three questions.

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

20. FY 1986 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined as supporting or participating in the management of a program of coercive abortion or involuntary sterilization?

NO to both questions.

If assistance is from the population functional account, are any of the funds to be made available to family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services?

21. FY 1986 Continuing Resolution Sec. 529. 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?

NO

22. FY 1986 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree?

NO

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

NO such determination has been made by the Department of State.

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2. Economic Support Fund  
Country Criteria

FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

NO such determination has been made.

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the 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 imposing limits on certain uses of funds.

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

A. Procurement

- 1: FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? N/A..
  
- FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?? N/A
  
- 3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? N/A
  
- 4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). 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? (Exception where commodity financed could not reasonably be procured in U.S.) N/A

5. FAA Sec. 604(q). Will construction or engineering services be procured from firms of countries which receive direct economic assistance under the FAA and which are otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? Do these countries permit United States firms to compete for construction or engineering services financed from assistance programs of these countries? N/A
6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, 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 such vessels are available at fair and reasonable rates? N/A
7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? N/A

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8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? N/A
9. FY 1986 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? N/A

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? N/A
2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? N/A
3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP)? N/A

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? N/A
  
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? N/A
  
- 3: FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? Yes
  
4. Will arrangements preclude use of financing:
  - a. FAA Sec. 104(f); FY 1986 Continuing Resolution Sec. 526. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo Yes

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sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

- b. FAA Sec. 488. To reimburse persons, in the form of cash payments, whose illicit drug crops are eradicated? Yes
- c. FAA Sec. 620(q). To compensate owners for expropriated nationalized property? Yes
- d. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? Yes
- e. FAA Sec. 662. For CIA activities? Yes
- f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? N/A

- g. FY 1986 Continuing Resolution, Sec. 503.  
To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel? Yes
- h. FY 1986 Continuing Resolution, Sec. 505.  
To pay U.N. assessments, arrearages or dues? Yes
- i. FY 1986 Continuing Resolution, Sec. 506.  
To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? Yes
- j. FY 1986 Continuing Resolution, Sec. 510.  
To finance the export of nuclear equipment, fuel, or technology? Yes
- k. FY 1986 Continuing Resolution, Sec. 511.  
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? Yes
- l. FY 1986 Continuing Resolution, Sec. 516.  
To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes

3(A)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 Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

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

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1986 Continuing Resolution Sec. 524; FAA Sec. 634A.

Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

A Congressional Notification was submitted to Congress on 5/16/86 which fully described the nature and scope of BSP. Neither has changed since that time.

2. 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?

Further legislative action is not required.

3. FAA Sec. 209 Is assistance more efficiently and effectively given through regional or multilateral organizations? If

No. The primary purpose of BSP is to provide direct bilateral general budget support to priority budget categories.

The Philippines is not a "newly Independent country".

so, why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs.

FAA Sec. 601(a) 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.

The priorities of the new GOP Administration include a return to positive economic growth, particularly in agriculture and labor intensive industries, by increasing private sector investment and production through substantial deregulation, liberalization and structural economic reforms. However, the essential first step in achieving these objectives is the reduction of the GOP Budget deficit to manageable proportions.

5. FAA Sec. 601(b) Information and conclusions 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).

BSP is a peso budget support program that will safeguard financial and economic stability in the Philippines and support the GOP's ability to make substantive economic policy reforms. The resulting improved business environment will encourage U.S. trade, including services, and U.S. investment in the Philippines.

6. FAA Sec. 612(b), 636(h); FY 1986 Continuing Resolution Sec. 507. 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 U.S. are utilized in lieu of dollars.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? N/A
8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? N/A
9. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds? Assistance is not being furnished under the Sahel Development Program.
10. FY 1986 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? No

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of part I of the FAA?

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

Yes. The GOP's budget crisis could undermine policy reform objectives and ultimately the viability of the government itself. Economic and political stability will be assisted by providing resources which will allow the GOP to continue financing basic services. This assistance will be provided in sectors considered priority by both the U.S. and Philippine governments to economic reform and recovery efforts.

No

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

No

d. ISDCA of 1985 Sec. 205. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used?

No

e. ISDCA of 1985 Sec. 801. If ESF funds will be used to finance imports by an African country (under a commodity import program or sector program), will the agreement require that those imports be used to meet long-term development needs in those countries in accordance with the following criteria?

N/A

(i) spare parts and other imports shall be allocated on the basis of evaluations, by A.I.D., of the ability of likely recipients to use such spare parts and imports in a maximally productive, employment generating, and cost effective way;

(ii) imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. A.I.D. shall

assess such plans to determine whether they will effectively promote economic development;

(iii) emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products;

(iv) emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions;

(v) in order to maximize the likelihood that the imports financed by the United States under the ESF chapter are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses;

(vi)(A) seventy-five percent of the foreign currencies generated by the sale of such imports by the government of the country shall be deposited in a special account established by that government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities

which are consistent with the policy directions of section 102 of the FAA and which are the types of activities for which assistance may be provided under sections 103 through 106 of the FAA;

(B) the agreement shall require that the government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government.

f. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

No

g. 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

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