PD-ABD-635

U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D.C. 20523

PROGRAM ASSISTANCE APPROVAL DOCUMENT

PHILIPPINES
Private Enterprise Policy
Support Program
492-0457

Dated: August 30, 1991

U N C L A S S I F I E D

PD-ABD-635

PRIVATE ENTERPRISE POLICY SUPPORT PROGRAM

TABLE OF CONTENTS

ABBREVIATIONS/ACRONYMS

A.I.D.	Agency for International Development
APT	Asset Privatization Trust
ASEAN	Association of Southeast Asian Nations
BAP	Bankers' Association of the Philippines
BIR	Bureau of Internal Revenue
BOI	Board of Investments
BOP	Balance of Payments
BOT	Build, Operate, and Transfer
BSP	Budget Support Program
BSP II	Budget Support Program II
BTr	Bureau of Treasury
CAG	Corporate Affairs Group
CARP	Comprehensive Agrarian Reform Program
CB	Central Bank of the Philippines
CCFF	Compensatory and Contingency Financing Facility
CFBP	Comprehensive Foreign Borrowing Program
COA	Commission on Audit
COP	Committee on Privatization
CPSD	Consolidated Public Sector Deficit
CY	Calendar Year
DBM	Department of Budget and Management
DBP	Development Bank of the Philippines
DOF	Department of Finance
DOTC	Department of Transportation and Communications
DPWH	Department of Public Works and Highways
EFF	Extended Fund Facility
EPR	Effective Protection Rate
ERP	Economic Recovery Program
ERTAP	Economic Recovery Technical Assistance Project
ESF	Economic Support Fund
FIA	Foreign Investments Act of 1991
GATT	General Agreement on Trade and Tariffs
GNP	Gross National Product
GOCC	Government Owned and Controlled Corporation
GOP	Government of the Philippines
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund

LIBOR	London Interbank Offered Rate
MAI	Multilateral Assistance Initiative
MTPDP	Medium Term Philippine Development Plan
NEDA	National Economic and Development Authority
NFA	National Food Authority
NGO	Non Governmental Organization
NPC	National Power Corporation
ODA	Official Development Assistance
OPSF	Oil Price Stabilization Fund
OEA	Office of Energy Affairs
OECF	Overseas Economic Cooperation Fund
PAP	Philippine Assistance Program
PASS	Philippine Assistance Strategy Statement
PEPS	Private Enterprise Policy Support
PES	Performance Evaluation System
PITO	Private Investment and Trade Opportunities Project
PNB	Philippine National Bank
PNOC	Philippine National Oil Company
PVO	Private Voluntary Organization
RIG/A	Regional Inspector General for Audit
RORO	Roll On/Roll Off
SAI	Special Assistance Initiative
SDP	Support for Development Program
SDR	Special Drawing Rights
UNDP	United Nations Development Program
USAID	United States Agency for International Development

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 492-0457	2. Country: Philippines
3. Category: Cash Transfer	4. Date:
5. To: Malcolm Butler, Director	6. OYB Change Number:
7. From: Richard A. Johnson, Deputy Director	8. OYB Increase: To be taken from:
9. Approval Requested for Commitment of: $ 79,828,000	10. Appropriation Budget Plan Code: SA-MAI FY 90-91
11. Type Funding: ☐ Loan ☒ Grant	12. Local Currency Arrangement: ☐ Informal ☐ Formal ☒ None
13. Estimated Delivery Period: Sept. 1991 Sept. 1993	14. Transaction Eligibility Date:

15. Commodities Financed

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	$575,000
Limited F.W.	Code 941 and Philippines $828,000	Industrialized Countries	
Free World		Local	$253,000
Cash	$79,000,000	Other	

18. Summary Description

The objective of PEPS is to support the Government of the Philippines (GOP) in implementing significant policy reform actions that will assist in creating a business environment conducive to sustainable economic growth, led by the private sector. PEPS will help the GOP meet its external financing requirements by providing balance of payments (BOP) support on a grant basis. The GOP will use the dollars to service official non-military debt owed to the United States Government, the multilateral development institutions or such other uses as may be agreed to. A small portion of the grant will be set aside to cover monitoring and evaluation, technical asssistance and policy study services.

The provisions of the payment verification policy regarding methods of implementation and financing, financing capability of recipients, and adequacy of audit coverage have been adequately addressed in this document.

J. C. Stanford, Controller

19. Clearances	Date
OPE:PRDeuster	8/27/91
ODRM:JAPatterson	27 Aug 91
OLA:LChiles	8/24
ONRAD:KAPrussner	8/23
OPHN:EVoulgaropoulos	8/22
PESO:BCornelio	8/23

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Malcolm Butler

Date: AUG 30 1991

Title: Director

AID 1120-1 (5-82)

CLASSIFICATION:

1

I. SUMMARY AND RECOMMENDATION

A. Program Title	:	Private Enterprise Policy Support (PEPS) Program
B. Grantee	:	The Republic of the Philippines
C. Grant Amount	:	Life of Program: $79.828 million
D. Funding Source	:	Special Assistance Initiative (SAI)/ FY 1990 and FY 1991 appropriations for the Multilateral Assistance Initiative (MAI) for the Philippines
E. Initial Obligation	:	FY 1991
F. Program Objective	:	The objective of PEPS is to support the Government of the Philippines (GOP) in implementing significant policy reform actions for private sector led, sustainable economic growth, through the provision of balance of payments (BOP) support.
G. Program Description	:	PEPS will provide $79 million for BOP support in two tranches upon GOP attainment of specific policy implementation actions and/or expected results. PEPS BOP support dollars will be used for official non-military debt service payments to the United States Government and multilateral development institutions or such other uses as may be agreed to. An additional amount of $828,000 will be made available to finance monitoring, evaluation, policy research, and technical assistance.

H. Estimated Completion Date : FY 1993

I. Statutory Requirements : All statutory requirements have been met (See Annex C).

J. Recommendation : That a $79.828 million SAI grant to the GOP be authorized, with life of program obligation in FY 1991, based on the terms and conditions described in the attached Program Assistance Approval Document (PAAD).

II.. OVERVIEW

The Philippine economic performance during the first half of the 1980s was dismal. Average yearly real GNP growth registered a negative 1.3 percent during 1981-85 while population continued to grow at 2.4 percent a year. While this was a period of worldwide recession, many developed countries, newly industrializing countries, and some developing economies began to show signs of recovery by 1983. The Philippine economy, on the other hand, not only failed to recover from the impact of external recession, but further plunged into a deeper recession during 1983-85. Real GNP declined by 7.1 percent and 4.1 percent respectively in 1984 and 1985. The deep recession helped bring about the people's revolution and the new government of Corazon Aquino in 1986.

Substantial reforms have occurred since 1986. These changes have altered both the political and economic environments. Average real GNP growth from 1986 to 1989 was 6.1 percent. Most of the reforms, however, occurred in the beginning of the new administration's term of office. In addition ~~to~~ drafting a new Constitution and holding elections, the government instituted various economic reforms, including dismantling of monopolies, privatization and trade liberalization. Nevertheless, major obstacles to building a more efficient and competitive economy that would catapult the Philippine economy onto a sustainable higher growth path remained after the initial period of reform.

While reforms continued to be implemented, the pace of economic reform had slowed in 1988 and 1989. The deteriorating economic situation, including the effects of the attempted coup of December 1989, July 1990 earthquake and Middle East crisis, made the need for economic reforms more urgent. Faced with mounting current account and budget deficits and unwieldy inflation, the GOP responded, in the second half of 1990, with depreciations of the peso and upward adjustments of petroleum product prices. In addition, the GOP worked out a new 18-month IMF Standby Arrangement in February 1991 to stabilize the economy and to set the stage for sustainable growth for the 1990s. As a result of these policy measures, the Philippine economy during the first 5 months of 1991 shows signs of stability and recovery. The government budget is under control, inflationary pressures have receded, interest rates are lower, and the exchange rate has stabilized. In June of 1991, there were signs of renewed investment and growth. To strengthen the growth process, the GOP has successfully negotiated a Paris Club debt rescheduling.

PEPS supports the GOP efforts to implement significant policy reforms -- the Foreign Investments Act (FIA) of 1991 and Executive Order 413 (E.O. 413) -- that are considered essential to make the private sector to become more efficient and competitive. In June 1991, the Philippine Congress passed the Foreign Investments Act of 1991 which will make the Philippines more comparable with other ASEAN countries in terms of encouraging foreign private investments. The implementing rules and regulations for this Act still need to be issued. Furthermore, the Aquino administration plans to issue a modified version of E.O. 413 to reduce and simplify the tariff structure for the purpose of making Philippine industries more open, efficient and competitive. PEPS funding for $79.828 million consists of FY 1990 grant funding of $39.828 million and FY 1991 grant funding of $40 million. The source of the grant funds is SAI appropriations. The Mission anticipates that PEPS will be the framework for providing more assistance for further private sector supportive policy reforms in future years.

PEPS will assist in meeting higher than anticipated external financing requirements of the GOP by providing balance of payments support on a grant basis. PEPS will provide dollars for balance of payments support of $79 million to help the GOP mitigate the adjustments accompanying appropriate policy reforms leading to an environment for private sector led, sustainable economic growth. Since the dollar will be used for foreign exchange costs (external debt), there will be no net local currency resource flows to the GOP because of the assistance. However, it is expected that the GOP will make available the necessary financial and other resources to attain acceptable progress in major policy actions. The GOP will use the dollars from PEPS to service its official non-military debt to the United States Government (first preference) and to multilateral development institutions and/or such other uses as may be agreed to. PEPS assistance is particularly critical since foreign exchange resource flows are needed to enable the GOP to stabilize the BOP situation.

The monitoring, evaluation, technical assistance, and policy study component of the program is estimated at $828,000. It will be administered through A.I.D. direct contracts and the method of financing can either be by direct reimbursement or A.I.D. direct payment.

Since October/November of 1989, A.I.D. and the GOP have engaged in continuing discussions on reform progress critical to obtaining the PEPS and MAI objectives, including exchange rate reform, trade liberalization, encouragement of foreign private investment, privatization, reform of the taxation system, and financial market reforms. A.I.D. and GOP agreed that PEPS supportive reforms would be foreign investment liberalization and tariff simplification. Because of political sensitivity of the reforms to be supported, it was also agreed that the formal recording of the agreement would wait until the reforms were essentially completed. Both reforms, separately or together, mean significant improvement in creating a favorable economic environment for sustainable growth led by the private sector. Foreign investment liberalization will mean an infusion of highly productive foreign capital, technology and/or market connections which will provide employment opportunities, improve labor productivity, and lead to a higher standard of living. Tariff simplification, in terms of lower effective rates of protection and fewer tariff classifications, will mean less protection for the import substituting industries and will encourage competition and hence efficiency in domestic production and distribution. This will likely lead to more balanced sectoral and geographical growth.

A description of the present political environment in the Philippines, the GOP's development strategy, and PEPS relationship to USAID assistance program and other donors' activities are presented in Section III of this document. Section IV analyzes the economy's recent performance, economic stability issues, and prospects for 1991 and beyond. The economic rationale for the policy thrusts of PEPS, i.e. private enterprise growth through appropriate trade and investment regimes are all discussed in Section V.

The core of the initial PEPS grant support is laid out in Section VI where the two policy reform options for FY 1991, i.e., foreign investment liberalization and tariff simplification, are presented. Section VII describes PEPS program funding, rationale for PEPS balance of payments support, monitoring, evaluation, technical assistance, and policy study component of the program as well as grant signing and disbursement. The details of how to implement the program are specified in Section VIII. Section IX contains the conditions and covenants to the program agreement with the GOP.

III. THE SETTING

A. Political Setting

The "people power" revolution of February 1986 ended the twenty-year rule of President Marcos. Since then, the Government of the Philippines under President Aquino has enacted a new constitution, held Congressional and local elections at the provincial, city, municipality and village levels, and has restored political liberty. Unfortunately, concerns on political instability still plague the country. The Communist insurgency and Muslim separatist activities continue (although the government has been making progress), and right-wing elements of the military have attempted six coups against the President (the most recent and bloodiest in December 1989). Although threats of another coup attempt have diminished, the present political situation is still considered fragile.

The prospects for the future political situation do not indicate radical change from the present situation. Two events will dominate the political environment over the remaining 12 months of the Aquino administration: the negotiations over the presence of U.S. military bases in the Philippines and the May 1992 national election. Posturing for the elections has already begun and is much reported in the press. The pre-election maneuvering, along with the accompanying protests and rhetoric of the base negotiations, is likely to preoccupy politicians and the press and distract attention from economic issues requiring government attention.

B. Philippine Development Strategy

With its ascension to power in 1986, the Aquino administration undertook substantial reforms. These efforts attempted both to fulfill economic reforms started under the Marcos administration in the early 1980s but blocked by cronies/interest groups and to launch major initiatives to restructure the overall orientation of the economy from a government-dominated one to a more private sector oriented market economy. These reform policies included import liberalization and tariff simplification; dismantling of agricultural monopolies; a program to privatize government owned and controlled corporations and acquired assets; foreign investments liberalization; foreign exchange market liberalization; and an overall emphasis on private sector led growth, especially by small and medium sized enterprises in areas outside the Metropolitan region. As described in subsequent sections, the record of success of these policies has been mixed, which has led to refinements in the policies.

The GOP's overall development plan is articulated in the 1987-1992 Medium Term Philippine Development Plan (MTPDP). MTPDP's goals are to alleviate poverty, generate productive employment, promote equity and social justice, and attain sustainable economic growth. The Plan's policy thrusts include trade liberalization; decentralization in planning; better implementation of infrastructure projects; redistribution of land assets and services as embodied in the Comprehensive Agrarian Reform Program (CARP); plans to expand low-income housing; and plans, to expand social services including free secondary education.

The development policy measures have had positive impacts. GNP growth registered an average annual rate of 6.1 percent during 1986-89, primarily buoyed by robust consumer expenditures. Furthermore, the GOP came to terms with the IMF for a 3 year $1.06 billion Extended Fund Facility (EFF) in May 1989 that set a stage for growth oriented development programs. Unfortunately, however, unforeseen adverse external events as well as misguided internal economic policy slippages derailed the growth momentum. The December 1989 coup attempt, 1989-90 drought and power shortage, devastating earthquake and typhoons, and finally the Gulf War stymied the growth momentum in 1990. In addition, increased public sector expenditures without corresponding revenue increases, in part due to excessive public sector wage adjustment, and slow adjustment of domestic petroleum product prices faced with increasing world oil prices resulted in a large public sector deficit which brought about increasing inflation, higher interest rates and pressure for exchange rate adjustments. In mid 1990, the GOP was unable to comply with the EFF performance target on the public sector deficit ceiling and ruptured the EFF agreement. A net result was a GNP growth reduction to 3.7 percent in 1990 and further expected decline to about 2 percent in 1991.

In response, the GOP adopted the five point action plan proposed by Department of Finance (DOF) Secretary Jesus Estanislao. To increase revenues, the GOP proposed improving collection efficiency, speeding up privatization of big ticket items, introducing a tax reform package, and facilitating the passage of legislation on other revenue measures. To control expenditures, the GOP implemented a 10 percent mandatory savings on all government spending and regulating budgetary releases by controlling expenditures to the flow of revenues. Furthermore, the GOP raised the domestic petroleum product prices by 30 percent in September and by 32% in December 1990 and devalued the peso by 12 percent from ₱ 25:1 U.S.$ in August 1990 to ₱28:1 U.S.$ by end October. With this program in hand, the GOP renewed negotiations with the IMF for a stabilization program and agreed to an 18-month Standby Agreement in February 1991. The standby arrangement stipulates expenditure cuts, revenue increases, elimination of Oil Price Stabilization Fund (OPSF) deficit, increase in net international reserves to $3 billion, and reduction of the consolidated public sector deficits to 3.7 percent of GNP in 1991 and to 2.5 percent in 1992. In addition, the GOP was able to convene in February 1991 the second Multilateral Assistance Initiative (MAI)/Philippine Assistance Program (PAP) meeting in Hong Kong and succeeded in obtaining $3.5 billion in pledges, which exceeded the anticipated amount. To further solidify its stability and lay foundation for future growth, the GOP has negotiated a $1.5 billion debt payment reschedule in the Paris Club in June 1991.

The net result of the policy measures has been a tremendous improvement in the macroeconomic situation. The public sector budget has been in surplus for the first 5 months in 1991, interest rates has come down to the 20 percent level from over 35 percent in January, the exchange rate has stabilized, and inflationary pressure seems to have receded. To be sure, economic activities have been subdued due to still high, although declining, interest rates, imports have declined mainly due to expected elimination of a 9 percent import levy, similarly exports have increased but not as much as anticipated due to the imported input cost increases of the 9 percent import levy. It is expected that the OPSF deficit will be completely eliminated by the end of August if the GOP continues to maintain the current petroleum product price levels. In addition, an important change in the attitude of Philippine people on foreign investment and foreign trade has been manifested recently. The Philippine Congress passed the Foreign Investments Act of 1991 and the President has signed it into law which makes the Philippines more comparable with its ASEAN competitors in terms of welcoming foreign capital and investments. Further, it is expected that the administration will issue a modified E.O. 413 which reduces nominal tariffs as well as effective rates of protection across the entire range of imports and exports. With lower protection and increased foreign investment, it is expected that competition will be keener among hitherto protected domestic industries and will likely make them more efficient.

With the economic stabilization in hand, the Philippine economy is poised to embark on a renewed growth path for 1992 and onward. A critical juncture is the 1992 national election. The new administration must continue to carry the banner of economic growth based on open economy, higher domestic efficiency, and international competitiveness.

C. Relationship to USAID Assistance Program

1. USAID Strategy

The overall goal of the USAID program, as expressed in the Philippine Assistance Strategy Statement (PASS) FY 1991-95, is to promote broad based, sustainable economic growth through the active partnership of the public and private sectors in fostering open and efficient markets and an open society. The private sector is one of the three themes (the other two are policy reform and decentralization) that cut across the USAID program's five objectives: 1) a policy and institutional framework stimulating market-based private sector growth, 2) open and competitive markets, 3) infrastructure that facilitates expanded private sector activity, 4) more efficient delivery of essential services, and 5) effective and sustainable management of natural resources.

USAID's focus on the private sector as the main engine of growth for the Philippine economy is a theme which is deeply ingrained throughout its strategy. USAID views the private sector as the most effective force for stimulating economic development in the Philippines. When operating in a competitive environment, the private sector is the most productive source of growth and efficient means of producing goods and services and providing jobs. The private sector's ability to create jobs is especially crucial, given the Philippines' substantial un- and underemployment.

USAID's emphasis on the development of an efficient and competitive private sector is reinforced through its role in the Multilateral Assistance Initiative (MAI), a special cooperation initiative between the GOP and various foreign donors. As a major initiator of and contributor to the MAI, USAID supports the establishment of a policy environment which strengthens the competitive private sector as the primary engine of growth. The MAI calls for extraordinary levels of official assistance on the part of donors and for restructuring of the Philippine economy on the part of the GOP. The main thrust of restructuring is to reorient the economy from the current import substitution mode of inward looking policy to creation of a more open and competitive business environment characteristics of an outward looking development strategy. In the February 1991 MAI meeting, donors, while pledging $3.5 billion assistance, stressed the importance of the GOP undertaking policy measures for stabilization, the passage of liberal foreign investment law, reduction and simplification of the tariff system, continued privatization, establishment of free exchange markets and competitive exchange rates, financial and capital market reforms.

USAID support to the MAI initially comes in the form of a policy based balance of payments support program (PEPS), a sector program in Natural Resources Management, development and rehabilitation of infrastructure through a credit facility in conjunction with the U.S. Export Import Bank, funding assistance to MAI Special Development Project for the General Santos/South Cotabato area, support and institutional feasibility studies fund, and promotion of greater involvement of the U.S. private sector in the country's development.

2. Past and Present USAID Assistance

USAID has directed a large share of its assistance toward improving the policy climate for the private sector. Through its policy dialogue and its program assistance aimed at bringing about policy changes in various economic fronts, USAID has been and continues to encourage the establishment of a more open and competitive economy. In 1986 and 1987, USAID provided $300 million and $150 million, respectively, under Budget Support Programs I and II (BSP and BSP II). BSP and BSP II supported policy changes aimed at trade liberalization, market-oriented exchange rate, reduced government involvement in the economy/deregulation, simplification of investment rules, fiscal and monetary responsibility. In 1989, USAID established the $218 million grant Support for Development Program (SDP). SDP provided support for policy reforms which would foster broad based, employment-generating, private sector led development, with broader distribution of economic opportunity. The SDP policy package included reduced government involvement in the Philippine economy through privatization of government owned and controlled corporations, liberalization of interisland shipping regulations affecting private business and improved tax collection.

USAID is directing $10 million worth of assistance to accelerate private investments and trade through its Private Investment and Trade Opportunities Project-Philippines (PITO/Philippines), a parallel project to the ASEAN Representative Office's PITO Project. PITO/Philippines aims to assist Filipino businessmen gain access to new markets and enlarge its market share within established markets by providing institutional support to private sector trade organizations and by establishing trade linkages with the USA and an intra-ASEAN private sector trade network.

USAID's Small Enterprise Credit Project, which is a $13 million grant project started in 1989, as well as USAID's support for many of AID/Washington's guarantee programs in the Philippines, seek to provide assistance to private businessmen in overcoming financial constraints to the diversification of business activity and to strengthen institutional support for the private sector.

In 1988, USAID initiated a $5 million grant Privatization Project. The Privatization Project seeks to reinforce the privatization policy of the GOP by providing technical assistance to the Asset Privatization Trust (APT) and different disposition entities for the development of company specific privatization strategies and for the implementation of privatization plans.

Cognizant of the potential for expanding private sector investments through the upgrading of the human capital base of private enterprises, USAID finances, through its Development Training Project, technical and managerial training in the Philippines, third countries and the United States. This training for the private sector addresses selected constraints to productivity and profitability of nonfarm private enterprises.

Through a $5 million technical assistance and commodity support, in combination with a loan fund established by the Office of Energy Affairs (OEA), USAID is able to facilitate private sector investments in innovative energy conserving technologies and processes.

By co-financing private sector efforts, USAID supports community development work of Philippine and U.S. NGOs/PVOs (Non-Government Organizations/Private Voluntary Organizations) and private firms which promote greater voice and choice for the private sector in economic development activities. USAID also provides technical assistance to private institutions which support private enterprise activities, i.e., chambers of commerce, private research organizations and trade associations.

D. Relationship to Other Donors

1. Macroeconomic Reform Programs

Many foreign donors to the Philippines have focused their assistance in building a macroeconomic framework supportive of the private sector. This is critical because without a sound macroeconomic environment, private sector initiative and growth will not flourish.

In 1986, the International Monetary Fund (IMF) granted the Philippines the 1986-1988 (18-month) Stand-By Arrangement Program in an amount equivalent to SDR 198 million (approximately $242 million). The program focused on initiating and strengthening economic recovery through an initial fiscal stimulus provided by the program, followed by a sustained reduction in the public sector deficit and comprehensive structural changes covering tax reform, public expenditure program, public financial and nonfinancial institutions, trade liberalization and agricultural reforms. With rescheduling, achievement of the targets laid out in the Standby Agreement was successful.

In 1987, the World Bank (IBRD) approved for the Philippines a $300 million Economic Recovery Program (ERP) and its accompanying $10 million Economic Recovery Technical Assistance Project (ERTAP). The ERP supports

GOP's reform efforts in the areas of tax reform, trade liberalization, public investment program, and rationalization of government financial institutions.

During the second quarter of 1989, the IMF approved an Extended Fund Facility (EFF) and Compensatory and Contingency Financing Facility (CCFF) amounting to about $1.06 billion ($660 million for EFF and $400 million for CCFF). The program emphasizes monetary restraint, trade liberalization, and revenue enhancement. Release of money is conditional upon the GOP's performance in specified targets set for public sector borrowing, money supply, new external medium and long term nonconcessional lending, short term external debt outstanding, and net international reserves. The program calls for a total of five reviews, on a semi-annual basis, between the time of agreement and the final review on December 31, 1991. The EFF arrangement was ended in late 1990 due to non-compliance with the performance targets.

In February 1991, the GOP and the IMF agreed on an 18-month Standby Arrangement. The program was designed to stabilize the economy and lay foundation for sustainable growth in 1992 and beyond. The program includes the usual Standby conditions on reducing public sector deficits, constraining money supply growth, limiting new foreign debt, and building up international reserves. A special emphasis is on the reduction of consolidated public sector deficits to 3.7 percent and 2.5 percent of GNP, respectively, in 1991 and 1992 from 5.2 percent in 1990. To meet the performance targets, the GOP has imposed a 9 percent import levy across all imports with few exceptions, and will eliminate Oil Price Stabilization Fund (OPSF) deficit by September 30, 1991. As of June 1991, the GOP is meeting all performance targets.

2. Other Relevant Programs and Projects

In September 1988, IBRD granted the Philippines a $200 million loan to support the Reform Program for Government Corporations. The program constitutes a series of phased structural adjustments of the Philippines' public corporate sector. Under the program, the GOP committed to undertake appropriate policies which would reduce, limit, and rationalize government corporate activities, initiate improvements in efficiency, cost recovery and effectiveness of government corporations and gradually reduce the heavy burden that public corporations presently impose on the government budget and on the Philippine economy.

Reforms in the investment incentives system are expected to be reinforced by IBRD technical assistance through its $200 million Debt Management Program, a stand-alone loan to finance the debt buyback operations of the GOP. IBRD assistance is financing research studies on the investment incentives system and administrative improvements on the grant of tax incentives.

The United Nations Development Program (UNDP) is assisting the GOP in its other disposition actions which are partly related to the reduction of the government's involvement in the economy. UNDP is providing technical assistance to the Department of Budget and Management (DBM) in the preparation of detailed implementation plans for government corporations approved for regularization, abolition (liquidation), and conversion (to private foundations). Detailed implementation plans have been prepared for around 98 government corporations.

3. PEPS Specific Reforms

Through its policy dialogue efforts with the GOP, A.I.D. has aimed at bringing about more liberalized investment and trade regimes. USAID's budget support programs in earlier years, i.e. BSP and BSP II, provided assistance to policy changes aimed at trade liberalization, but mostly covering lifting of quantitative restrictions on imports, and at improvement on investment procedures. SDP also provided support for GOP phased lifting on import controls on a specific set of commodities of which the liberalization had been delayed by the 1983-1985 crisis. (All related indicators have been fully met.) However, none of these programs dealt specifically with the PEPS reforms of foreign investment liberalization and tariff reduction and restructuring.

Both the IMF and the World Bank have supported GOP phased lifting of quantitative import restrictions. The GOP expressed in its Memorandum on Philippine Economic Stabilization Plan, 1991-92, its intent to carry out tariff reform aimed at rationalizing and simplifying the system, to replace further quantitative restrictions on imports with tariffs and to liberalize foreign investment. However, the current IMF standby does not require any specific action in these areas. While the GOP is presently discussing with the World Bank and the Asian Development Bank, structural adjustment loans to cover reforms in trade, energy, investment and capital markets, no explicit agreement has yet been reached.

IV. THE ECONOMY

A. 1990 Economic Performance

Policy slippages combined with the adverse effects of the December 1989 coup attempt, 1989-90 drought and power shortage, the July earthquake concentrated in Northern and Central Luzon, the August oil price shocks and the November typhoon ('Ruping') that wrought havoc in the Visayas and Northern Mindanao explain the poor economic performance of the Philippine economy in 1990. Delays in the implementation of needed reforms (e.g. delays in the implementation of revenue measures and adjustments of domestic petroleum prices and the exchange rate) and higher-than-anticipated government spending are major policy slippages that contributed to economic problems in 1990. The Philippine economy managed to grow in real terms by only 3.7 percent in 1990 compared to 5.5 percent in 1989.

1. Consolidated Public Sector Deficit and Domestic Interest Rates

Unanticipated expansion of the consolidated public sector deficit (CPSD) is regarded as the main cause of economic instability last year. CPSD has three parts, namely: national government deficit, monitored government corporate sector imbalance, and deficits in the nonbudget operations such as those from the oil price stabilization fund (OPSF) and the Central Bank (CB). Large CPSD financing needs in 1990, estimated at Pesos 58.5 billion or 5.2 percent of GNP, caused high real yields on government debt, real appreciation of the local currency and monetary expansion.

The national government deficit showed the largest expansion from Pesos 19.6 billion in 1989 to Pesos 40 billion in 1990. While revenue collection improved by over 20 percent, it was not sufficient to match the increase in current and capital expenditures of the national government. Costs of the full implementation of the wage standardization program and high interest payments explain the increase in current spending. There was also a Pesos 5 billion transfer to settle part of the oil companies' outstanding claims on the OPSF. Excessive reliance on domestic short-term debt to finance the deficit caused yields on government debt to soar leading to higher interest payments and a larger deficit. Further improvements in the GOP's disbursement systems and project implementation boosted capital spending.

Imbalance of the monitored government corporations rose to Pesos 12.5 billion in 1990 from Pesos 4.4 billion in 1989. Decline in internal cash generation of most government corporations especially the National Power Corporation (NPC) and higher capital outlays of Philippine National Oil Corporation (PNOC) and National Food Authority (NFA) explain the hefty deficit of the monitored government corporate sector.

An additional Pesos 7.4 billion was added to the OPSF deficit in 1990 after incurring a Pesos 9 billion of payables in 1989. Similar to the 1989 experience, slowness in adjusting domestic petroleum product prices to increases in international prices led to higher outstanding claims by the oil companies on the OPSF.

The CB's net financial loss from operations increased to Pesos 22.2 billion in 1990 from a deficit of Pesos 20.8 billion in 1989. Losses from its foreign exchange swap arrangements, arrears in the payment of emergency loans given in the past, delay in debt service payments of peso counterpart obligations of government corporations and interest losses from having assumed Philippine National Bank (PNB) and Development Bank of the Philippines (DBP) foreign debt payments have contributed to the sustained financial losses of the CB.

For the period 1990, nominal and real interest rates were clearly on an uptrend. This reflected public sector claims on the economy's resources and lender's demand for premiums to offset increased risks associated with rising inflationary expectations and expectations of further depreciation in the foreign exchange rate. The 91-day treasury bill rate was 25.4 percent in the first quarter 1990 compared to 15.7 percent in the first quarter of 1989, 23.2 percent in the second quarter vis-a-vis 17.3 percent in the same quarter the previous year and 28.4 percent in the third quarter 1990 versus 23.5 percent the previous year.

2. Monetary Growth and Inflation

Expansionary fiscal policy and concern over high domestic interest rates caused wild swings in the growth of monetary aggregates in 1990 but in general, monetary growth was rapid during the period. After the growth of base money was reduced to 27 percent at the end of the first quarter 1990 from a high of 36 percent at the end of December 1989, monetary policy turned expansionary in the second and third quarters.

GOP was withdrawing its CB deposits to finance the deficit while domestic interest rates were rising due to higher government borrowing requirements that included replenishment of government deposits with the CB. Base money growth accelerated to 29 percent by end of June and 34 percent by end of September. CB had to reintroduce its own short-term securities to slow down monetary growth in September 1990. Reserve requirements had to be raised from 21 percent to 23 percent in November and further to 25 percent in December 1990 to finally stabilize base money growth at 23.5 percent.

Inflation as a consequence averaged 12.7 percent in 1990. However, towards the last quarter of the year, inflation showed signs of surging past the yearly average because of expectations of a major devaluation and adjustments in petroleum prices which transpired in end of October and December, respectively. Year-end inflation was recorded at 14.2 percent.

3. Balance of Payments and the Exchange Rate

The current account deficit widened by $1.2 billion in 1990 to $2.7 billion. As a share to GNP, the current account imbalance was 5.8 percent. The expansion of the current account deficit was attributed mainly to the deterioration in the trade balance. Terms of trade fell by 6 percent as indicated by soft export prices for traditional exports, slackened world demand for electronic goods and garments and steep crude oil price increases. Coupled with supply constraints caused by a series of external adverse effects, exports of manufactures and other items could only muster a 4.7 percent growth. Imports, on the other hand, driven by buoyant demand and the abrupt rise in international crude oil prices grew by 17.2 percent in 1990. Imports of capital goods outpaced the rest owing to the investment recovery and refurbishment of equipment in the air transport and power sectors. Net merchandise trade registered a deficit of $4 billion, 1.5 times the deficit in 1989.

Services account, consisting of nonmerchandise trade and transfers, registered surpluses of $618 million and $714 million, respectively in 1990. Higher worker's remittances as the number of workers deployed overseas rose, more efficient channels of repatriating earnings of overseas workers through the banking system, increased ESF drawdowns and higher operating expenses of multinational corporations boosted invisible receipts to $4.8 billion. Invisible payments, on the other hand, amounted to $4.2 billion as interest payments declined to $2.2 billion in 1990 from $2.4 billion in 1989 due to lower foreign interest rates and the impact of the debt buyback.

Capital account balance was a surplus of $1.49 billion in 1990, slightly lower than the surplus of $1.52 billion in 1989. All the major capital accounts accumulated surpluses including the errors and omissions. The surplus in the net foreign direct investments of $469 million, however, was 44.3 percent lower than the previous year's surplus of $843 million. Suspension of approvals for new debt conversion and the uncertainty brought about by deteriorating economic developments and worrisome political signals in the Philippines may have affected adversely the perception of foreign investors. Inflows of medium- and long-term loans consisted of the drawdown on the pipeline of existing commitments estimated at $485 million, new commitments worth $1.49 billion and rescheduling of $1.77 billion. Balance on medium- and long-term loans was $392 million, slightly ahead of the estimate for 1989. High domestic interest rates may have attracted speculative foreign capital reflected by errors and omissions as it rose by 61.9 percent to $620 million in 1990.

Overall balance of payments, however, was a deficit of $183 million in 1990 as the capital account surplus, gold sales and revaluation adjustments failed to offset the hefty current account deficit. Gross international reserves of the CB declined from $2.3 billion at end-year 1989 to $2 billion as of December 1990. This amount corresponded to less than 1.5 months of imports.

External debt as of November 1990 stood at $28.9 billion, $1.93 billion more than the previous year's estimate. As of June 1990, however, external debt was $27 billion, down from $28.6 billion in 1987, due to the impact of the debt buyback operation in January 1990 and previous debt-equity and other conversion schemes. Increased borrowings from multilateral and official bilateral creditors and the slowdown in debt conversions for the most part of the year explained the increase in the debt stock after June. The face value of debt retired under various debt conversion schemes in 1989-90 was $650 million or $300 million lower than the face value of debt retired in 1988 at $950 million. Debt service ratio after rescheduling was 24.9 percent in 1990. Share of external debt to GNP was 62.9 percent.

Monetary expansion placed pressure on the peso to depreciate in the first few months of 1990 and was intensified by the steep increase in the import prices of crude oil. From 22.4 Pesos:1 U.S. in December 1989, the exchange rate fell to 25 pesos:1 U.S.$ in end of August. Despite this, the spread between the official and curb rates remained relatively high at 6 percent in August and almost 10 percent in September, compared to an average spread of 1 percent in 1989. The Bankers' Association of the Philippines (BAP) and the CB adopted measures that restricted exchange rate spreads on customer transactions, provided special arrangements to provide foreign exchange to oil importers and imposed limits on the opening of non-oil trade credits to ensure adequate supply of foreign exchange to oil importers and import-dependent exporters while discouraging speculative activities. Despite these arrangements and the substantial sales of dollars by the CB in the interbank market, the pressure on the exchange rate continued. The rate fell to 28 pesos:1 U.S.$ at the end of October. The resulting real effective depreciation for 1990 was estimated at 14.5 percent vis-a-vis trading partners and 16 percent vis-a-vis competitors.

4. Economic Stabilization Actions in the Last Quarter

Towards the end of 1990 when there were clear signs of an economic slowdown, the GOP adopted policy actions to buck the worsening trend. Earlier it was mentioned that a major devaluation took place at the end of October 1990 that doused foreign exchange speculation and brought some degree of stability in the foreign exchange markets. Petroleum product prices were raised by 30 percent in September and again by 32 percent in December to reflect the reality of higher crude oil prices abroad. The Administration's technocrats put together a deficit reduction package for 1991 consisting of budget cutting and revenue enhancing measures despite refusal by Congress to act on the administration's tax proposals. The Aquino administration must be given credit for adopting these reforms in the face of severe political constraints and certain loss in political support.

B. First Quarter 1991

1. IMF Targets

The stabilization measures adopted by the GOP in the last quarter of 1990 will have to be complemented by adequate financial support in 1991 and 1992 to reduce the adjustment costs. The Extended Fund Facility (EFF) of the IMF obtained in 1989 was not the appropriate program to support the current economic policy package since an EFF normally backs a country's medium term reform program. The Philippine medium-term economic targets, assumptions and performance criteria supported by the EFF were no longer realistic given recent external and domestic developments and trends in 1990. Economic instability as reflected by the hefty fiscal gap, current account instability and double-digit inflation in 1990 will spill over into 1991 unless present efforts to address them are effectively implemented by the GOP.

Pursuant to the stabilization actions conducted in the last quarter of 1990, the GOP applied anew for financial support from the IMF. In February 1991, the GOP obtained the IMF Board approval for its application of an

18-month Standby Arrangement and Compensatory Contingency Fund Financing (CCFF) amounting to roughly $900 million. The Standby will provide financial support for the economic stabilization measures to be implemented by the GOP for calendar year (CY) 1991 and 1992. Following are the targets:

IMF Standby Performance Targets

	Mar.31	June 30	Sept.30	Dec.31
		(In billions of Pesos)		
Domestic Sector Ceilings				
Base money	117.4	116.8	114.5	133.6
Public sector borrowing requirement (PSBR)	16.7	20.5	17.3	27.4
OPSF outstanding balance	-11.8	-9.4	-----	-----
External Sector Floors/Ceilings (In millions of U.S.$)				
Net International Reserves (NIR) of the monetary authority (floor)	-300	-400	-50	800
Short-term external debt outstanding	4,350	4,350	4,350	4,350
Approvals of external borrowing with maturities of 1 - 12 years	350	700	1,100	1,500
Approvals of external borrowing with maturities of 1 - 5 years	200	200	200	200

Source: IMF

2. End of March Performance

Recently, the CB reported that the first performance based tranche of the IMF amounting to Special Drawing Rights (SDRs) 37 million was released. The GOP has met the end of March performance criteria. While actual figures have not yet been released, reports allude to a fiscal surplus of Pesos 3-4 billion in the first four months of the year. This may translate into lower PSBR for the government since the financial operations of the national government yielded a surplus.

As of May 1991, the OPSF deficit is slightly over Pesos 10 billion from nearly Pesos 16 billion in December 1990. The Aquino administration's refusal to realign domestic petroleum prices to current lower crude oil prices in the face of pressure from militant trade unions, student and consumer groups including big business have resulted in the reduction of the OPSF deficit. Given the lower OPSF deficit and the financial surplus in GOP operations in the first quarter, the consolidated public sector deficit is likely reduced.

For the week of March 18-22, the average level of reserve money is Pesos 113.6 billion. Since there were no major 'shocks' during March that could have raised money demand, a stable trend in liquidity growth is expected. Furthermore, reserve eligible bank securities (plus reserve money equals base money) are unlikely to have increased significantly in the period because there were no reserve requirement adjustments. Hence, reserve money levels in the first week of March is a good gauge that the base money target, a major performance criteria under the Standby, was met.

Due to the low level of imports because of weak economic activity, the negative effects of the 9 percent import duty and the CB imposed-limits on foreign exchange holdings of commercial banks as well as more efficient channels of repatriating overseas manpower remittances through the banking system, the market is currently flooded with foreign exchange which the CB has exploited to raise its level of reserves. As of June 7, the CB claims an international reserve position of $3.3 billion, the highest ever posted in 11 years. Performance criteria for March and June 1992 will be determined by February 1992 when the second performance review is completed. The first performance review is to be completed by August 31, 1991.

3. Impact

From 35.15 percent as of January 1, 1991, the average yield on 91-day treasury bills as of March 20 fell by 1200 basis points to 23 percent. As a consequence of the reduction in the public sector deficit, the GOP can afford to turn down sales of government debt with a low asking price or high yields. The exchange rate appreciated from Pesos 28: 1 U.S.$ as of January 1991 to Pesos 27.806:1 U.S.$ by end of May indicative of the weak import demand, albeit the strengthening of the U.S. dollar in the world currency markets casted doubt on the market trend of the peso appreciation. Although the year-to-year inflation for March is 18.8 percent, which is higher than the year-to-year inflation for January, inflationary expectations are lower than they were at the start of the year because of lower crude oil prices and a credible deficit reduction program of the GOP. Inflation in the succeeding months is expected to taper off.

GNP, at constant 1985 prices, for the first quarter this year barely grew at 0.2 percent, confirming the slowdown in the economy. Even in a recession, personal consumption is expected to perform relatively well; even for the first quarter it grew moderately at 4.6 percent compared to 5.5 percent a year ago. Government consumption expenditures fell by 2.7 percent as the austerity measures of the government continued. Gross domestic capital formation or total investments fell by 15.6 percent mainly because of high interest rates and exchange rate at the start of the year, the Gulf crisis and the 9 percent import duty tax. Hardest hit among the investment sectors is construction which fell by 33.95 percent.

The only bright spot in the gloomy first quarter horizon is the growth of exports estimated at 8.4 percent. The devaluation at the end of October 1990 may already be taking effect, although the full impact on exports is expected to materialize later. Reported export growth for the first quarter 1991 exceeds any of the quarterly percent changes of exports in 1990. As a consequence, its percent share of GNP for the quarter is 33.2 percent, even higher than the share of total investments. Imports, on the other hand, posted a growth rate of 2.6 percent which is considerably lower than the year ago quarterly change of 17 percent. This development is another indication of a weakened economy.

On the supply side, agriculture, fishery and forestry sector grew by 4.6 percent. Industrial output declined by 4.4 percent while the service sector managed a 1.9 percent growth.

A BOP surplus of $28 million was registered in the first quarter 1991, a major turnaround from the $369 million deficit recorded in the same period last year. Improvements in the net medium- and long-term (MLT) loans inflow compensated for the merchandise trade deficit and the decelerations in the service accounts. Merchandise imports grew by 7.9 percent to $3.048 billion while merchandise exports grew by 4 percent to $2.027 billion causing a trade gap of $1.021 billion, 16.8 percent higher than the deficit a year ago. Reduction in invisible receipts by 4.9 percent accounted for the decline in the surplus of net nonmerchandise trade from $225 million in the first quarter last year to $177 million, despite lower interest expenditures due to the downturn in foreign interest rates. Surplus in net transfers for the quarter was $159 million. The current account deficit for the first quarter of the year registered $619 million or about 6 percent of GNP.

Net MLT loan inflows for the quarter amounted to $246 million, in sharp contrast to the net outflow of $958 million in the same quarter last year. Payments amounted to $449 million, a 75 percent decline compared to disbursements of same quarter in 1990. Loan availments equaled $695 million, slightly less than last year's first quarter estimate of $760 million. The surplus in net direct foreign investments is $130 million resulting from a significant slowdown of capital withdrawals from the country.

Deep cuts in GOP expenditures and improvements in revenue performance explain the Pesos 4.4 billion cash surplus in the first four months of the year. Overall revenues were estimated at Pesos 74.78 billion, higher by Pesos 4.9 billion or 7 percent than the revenue target of Pesos 69.88 billion. This resulted from the higher-than-anticipated revenue take of the Bureau of Internal Revenue (BIR) at Pesos 42.17 billion, Pesos 1.17 billion more than the BIR target of Pesos 41 billion for the first quarter. On the expenditure side, the national government spent Pesos 17.77 billion less than the programmed expenditure level of Pesos 88.13 billion during the period or Pesos 70.36 billion. Interest payments alone had a 36 percent share of total expenditures or Pesos 24.98 billion. The cash surplus of Pesos 4.4 billion during the period and net drawdowns on external loans of the GOP of Pesos 5.82 billion enabled GOP to retire domestic debt worth Pesos 10.24 billion.

C. Prospects

1. General

Given the stabilizing effects of the GOP's deficit reduction and economic stabilization package felt in the first quarter, GOP could have earned the 'credibility' needed to sustain the effectiveness of the policy package. However, forces are at work that may test the GOP's political will to stick to the stabilization measures as well as other reform activities reactivated (e.g., privatization) or about to be started (e.g., tariff reduction and investment liberalization). Prominent among the demands of those who opposed to the stabilization measures are the reduction, if not the rollback to the December 1989 levels, of present domestic prices of petroleum products despite a hefty deficit still remaining in the OPSF and the reduction of the 9 percent import levy. Pressures are also being exerted by nationalist businessmen and big local business groups for watered-down implementing rules and regulations of the new foreign investment law and the soon-to-be released E.O. 413, the tariff reduction program.

Damage to public and private property caused by the eruption of Mt. Pinatubo is estimated to be Pesos 6-15 billion which will further strain the government's tight budget. Capital expenditure projects are either delayed or being postponed indefinitely as a result of inadequate counterpart funds due to fiscal austerity measures. Recent reports claim that as of May this year, the national government has incurred a deficit of Pesos 58 million. While negligible relative to total GOP expenditures, this may be indicative of the trend for the remainder of the year. It will not be surprising if the GOP will ask the IMF for higher deficit targets in view of the recent calamity and the need for more counterpart funds to carry out foreign-assisted capital projects.

Despite looming higher deficits, reduction of interest rates and foreign exchange stability as well as more favorable external factors (e.g., U.S. economic recovery) may justify a re-evaluation of growth prospects this year. The GOP originally projected a 1.5 percent real economic growth this year, but with the better-than-expected economic performance in the first quarter, the economy may have bottomed out faster than anticipated. Currently, government economists are talking about a 3-3.5 percent economic projection for the year.

Following are the key GOP macroeconomic projections for 1991:

a. Real GNP growth of 1.5 percent, but could be higher.

b. Year-end inflation (CPI-based) of 9.5 percent.

c. Current account deficit of $2 billion or 4.5 percent of GNP.

d. Consolidated public sector deficit equal to 3.7 percent of GNP of which the national government deficit is 2 percent of GNP.

e. Base money year-end growth of 10.9 percent.

f. Gross official reserves of $3 billion or 2.1 months of imports.

g. Debt service ratio after rescheduling of 26.4 percent.

h. External debt of $30.7 billion or 70.1 percent of GNP.

Note that the above projections have not factored in the impact of Mt. Pinatubo on the economy. While initial estimation of the impact on GNP growth is relatively small, rehabilitation and reconstruction efforts will have substantial impacts on public sector deficits, monetary growth, and the current account deficit.

2. <u>Financing Gap</u>

The IMF Standby Agreement estimated the balance of payments gap in 1991, 1992, and 1993 at $872 million, $1273 million, and $1177 million, respectively. The large financing requirements are in part due to the additional resources needed in support of the Standby stabilization program and the programmed increase in the net international reserves (NIR) of $1060 million in 1991, $962 million in 1992, and $1201 million in 1993. During the first half of 1991, the Central Bank purchased approximately $1 billion from commercial banks in the BAP on-floor trading. As a consequence, Central

Bank's international reserves increased to about $3 billion in July 1991, an equivalent of 3 months import financing. Although this level of international reserves is an all time high for the Philippines, the balance of payments situation is still highly precarious, because the current account deficit situation has not improved and the reserves are needed to maintain stability in the external sector. The Central Bank large purchase of foreign exchange in the BAP floor was an unusual event that was made possible due to the issuance of a new Central Bank regulation that limited foreign exchange holdings of commercial banks and the imposition of nine percent levy on imports which depressed demand for imports.

Furthermore, the IMF BOP estimation is based on a number of uncertain and likely overly optimistic assumptions. Actual financing needs may well be substantially greater. Exports are projected to grow at 13 percent, while imports slow down to less than 10 percent a year -- a virtual reversal of actual performance during the past four years. The impact of the revised E.O. 413 is not expected to be as beneficial to exports as under the original version. Fiscal performance in 1990 was unsatisfactory and new tax measures to replace the 9 percent import levy and the revenue loss from the realignment of domestic petroleum prices have yet to be identified. Although the actual fiscal deficit in June 1991 is under control, it is expected to increase rapidly in the second half of 1991 and put pressure on the current account through its effect on imports. In addition, the economic losses caused by the eruption of Mt. Pinatubo are placing significant pressure on the fiscal deficit to expand. Recent estimates put the total damage at Pesos 6-15 billion. Initial estimates of the foreign exchange losses (e.g. lost tourist earnings) is $400-$500 million. Another area of concern is the uncertainty governing direct foreign investment. While the investment law has already been signed by President Aquino, the implementing guidelines have not yet been finalized and its effective implementation remains to be seen.

If the trade and investment reforms to be carried out this year are not implemented effectively, the projected rapid growth of manufactured exports and the envisaged buildup in foreign investment flows will likely be jeopardized. This will have serious implications on the country's growth prospects, particularly in the medium-term. The need for additional external resources remains great.

V. PRIVATE ENTERPRISE GROWTH AND REFORMS

A. Private Sector Development

1. Economic Rationale

A freely functioning open market economy, with the private sector as dominant player and economic force, results in economic progress, efficient utilization of resources in a global framework, a rising standard of living that is distributed with reasonable equity, and a society characterized by social mobility and political freedom. The experience of market economies (with strong private sector initiatives) in the industrialized West, Japan and the newly industrializing countries of Asia and more recent experience of Eastern Europe magnify the extent of economic weakness of government controlled economies, public failures of regulatory, interventionist states and the economic wisdom of open market economies and an open society. However, private sector led growth does not preclude a role for government. Rather, government is expected to put in place a framework in which private enterprise can operate effectively and in a manner responsive to the needs of society and markets. In essence, the key to accelerating economic development is by transfering to the private sector those responsibilities which could be more efficiently handled by private individuals.

2. Background

The Philippine private sector in its indigenous form can be described as one of the most enterprising, innovative, creative, and hardworking in the developing world. With its foreign elements, the Philippine private sector can be characterized as even more adaptable, talented, and active. It draws strength from its diversity and sophistication and has potential which rival that of many developed countries.

However, its potential for growth was seriously hampered during the Marcos years. During the period 1972-1985, government involvement and control over economic activities, from the provision of public services to the establishment of agricultural monopolies and big industrial/manufacturing firms, vastly expanded. This established a dominant presence of government in many businesses in the economy (about 299 existing government owned and controlled corporations in 1985). This led to serious inefficiency in the use of scarce resources, such as the wasteful use of foreign exchange, placed a substantial burden on government coffers, depleted renewable natural resources, created economic rents for a privileged few and in general constrained the expansion of private sector initiative and productivity.

The large presence and negative consequences of government corporations in business can be illustrated by the huge drain they imposed on the government budget. From 1975 to 1986, the annual budgetary support to public enterprises consisting of budgetary transfers, equity contributions and net lending from government increased from 5 percent of national government expenditures in 1975 to a peak of 30.7 percent in 1984, before declining to 26.4 percent in 1986. The proliferation of public enterprises required huge amounts of budgetary support for their administration. The average fiscal burden from 1975 to 1986 was 1.2 times the budget deficit. The national government would have posted budget surpluses during this period if it was not for budgetary support for government enterprises.

An analysis of the private sector shows a wide disparity between the development of large firms and small enterprises, with a missing middle category of the medium sized private enterprises. The large firms consist of only two percent of the total number of registered industrial firms but account for more than half of total employment in the formal sector. The slow growth and inability of small scale enterprises to graduate into the medium size category can be traced to long standing policy and regulatory constraints which favored the development of large, capital intensive firms, while creating serious biases against labor intensive, small and medium enterprises.

One important feature of the Philippine private sector is the predominance of profit making activities in the informal sector. There is growing acknowledgment of the large role which informal businesses play in moving the Philippine economy. Government policy, e.g., Kalakalan 20, aims to bring into the legitimate business environment the numerous informal businesses existing in the country in order for these businesses to access more easily public services and eventually join the ranks of the small and medium scale enterprises.

The strong partnership of local and foreign investors is a distinguishing mark of the Philippine private sector. Both local and foreign private investments have helped propel the growth of the Philippine economy. Private foreign investments have supplemented limited domestic savings in increasing the economy's capital stock and in adding to national output and national income. In 1989, for instance, the inflow of local private investments registered with the Board of Investments (BOI) was valued at ₱22.2 billion or $1.0 billion. At the same time, private foreign capital inflow was estimated at ₱17.5 billion or $0.8 billion. While American private investments were dislodged in 1989 from the top positions by Taiwan and Hongkong nationals, historical figures show that in terms of total investment in the country, the Americans and Japanese have still the largest foreign stakes in the economy. In terms of sectoral distribution, there is a preponderance of private investment in the industrial/manufacturing sector.

3. Current Reform Efforts

Beginning in 1990, the GOP implemented a new series of economic policy measures designed to continue to shift trade and investment policy from regulatory, rent seeking and government led approaches to liberalized, market based and competitive policies directed to sustain private sector led growth. These measures included substantial increase in petroleum products prices, depreciation of the peso, the IMF Standby Arrangement, and the passage and signing into law of the Foreign Investments Act of 1991. As a result, budget deficits turned to surplus in the first quarter of 1991 and inflationary pressures and interest rates came down substantially. In addition, it is expected that the administration will issue a modified version of E.O. 413, the tariff reduction and simplification measures, to encourage competitiveness of domestic industries. Nevertheless, the economy remains inward looking. An overvalued exchange rate penalizes Philippine exports, making them less competitive in world markets, resulting in lower export sales and lower incomes for Philippine exporters. The high and uneven level of effective rate of protection for domestic, import substituting, capital intensive industries has caused the industrial sector to attract a disproportionately large share of the country's resources.

B. Investment Policy

1. Background

a. Economic Rationale

Investment is needed for economic growth; investment, in turn, requires both domestic and foreign savings. Since most developing countries are constrained by inadequate domestic savings, the inflow of foreign savings and investment is vital for economic growth of developing economies. Even if sufficient domestic savings were mobilized, many developing economies would not possess the flexibility to transform domestic savings into foreign resources. In addition, foreign savings in the form of physical capital investments bring superior technological know-how crucial to expanded national output and increased productivity. Foreign investments increase competition in the local economy which results in lower prices, increased output and employment. Capital brought in by foreign owned firms often provides greater and better access to foreign markets as well. Market access is critically important in the light of protectionist trends in world trade.

The beneficial effects of capital inflows are not derived from their production benefits alone. They can also be realized in the context of consumption smoothing. The ability to borrow in the world capital market allows a country to sustain consumption in the event of short term, transitory shocks and therefore raises utility. Transitory shocks may either be foreign (international trade disturbances such as the 1974 oil crisis) or domestic (when deficits are excessive). Consumption smoothing may also arise in the context of economic growth. Foreign savings may be used to initiate a growth process, thus permitting a more stable path of consumption, such as heavy foreign borrowings financing investment in the initial stage of economic growth and then followed by a transition toward a high domestic savings rate such as the case of South Korea.

b. Philippine Investment Policy

A major investment promotion policy was undertaken in 1967 with the passage by the Philippine Congress of Republic Act 5186 or the Investment Incentives Act. This law provided tax incentives to investments in identified priority sectors. The tax incentives were mainly capital cheapening such as accelerated depreciation, tax and duty exemption on capital equipment, etc. Republic Act 5186 created the Board of Investments (BOI) and gave it power to regulate investments and administer the grant of incentives. In 1969, this power was broadened to include regulation of entry of foreign investments with the enactment of Republic Act 5455 or the Foreign Business Regulation Act. BOI's administration of incentives was widened in 1970 to include export industries under Republic Act 6135 or the Export Incentives Act. In 1978, incentives to agricultural investments were provided for under Presidential Decree 1159 or the Agricultural Incentives Act.

All the above mentioned investment laws were consolidated into the Omnibus Investments Code in 1981 without major changes. In 1983, major reforms in the investment incentives system under Batas Pambansa Act No. 391 were undertaken under the World Bank assisted Structural Adjustment Loan Program which brought about a more economically sound tax incentive package. The new incentives law introduced a more simple, factor neutral incentives system based mainly on value added and local content. The rationale for the incentives system was not solely for investment promotion but also for offsetting market failures and distortions in order to achieve a better allocation of investment. The new incentives system was hailed as an economic breakthrough since it was performance based, simple and highly accountable. However, despite the reforms, BOI continued to enjoy its discretionary powers to grant incentives to favored sectors.

In 1987, the Omnibus Investments Code of 1987 (E.O. 226) was promulgated, replacing the performance based incentives with the income tax holidays and retained the regulatory and discretionary powers of BOI.

2. Current Status of Reforms

For almost four decades, the Philippines used fiscal investment incentives, together with a protectionist trade policy, to promote investments, industrialization and growth. However, the outcome has not been good. The Philippines has steadily fallen behind many of its East and Southeast Asian neighbors in per capita income growth and in industrial expansion. The industrial sector has failed to develop an export capability across a broad spectrum of industries and the ability to create jobs at a rate that would reduce labor surplus.

During the period 1976-80, the ratio of investment to gross national product (GNP) averaged 28.4 percent, the highest in Philippine history and high by international standards over the entire 1960's and 1970's. Yet, the gains in growth of output and employment have been modest at best and disappointing at worst. The multitude of nonperforming assets held by the government today is proof to the misallocation of investment in the 1970's. This experience clearly shows that a serious problem in the Philippines is the misallocation of investment resources, i.e., the poor quality of investments realized rather.

a. The 1983 Reforms

The 1983 reforms, which called for the adoption of a simpler, factor neutral, performance based, and highly accountable system of investment incentives, represented an economically sound step undertaken by the government in improving the investment climate in the Philippines. Under the 1983 reform, the role of investment incentives was extended from purely investment promotion to compensating for market imperfections, attaining certain social goals, and guiding investment allocation in accordance with "long run comparative advantage." The 1983 reforms' strong preference for the promotion of exports was an indication of the incentives' role of compensating for market distortions arising from government policies having an anti-export bias.

Unfortunately, the subsidy to exports given by the 1983 investment incentives system, represented by the tax credit on net local content and net value earned, was viewed as incompatible with the Philippines commitment to the General Agreement on Trade and Tariffs (GATT). Thus, the Philippines had to commit itself to its eventual elimination which led, in turn, to the adoption of new system in 1987.

b. The 1987 Reforms

The Aquino administration adopted its own investment promotion policy. The Omnibus Investment Code of 1987 retained the features of the 1983 Code with respect to the regulatory and discretionary powers of the BOI and the administration of the investment incentives system. The reforms under the 1983 Code were reversed in the 1987 Code.

The incentives provided under the 1987 Code were uniform among exporters and nonexporters to avoid the export subsidy element. The most important change was the introduction of an income tax holiday to replace the performance based incentives of tax credits on net value earned and net local content. While the 1987 incentives were more neutral with respect to exporters and nonexporters, they were less neutral with respect to the choice between labor intensive and capital intensive industries and techniques of production. Under the 1987 Code, priority industries were granted tax and duty exemption on capital equipment and accompanying spare parts which represented a return to the pre 1983 reforms. The 1983 Code only allowed the investor to pay the duty and tax due on the imported capital equipment over a specified time period out of tax credits earned. The bias toward capital intensity was reinforced under the 1987 Code with the substitution of the income tax holiday for the tax credits on net value earned and net local content. The latter had a strong labor bias while the income tax holiday reduced the user cost of capital and encouraged substitution of capital for labor.

To illustrate the return of system's capital bias, a recent report by John Power (July 1990) shows that the average capital cost of project (which is related to firm size) was less than ₱10 million during 1985-1987 compared to over ₱60 million during 1981-1983 (values in real terms using GNP deflator). With the passage of the 1987 Code, average size rose to ₱18 million. The average capital-labor ratio (in real terms) declined sharply after the 1983 reform eliminated the capital-cheapening incentives. The average capital-labor ratio was ₱302,000, dropping to around ₱50,000 during 1985-1987. With the reintroduction of the capital-biased incentives under the 1987 Code, the average capital-labor ratio rose to over ₱87,000 in 1988.

c. The Foreign Investments Act of 1991

On June 6, 1991, the Philippine Congress passed the Foreign Investments Act of 1991 which was aimed at encouraging and attracting more foreign investments in the Philippines. President Aquino signed the legislation on June 13. Under the new law, foreign investors engaged in export actitvities (exporting more than 60 percent of total output) are allowed up to 100 percent foreign ownership provided that their products and services do not fall in negative lists A and B. Foreign investors whose products are primarily sold in the domestic market (exporting less than 60 percent of total output) are also allowed up to 100 percent foreign ownership provided that the products do not fall in negative lists A, B, and C. The negative list A enumerates the areas of activities reserved to Philippine nationals by the Constitution and specific laws; the negative list B contains the areas of activities related to defense, such as firearms and weapons, military ordinance, explosives, etc. and to public health and morales such as the manufacture and distribution of dangerous drugs, all forms of gambling, nightclubs, bars, dance halls, sauna and steam bathhouses and massage clinics. In addition, small and medium-sized domestic market enterprises, with paid-in capital of less than $500,000, are reserved to Philippine nationals unless they involve advanced technology as determined by the Department of Science and Technology. Export enterprises which utilize raw materials from depleting natural resources, with paid-in capital of less than $500,000, are likewise reserved to Philippine nationals. The negative list C contains the areas of investment in which existing enterprises already serve adequately the needs of the economy and the consumer and do not require further foreign investments, as determined by NEDA. Upon petition by a Philippine national entity, NEDA may recommend an area of investment for inclusion in the negative list C if it satisfies all the following criteria: (a) the industry is controlled by firms owned at least 60 percent by Filipinos; (b) industry capacity is ample to meet domestic demand; (c) sufficient competition exists within the industry; (d) industry products comply with Philippine standards of health and safety or, in the absence of such, with international standards, and reasonably competitive in quality with similar products in the same price range imported into the country; (e) quantitative restrictions are not applied on imports of directly competing products; (f) the leading firms of the industry substantially comply with environmental standards; and (g) the prices of industry products are reasonable.

The new law provides a 3 year transitory period, which will start after the issuance of implementing rules and regulations by NEDA within 120 days of the promulgation of the law. During this period a short negative list C, in addition to lists A and B, is provided in the law. The short negative list C contains 3 areas of prohibition; (1) import and wholesale activities not integrated with production or manufacture of goods; (2) services requiring a license or specific authorization; and (3) enterprises owned in the majority by a foreign licensor and/or its affiliates for the assembly, processing or manufacture of goods for the domestic market which are being provided by a Philippine national as of the date of effectivity of this Act under a technology, know-how and/or brand name license from such licesor during the term of the license agreement.

2. Remaining Tasks

The new legislation is considered liberal and transparent compared to the Omnibus Investment Code of 1987. Whether or not more foreign investments will take place in the Philippines depend critically on how well the administration, particularly NEDA, implement the spirit of the new law faced with mounting pressures from protectionist elements in the Philippines. The most critical step in achieving the benefits is the issuance of acceptable implementing rules and regulations.

In addition to implementing the foreign investment legislation, other planned legislation or regulations towards improving the investment climate are needed. They include amending the condominium law to allow increased foreign ownership of land, general availability of tax incentives such as net operating loss carryover and accelerated depreciation, and suspension of the nationality requirement for investments of international multilateral institutions. In addition, the GOP issued on April 3, 1991 the implementing rules and regulations for the Build Operate Transfer Law. Other administrative reforms planned include a more focused investment priority determination, and reorientation of the role of the Board of Investments (BOI) from less regulatory to more promotional.

C. Trade Policy

1. Background

Trade policy is a crucial feature of economic development strategy in view of its effects on the structure of the economy, employment generation, and overall economic growth. Theory and empirical evidence both argue that a liberalized trade regime brings about the most rapid as well as sustainable expansion in growth and income. Such a regime fosters competition, minimizes market distortions, and supports outward looking production activities.

Import controls in the form of quantitative restrictions, often justified for balance of payments stability and industrial promotion, create serious market distortions, lead to major sectoral biases and economic inefficiencies. They attract resources into industries and sectors that would otherwise be unprofitable. With the lifting of import controls, tariffs become the next line of protectionist defense. Biases resulting from a high and widely dispersed tariff structures favor import dependence in both production and consumption. At the same time, exports are penalized since tariffs represent an implicit tax on exports. To the extent that the tariff structure favors industry and capital intensity, both agriculture and employment are penalized as well.

Philippine trade policy in the 1950s through the 1970s consisted of an import substitution strategy. The protectionist trade regime, characterized by heavy quantitative import restrictions, high effective protection rate, and an overvalued exchange rate, has resulted not only in serious misallocation of resources and sectoral and geographical biases, but also in recurrent balance of payments crises.

In 1980, as part of its initial structural adjustment efforts, the Philippines initiated a trade liberalization program consisting of reduction in the level and dispersion in tariff rates; removal of quantitative import restrictions; realignment of indirect taxes to make them neutral; and curtailment of exemptions to import substituting industries.

a. Tariff Reform

The initial tariff reform component, which was completed in 1985, had a significant effect in reducing nominal and effective tariff rates: (1) reduction of average nominal tariffs from 43 percent to about 28 percent; (2) narrowing of the dispersion in rates from the range of 5-100 percent to 10-50 percent; and (3) parallel reduction in the weighted average nominal rate of protection for all sectors from 24 percent in 1979 to about 14 percent in 1985.

When the Aquino government came into power in 1986, modest tariff changes continued as policy shifted from reliance on quantitative restrictions to tariff protection. Six important changes in the tariff structure occurred. One reduced the duty on crude oil from 20 percent to 16 percent (on October 1987). The other three executive orders implemented in 1986 and 1987 involved both increases and decreases in duties. Duties on 82 items were increased while those on 62 items were lowered. Changes in classification involving no actual change on the tariff were made on 104 tariff line items. The net effect of all these actions actually raised the average tariff level slightly. The weighted average tariff level at the end of 1988 was 15.5 percent compared with 14.6 percent in 1985. However, the average effective rate of protection fell from 49 percent in 1985 to 36 percent in 1988, reflecting a reduction in protection from the removal of import restrictions. However, as of 1988, the structure of effective protection indicated that manufacturing was still strongly favored over agriculture and mining, and the strong bias against exports remained.

The tariff modifications of July 1989 and January 1990 involved only reductions in duty levels. In July 1989, tariffs on 115 items were reduced, including such items as logs, rattan poles, foundry coke, scrap metals and other raw materials and equipment. The January 1990 reductions had been prompted by the transport crisis and involved duty reductions on various types of buses, automotive spare parts, shipping vessels' components, agricultural machinery and engines. The net effect of these two tariff cuts may have reduced the average tariff by one or two percentage points.

b. Lifting of Quantitative Restrictions

The Aquino administration continued to pursue the phased lifting of quantitative restrictions which was interrupted by the 1983-1985 economic crisis. From the resumption of the import liberalization program in March 1986 to April 1988, quantitative restrictions on a total of 1,388 items were eliminated. After review and consultations, the remaining 673 items still subject to import licensing were classified as follows: (1) those for liberalization -- 104 items (List A); (2) those for review or further study -- 455 items (List B); and (3) those for continued regulation for reasons of health, safety and national security -- 114 items (List C).

Under Phase 2 of the import liberalization program, an additional 95 items under List A have been liberalized as of the end of 1989. Between March 1989 and December 1989, a total of 136 items under List B were liberalized. On February 1990, the Central Bank removed quantitative restrictions on 16 additional items on List B, covering spare parts for cars, trucks, utility vehicles, motorcycles and engines.

The impact of quantitative controls on overall protection may be greater than that of tariffs. In 1988, while the weighted average tariff was 15.5 percent, average level of tariff plus non-tariff protection was 21.4 percent. This combined level of protection remained essentially unchanged between 1985 and 1988, in contrast to the small increase in protection from tariffs alone.

2. <u>Current Status</u>

Initial examination of possible effects of the tariff changes and import liberalization that have occurred since 1988 appears to indicate a reduction in the average tariff rate as a result of the preponderance of downward tariff changes. The effect on effective protection rates (EPRs), however, is more complex. A reduction in nominal protection on imported inputs can raise the EPR on the output, even if nominal protection on the latter declines. Most tariff reductions occurred among low rate items; and these were predominantly inputs into other manufacturing industries. On the import liberalization front, the pattern is less clear; but based on the earlier experience, its effect would appear to reduce the EPRs by a modest degree.

Overall, the initial conclusion (pending completion of new EPR calculations) is that the trade policy regime has become somewhat less protective since 1988. The improvement has probably been a modest one, however.

As part of its reform efforts, in July 1990 the GOP issued Executive Order 413 to simplify and substantially reduce tariff rates. While GOP officials had been talking for several months about simplifying the tariff structure, the issuance was done without prior consultations with business groups and the Philippine Congress. The resulting outcry from affected protected industries and vote-conscious Congressmen was so great that President Aquino suspended implementation. The administration promised to consult with interested parties before proceeding.

The House and Senate, with executive branch representatives participating, held separate public hearings. The Senate held hearings from September to November, while the House hearings lasted from mid-December up to March 1991. The Department of Trade and Industry also held its own public consultations with interested private businessmen. Efforts are now underway to reconcile the differences between the House and Senate reports and between the positions of various executive branch agencies. Outstanding issues involve such items as fertilizers, cars, steel products, pulp and paper products and textiles/garments, which are considered vital for the development of domestic industries.

The planned tariff reform is aimed at improving international competitiveness of Philippine industries and simplifying tariff administration. Improvement in competitiveness will be achieved through reduction in both nominal and effective average protection levels in the economy as well as reducing disparity in protection across sectors. The most substantial changes are expected in the manufacturing sector importables, since these are highly and relatively more protected than other sectors and industries, especially agriculture. To reduce dispersion in rates and simplify tariff administration, the number of nominal tariff rates will be reduced from seven to four tiers and the range from 0-50 percent to 3-30 percent, as originally envisioned under E.O. No. 413. Unlike E.O. No. 413 where reform implementation would have been immediate and simultaneous for all industries, the planned reform will be phased over two to five years. However, the GOP expects to complete reform implementation for most of the items within less than a year of issuance of the E.O. No. 413 revision. The major exceptions will be certain sensitive items in three industries, i.e. iron and steel, chemicals and garments for which during an interim period intermediate rates or wider ranges of tariffs may be allowed.

The planned tariff reform is a major part of the GOP's trade reform strategy. The other significant part of this strategy is the progressive elimination of quantitative restrictions (QRs). Significant progress has been made in recent years on the elimination of QRs on a large number of goods and replacing them with tariffs. Less than ten percent of the items covered by the customs code remain subject to QRs. Recently, an additional 45 items were identified for immediate liberalization, and further phasing out of the remaining QRs is planned in the near term. The GOP intends that the only exceptions from import liberalization are those goods restricted for health, safety and national security purposes and those goods covered under previously approved industry rationalization programs, such as for motor vehicles and consumer electronics industries.

3. Remaining Tasks

Almost one year after the initial issuance of E.O. 413, the Aquino administration is now set to reissue a revised version of the E.O. 413. The revised version, while not made public yet, includes retention of the 50 percent rate for some sensitive items and a phasing-in implementation plan over 2-5 years. While doubtlessly, due to the political process necessary to achieve wide consensus on tariff reform, the revised E.O. 413 will achieve less, it should still be a significant reform step.

Of the 300 items remaining to be liberalized as of early 1990, the major portion is related to some "progressive" local content manufacturing program. Here the restriction is that only program participants are allowed to import. It is less certain whether each participant also is restricted in the amount of importation. In any case, the restrictions serve to protect the domestic producers from foreign competition and to limit entry, as well. It also appears that the liberalization was principally a procedural change, and therefore, barriers to entry into these industries undergoing rationalization are still there, despite liberalization.

The tariff reduction and simplification initiative represents a major reform effort. While this proposed reform would not eliminate the biases in the protective system, it would likely reduce the overall level and the wide dispersion of protection across sectors. Lastly, so long as the Philippine trade system remains biased against exports, compensatory export promotion measures, through industrial export incentives and through aggressive exchange rate policy, should be pursued.

VI. PEPS SUPPORTED REFORMS

A. Objective

The objective of PEPS is to support the GOP in carrying out further significant policy reform actions important for private sector led, sustainable economic growth. The attainment of sustainable growth depends in large part on a favorable policy and institutional framework under which the private sector can operate competitively and employ available productive resources for an efficient growth path. With the private sector as the dominant player and economic force in a freely functioning open market economy, economic progress is likely to be sustained through efficient utilization of resources.

Since October/November of 1989, A.I.D. and the GOP have been engaged in continuing discussions on critical policy reforms that are needed to obtain the PEPS and MAI objectives. A wide range of reform topics including trade liberalization, investment incentives reform, exchange rate reform, accelerated privatization, export enhancement measures, tax administration reform, capital market reform, and so on has been discussed as potential PEPS supported reforms.

In early February 1991, among various proposed actions, USAID and GOP representatives agreed to foreign investment liberalization and tariff reduction and simplification for the PEPS Program because these reforms would likely impact favorably on the private sector. By mid-March, GOP and USAID representatives reached agreement on the language of the policy objectives, details of the policy actions and the substance of the indicators for the investment and tariff reforms. On May 31st, the Mission Director confirmed agreement with the GOP Secretary of Finance and Acting Director of NEDA on the policies to be supported under PEPS.

B. Specific Actions

1. Investment Liberalization

Objective: Encourage foreign investments by clearly specifying areas where foreign equity investments are limited, and by liberalizing foreign equity participation for the other areas.

Progress to Date: The Foreign Investments Act of 1991 was signed into law on June 13, 1991 and took effect 15 days after publications in two newspapers of general circulation in the Philippines.

Remaining Policy Action: The implementing rules and regulations issued and in effect for the Foreign Investments Act of 1991, which liberalize foreign equity participation.

The completion of the remaining action will trigger the release of balance of payments support, provided A.I.D. judges the reform to be significant in terms of moving toward the achievement of the policy objective. In making its judgement, A.I.D. will consider the totality of the expected or actual effects of the reform. A.I.D. will examine such indicators of effect as information on and estimates of anticipated or realized foreign investments, the feasibility and implementability of the Act and implementing rules and regulations taken as a whole, the degree to which foreign equity participation of up to 100 percent is allowed in the economy during a transitory or holiday period, and the GOP not taking and not planning to take other actions which substantially and directly negate the effectiveness of the Act. If A.I.D. finds the transitory period provisions unsatisfactory, then A.I.D. may examine the first post transitory negative list in order to judge significance.

2. Tariff Reduction and Restructuring

Policy Objective: Encourage international competitiveness and improve tariff administration through reduction in average protection in the economy, particularly in the manufacturing sector, improvement in the protection structure particularly by reducing protection of manufacturing relative to agriculture, and simplification of the tariff structure to fewer levels and a narrower band for most items.

Progress to Date: The GOP has prepared and issued an ambitious executive order which reduces the present range of tariffs from 0-50 percent to 3-30 percent and reduces the number of classes from seven to four. However, implementation of the E.O. has been deferred to allow further consultations with Philippine industry and Congress.

Remaining Action: Bill signed or executive order issued and in effect.

The completion of the remaining action will trigger the release of balance of payments support, provided A.I.D. judges the reform to be significant in terms of moving toward the achievement of the policy objective. In making judgement, A.I.D. will consider the expected impact on the economy; the amount of reduction in the free trade value added (FTVA) weighted average nominal tariff rate for importables for the manufacturing and other sectors; the amount of reduction in the FTVA weighted average effective protection rate using book rate for importables for the manufacturing and other sectors; the amount of reduction in the difference between the FTVA weighted average effective protection rate using book rate for importables for the manufacturing sector and that for agriculture; the proportion of tariff lines reduced to between 3 to 30 percent; and how much of these changes are attained within the period of the present Philippine Administration.

Also required is that the GOP has not and is not planning to take other actions which substantially and directly negate the effectiveness of the tariff reform.

Other factors which also may be considered as appropriate in judging significance of the policy action include:

- Reduction in the dispersion of nominal tariff rates, as measured by the standard deviation based on FTVA weights for importables;

- Reduction in the dispersion of effective protection rates, as measured by the standard deviation based on FTVA weights for importables using book rate;

- Less negative effective protection rates for major competitive sectors currently with negative protection; and

- Reduction in intersectoral variation of effective protection rates for major sectors.

C. Expected Impact

1. Investment Liberalization

After decades of a nationalistic posture on foreign investments, the passage of Foreign Investments Act of 1991 is a politically and economically significant milestone. With an educated, English-speaking and still reasonably wage competitive labor force, and available amenities for a lifestyle favored by most expatriates, a more favorable investment climate should strongly increase foreign investors' interest in taking advantage of increased flexibility in both actual and legal status of their investments. Increased foreign investments will provide additional stability, infusion of new technology, and sustainable growth. Heightened competition will likely cause hitherto protected domestic producers to become more competitive and efficient.

The resulting increase in foreign investment as a result of the investment liberalization is difficult to quantify. However, interviews with members of the international business community and recent Indonesian experience in investment liberalization indicate that foreign direct investment can be expected to increase. Using the Philippine Institute for Development Studies (PIDS) - National Economic and Development Authority (NEDA) annual macroeconometric model for the Philippines, some indication of the impacts of liberalized investments may be obtained. Assuming a five percent increase in net foreign direct investment over reference projections for the first three years of the Foreign Investments Act (FIA), half of this for the succeeding three years, and assuming that half these amounts are spent on gross domestic capital formation, real GDP will be 0.01 percent, 0.02 percent, and 0.05 percent higher than reference projections in the first three years of the FIA; and 0.08 percent, 0.11 percent and 0.13 percent during the next three years. The effects on other macroeconomic variables, such as employment, tax revenues, and the balance of payments are favorable. Inflation will initially accelerate, perhaps due to supply bottlenecks during the first two years, but will decelerate thereafter. The economic internal rate of return (EIRR) from increased GDP for the six year period is 56.9 percent. A sensitivity test using half the assumed increases in net foreign direct investment in the base case results in an EIRR of 22.4 percent. (See Annex E.)

2. Tariff Reduction and Restructuring

A more liberalized trade regime, characterized by few or nonexistent import controls and fairly uniform tariff protection, will foster greater competition, provide a set of market prices more closely reflecting opportunity costs and give emphasis to external markets and hence exports. Increased competition will buoy up the export competitiveness of Philippine products in the world market and increase export incomes of exporters and farmers. Such reform will translate into efficiency in the allocation of scarce economic resources among different sectors. Improvement in incomes will be ensured as more job opportunities will be provided to surplus labor. This is expected to lead to more sectoral and geographical growth balance, and push expansion in agricultural output and farmers' incomes.

Lower and less varied tariff rates will reduce the implicit tax on exports, arising from tariffs on imports. A more uniform tariff reform will increase prospects for a sustainable current account balance and relative macroeconomic stability in the medium term. Tariff simplification will facilitate customs administration and overall tax effort, improve the fiscal operations of government, and help maintain the country's international reserves position.

High tariff rates reduce demand for imports as well as foreign exchange, generally resulting in an overvalued domestic currency. This overvaluation encourages imports, discourages exports, and often is a major cause of balance of payments difficulties. A reduction in tariff rates will, therefore, increase import demand, lead to depreciation of domestic currency, and hence encourage exports.

A general equilibrium analysis of the impacts of the suspended E.O. No. 413, if fully implemented, indicates that aggregate real income will increase by 0.09 percent or by about ₱1.176 billion per year in 1991 prices. Since the upcoming tariff reform is expected to mirror, but less than fully, E.O. No. 413, and to take into account indirect adjustment costs, it is assumed that the real income increase from reform implementation will be three-quarters that estimated for E.O. No. 413, i.e., ₱878 million per year. If it is further assumed that only two-thirds of that amount may be expected during the first two years of reform implementation, three-fourths during the next two years, and the full value for the remaining 11 years of a fifteen year period, the resulting EIRR is 45.9 percent. With a slower pace of implementation (half of the base case real income increase in the first two years and two-thirds during the next two years), a lagged impact of eighteen months for each reform phase, and less deep impacts (half the impacts resulting from the preceding two assumptions), the resulting worst case EIRR is 16.4 percent. (See Annex E.) Once the revised E.O. 413 is available, if necessary to ensure economic worthwhileness, the estimation of benefits will be recalculated before funds are released and funds will only be released if the reform is found worthwhile.

Full attainment of the above benefits will be more likely with appropriate exchange rate and other macroeconomic policies. With complementary policies in place, benefits, in addition to the above ones, may be expected from reduced disparity in protection across individual sectors and industries. This reduction will enable movement to a set of market prices more closely reflecting opportunity costs, and help improve resource allocation to more efficient activities across sectors and geographical areas, and, ultimately, improve the country's prospects for sustainable output and employment expansion. The additional benefits, while difficult to measure, are potentially larger than those estimated above.

VII. PEPS PROGRAM

A. Objective

The objective of PEPS is to support the GOP in implementing significant policy reform actions that will assist in creating a business environment conducive for sustainable economic growth, led by the private sector.

B. Program Funding

PEPS funding of $79.828 million grant consists of a $39.828 million appropriated in FY 1990 and $40 million appropriated in FY 1991. The source of grant funds is Special Assistance Initiative (SAI) appropriations, specifically, the 25 percent "cash transfer" allowed under the FY 1990 and FY 1991 MAI for the Philippines.

C. Description

As shown in Table 1, PEPS will provide $79.0 million grant to the GOP to assist in the implementation of investment liberalization and tariff reduction and restructuring reform action. The monitoring, evaluation, nonfederal audit if appropriate, technical assistance, and policy study component of the program is estimated at $828,000 (details are provided provided in Section VIII.A.). Tables 2 and 3 illustrate program expenditures by fiscal year and activity component. The $828,000 activity component will involve contracting of expatriate and local professionals. Professional services of local expertise are essential because of their high caliber of professionalism and familiarization of policy reform agenda.

The balance of payments support component will be implementd using the cash transfer mechanism while the monitoring and evaluation components will be through A.I.D. direct contracts and the method of financing will be through A.I.D. direct payment or direct reimbursement. The technical assistance policy study funding will be jointly programmed by A.I.D. and NEDA using direct contracts for expatriate as well as Filipino expertise.

Table 1

Estimated Allocation of Program Funds

Component/ Method of Implementation	Method of Financing	Estimated Amount ($000)
Balance of Payments Support/ Sector Support	Dollar Trache release	$79,000
Monitoring, Evaluation, Nonfederal Audit, Technical Assistance, and Policy Studies/A.I.D. Direct Contract	A.I.D. Direct Payment or Direct Reimbursement	828
	Total	$79,828 1/

1/ Planned obligation in FY 1991 and expenditures in FY 1991 and 1992.

Table 2

Private Enterprise Policy Support Program
Summary Cost Estimates and Financial Plan
($000)

Program Elements	LC	FX	TOTAL
1. Balance of Payments Support	-	79,000	79,000
2. Policy Studies	57	204	261
3. Technical Assistance	54	172	226
4. Monitoring, Evaluation and Audit	118	145	262
Subtotal Program Elements	229	79,520	79,749
Inflation for Elements 2-4	12	27	39
Contingency for Elements 2-4	12	27	39
Total	253	79,575	79,828

Details are shown in Table 3.
Totals may not add up due to rounding.

Table 3
Private Enterprise Policy Support Program
Projection of Expenditures by Fiscal Year & By Program Element
FYs 1991-1993 (US$000)

FISCAL YEARS

PROGRAM ELEMENTS	1			2			3			GRAND TOTAL		
	LC	FX	Sub Total	LC	FX	Sub Total	LC	FX	Sub Total	LC	FX	TOTAL
1. Balance of Payments Support	-	39,500	39,500	-	39,500	39,500	-	-	-	-	79,000	79,000
2. Policy Studies	6	22	28	43	153	196	9	28	37	58	203	261
3. Technical Assistance	6	18	24	41	129	170	8	25	33	55	172	227
4. Monitoring, Evaluation and Audit	12	15	27	88	109	197	17	21	38	117	145	262
Total PEs	24	39,555	39,579	171	39,891	40,062	34	74	108	230	79,520	79,750
Inflation (for PEs 2-4)	-	-	-	9	20	29	3	8	11	12	28	40
Contingency (for PEs 2-4)	1	3	4	8	20	28	2	4	6	11	27	38
TOTAL	25	39,558	39,583	189	39,931	40,120	39	86	125	253	79,575	79,828

Inflation Rate Assumption - 5% per year
Contingency Assumption - 5%
Exchange Rate Assumption - U.S.$1.00 = ₱27.00

1. Rationale

The cash transfer will help the GOP in maintaining external stability while implementing needed reforms. The PEPS dollars will be used to service official non-military debt to the United States Government, the International Bank for Reconstruction and Development (IBRD), International Monetary Fund, International Development Association (IDA), and Asian Development Bank (ADB) or for other agreed uses. The use of PEPS dollars for a commodity Import Program (CIP) was considered not practical at this time, because the initiation of CIP would not likely increase total Philippine imports from the U.S. Instead, it would likely delay the program disbursement and impose additional management burden. The other funds will enable the GOP and A.I.D. to monitor implementation, conduct evaluation, finance nonfederal audit if appropriate, provide technical assistance necessary for the success of PEPS program, and finance policy studies to make PEPS progam relevant for structural reforms. The assistance is being provided to support reform progress towards private sector led, sustainable economic growth. More specifically, the assistance is intended to facilitate implementation of GOP initiated reform actions identified as essential to the objectives of the Multilateral Assistance Initiative/Philippine Assistance Program.

2. Balance of Payments Support

PEPS is a balance of payments (BOP) support activity. The rationale of PEPS is to encourage major trade and investment reforms which assist private sector led, sustainable growth and over time improve the BOP situation.

3. Monitoring and Evaluation

The dollars will be used to make payments to the United States Government, IBRD, IDA and ADB. A.I.D. approval of a schedule of payments is a condition precedent to disbursement of dollars for balance of payments support. This approval requirement will enable A.I.D. to ensure that the dollars will be disbursed as quickly as possible for eligible loan payments. To comply with the statutory provisions and regulations on tracking dollar uses, special arrangements will be undertaken to this effect (details on Section VIII). These arrangements will ensure that each dollar disbursement by the Central Bank of the Philippines is made directly and is trackable to the payee.

In addition, PEPS will fund technical services to monitor and evaluate the policy action through one or more direct A.I.D. contracts. Estimated level of effort for monitoring is six person months, while evaluation is expected to require eleven person months. Monitoring and evaluation will include, during the implementation of PEPS and at one or more points thereafter:

(i) An evaluation of progress toward attainment of the objectives of PEPS;

(ii) Identification and evaluation of problem areas or constraints which may inhibit such attainment;

(iii) Assessment of how such information may be used to help overcome such problems;

(iv) Evaluation, to the degree feasible, of the overall development impact of PEPS; and

(v) Recommendations on actions to further the objectives of PEPS.

Since the economic impact of each policy reform will be pervasive and will extend to all segments of the economy, in addition to examining changes in foreign investment, imports, and exports, impact evaluation will be performed using a general equilibrium approach. For the impact evaluation of increased foreign investment, Mission proposes to estimate its impact by utilizing a model, such as the NEDA-PIDS (Philippine Institute for Development Studies) macro-econometric model. The model is capable of estimating changes in real GNP and income, employment levels, balance of payments situation, etc., given the estimated net increases in the value of foreign investment, due to the law. For the impact evaluation of the revised E.O. 413, Mission proposes to use the Computable General Equilibrium model, such as the one designed by Dr. Ramon Clarete for the Tariff Commission. Given the revised tariff schedule, the model is capable of estimating, among others, real income effects of the tariff reform, which can be used to compute costs and benefits of the reform for the entire Philippine economy.

It should be noted that a complete impact evaluation of the agreed on policy reform will not be possible during the life of PEPS program (September 1991-September 1993) because of gradual implementation of the reform programs, the time needed for the private sector to respond, and further lags in the responses of the economy to the initial reactions. The Implementing Rules and Regulations of the Foreign Investments Act of 1991 will be issued in October 1991 for the 3 year transition period, during which the first negative list for the post transition period will be issued. Without knowing the regular negative list, which may not be issued until October 1994 and without allowing time for investors to respond, the overall impact of the foreign investment law on the Philippine economy will not be fully known. Similarly for the revised E.O. 413, a two to five year phase-in program will not be completed for some time. Additional time will be needed for importers and the economy to respond. Evaluation efforts, therefore, will have to be carried out in two stages: an initial evaluation toward the end of this program, and a more complete follow-on evaluation later, that would have to be funded under some other project or program.

4. Technical Assistance and Policy Studies

Lessons we learned in the SDP I implementation process include the need for technical assistance to implementing organizations and for continued policy reform studies to maintain momentum for further reforms. Therefore, to further the objectives of PEPS, we provide under PEPS a funding mechanism for technical assistance and policy studies related to the PEPS Program. Technical assistance will be provided to PEPS implementing and involved organizations, such as the Central Bank, NEDA, Department of Finance, Tariff Commission, BOI, Department of Trade and Industry, for resolving technical problems that will arise in the process of implementing agreed on PEPS related reforms. Policy studies will address PEPS related policy issues.

Although technical assistance and policy study issues are treated as separate topics, in actuality the distinction between the two is blurred. For instance, technical assistance can be provided to implementing organizations to undertake policy studies as well as to address technical problems associated with implementation. Out of $828,000, approximately $538,000 will be set aside for technical assistance and policy studies. Three broad areas of assistance are:

- Support for Foreign Investments Law Implementation, such as assistance for formulating, selecting, and evaluating negative and strategic industries lists; institutional arrangements and information systems to administer and monitor application of negative lists and strategic industries criteria; and institutionalization of foreign investments data base including public data access arrangements at the National Statistical Coordination Board.

- Trade Policy Reform Formulation, Monitoring, and Implementation, such as building government and private sector capacity to update and analyze trade policy indicators, including effective protection rates and domestic resource costs, economic effects of nontariff barriers, fiscal and the overall macroeconomic impacts of trade reform; and developing criteria for further trade liberalization, means of implementation, and evaluation of effects on the economy.

- Foreign Investments Promotion and Administration, such as study on transition from regulatory to promotional, including interim steps towards universal application investment regime of investment incentives; provide technical assistance for simplification of investment registration and reporting systems; and develop and identify need, if any, for additional investment policy changes and propose expedient means of implementation.

5. Grant Signing

Grant signing will be contingent on progress toward the policy reforms informally agreed upon between GOP and A.I.D. as policy reforms to be supported under PEPS.

6. Grant Disbursement

PEPS grant funds will be obligated, subject to the availability of funds, upon progress toward the agreed upon policy reforms. PEPS will be disbursed subject to USAID determination that the GOP is in compliance with all the appropriate terms and conditions of the PEPS agreement, following major policy actions marking in USAID judgment significant movement toward achievement of the PEPS objectives. $39.5 million will be provided on the first-fulfillment of either policy action and $39.5 million for the fulfillment of the remaining policy action. $828,000 will be obligated and used for PEPS monitoring, evaluation, nonfederal audit if appropriate, technical assistance and policy studies to support the basic objectives of the program. The total grant will be $79,828,000.

D. Restrictions

PEPS balance of payments support dollars will be used exclusively for official non-military debt service payments of the GOP to the United States Government, IBRD, IMF, IDA and ADB, unless otherwise agreed to. Before each disbursement, USAID will determine whether use for servicing U.S. Government debt is practicable to achieve PEPS purposes; if not, A.I.D./Washington (AA/APRE) has concurred in using PEPS dollar payments to service debt to the multilateral institutions.

VIII. IMPLEMENTATION PROCEDURES

Presented below are the planned implementation procedures. Details will be finalized upon consultation and agreement between the GOP and A.I.D.

A. Process

1. Policy Implementation Actions

USAID and the GOP have agreed on policy actions deemed critical to the attainment of MAI objectives and which will help ensure the attainment of a sustainable, private sector led growth and on the progress needed to release the BOP support. This understanding has been carefully recorded in USAID files.

2. <u>Dollars</u>

a. Disbursement by A.I.D.

Upon completion of agreed upon policy actions and of legal, administrative and other conditions precedent to disbursement of dollars to the GOP, A.I.D. will disburse in two tranches, $39.5 million each, for deposit in the separate account or accounts with the bank or banks specified by the GOP. Disbursement will be effected through the electronic funds transfer system.

b. The PEPS Dollar Special Account

The separate bank accounts into which disbursed dollars are deposited will be referred to collectively as the "PEPS Dollar Special Account". Funds deposited in this Account will not be commingled with funds from any other source. The Account will include and will be credited for any interest earned from funds held in this Account and any GOP refunds for unacceptable disbursements from the Account including interest on such GOP refunds. The Account will be used for the payment of prospective official non-military debt obligations in accordance with mutually agreed upon implementation plans for PEPS or for such other purposes as A.I.D. may agree to in writing. The GOP will disburse dollars in the PEPS Dollar Special Account in accordance with the Dollar Implementation Plan. All dollar disbursements will be drawn directly from the Account and paid directly to the payees listed in the implementation plan for the amounts specified on the given due dates.

3. <u>Monitoring and Evaluation</u>

USAID'S Office of the Program Economist (OPE) has been identified as the technical office that will coordinate overall project implementation, including monitoring and evaluation. Assistance will be provided by other USAID offices such as the Offices of the Legal Adviser, Financial Management, Development Resource Management, and Contract Services Office.

a. GOP Quarterly Dollar Disbursement Reports

Dollar disbursements from the Dollar Special Account will be monitored by USAID's Office of Financial Management through GOP quarterly reports, which may be amended and are due by the end of the following quarter. They will contain at least the following information: each disbursement from the PEPS Dollar Special Account with a specification for each disbursement of the payee and the amount and date of payment, together with certifications: (i) that the GOP has obtained and is maintaining documentation for each disbursement, and (ii) that all funds disbursed from the PEPS Dollar Special Account have been used in accordance with the terms of the PEPS Grant Agreement.

b. Reform Progress Report

The GOP will submit a progress report on the policy action or results to the Office of the Program Economist when it considers the trigger indicators to have been satisfied and at least three weeks in advance of the desired disbursement date. Joint consultations on progress will be held. If necessary, the GOP and A.I.D. will exchange additional information regarding the satisfaction of the policy actions.

c. Progress Monitoring

The Office of the Program Economist will arrange for third party reform progress monitoring of PEPS. Reform progress monitoring will obtain detailed periodic information on the policy reform, relevant economic causative and impact variables, and developments in the environment that can directly or indirectly affect GOP implementation progress. A team of professional contractors will be used with expertise as necessary in such fields as economic stabilization and structural adjustment, macroeconomics, international economics, public finance, quantitative modelling, and computer programming. Estimated cost of the activity is $90,000.

d. Evaluation Arrangements

The Office of the Program Economist will use professional services to evaluate PEPS. The evaluation will cover appropriateness of program design, review of implementation and attainment of PEPS objectives, quantitative and qualitative assessment of their impacts on the economy, implementation process and reporting evaluation, and implications for the design and development of future grants under PEPS. Professional services will be utilized with expertise in economic stabilization and structural adjustment, international economics, public finance, quantitative modelling and computer programming. Evaluation activities will be carried out in 1992, some months after tranche release and are estimated to cost $200,000.

4. <u>Technical Assistance and Policy Studies</u>

A.I.D. and GOP will jointly program the PEPS funding for technical assistance and policy studies. Both expatriates and Filipino professionals will be contracted to provide services. To assure the successful implementation of PEPS program, the technical assistance and policy study program should be put in effect as soon as possible. It is planned that technical assistance and policy study activities will extend beyond the time of cash transfers to maintain continuity of policy reform efforts of the GOP. Estimated costs of technical assistance and policy studies are $250,000 and $288,000, respectively. Technical assistance and studies that cannot be completed by September 30, 1993 will be financed under other projects and programs.

5. Audit

The Office of the Regional Inspector General for Audit (RIG/A) has primary responsibility for audits of A.I.D. financed assistance. If necessary, provision for financial or compliance audit is carried out through nonfederal audit. Any nonfederal audit is carried out through contracts with recognized independent public accounting firms, and is financed through funds set aside within the activity. Provision is being made for funding of nonfederal audit in this activity for monitoring, evaluation, technical assistance, and policy studies, if appropriate. The dollar special account will be for the payment of specified debt obligations. This involves a very limited number of transactions, which have traditionally been verified by financial analysts within the Office of Financial Management.

B. GOP Implementing Entities

1. Department of Finance

The Department of Finance (DOF), through its International Finance Group, will be the lead implementing agency for PEPS. It will be responsible for timely and satisfactory implementation of PEPS activities including GOP monitoring and reporting requirements. DOF will also be responsible, in coordination with the Central Bank of the Philippines (CB), and Bureau of Treasury (BTr), for the preparation and submission to A.I.D. of implementation plans for the disbursement of dollars from the PEPS Dollar Special Account, prior to such disbursement. In addition to the DOF, at least three other GOP entities will be involved directly in implementing PEPS.

2. National Economic and Development Authority

Together with DOF, the National Economic and Development Authority (NEDA), through the Director General and the National Development Office, will represent the GOP in dealing with A.I.D. in regard to PEPS, especially in regard to technical assistance and policy studies. It also will coordinate with DOF, BTr, CB, and other entities, as necessary, in conducting a joint review with A.I.D. on the satisfaction of policy actions or results described or similar to those described in Sections VI and VIII.

3. Central Bank of the Philippines

The Central Bank (CB), through its Treasury Department, Management of External Debt Department and the Department of Economic Research, will:

a. With the agreement of A.I.D. and in coordination with the BTr, establish a separate account or accounts with the designated bank or banks into which BOP support dollars disbursed by A.I.D. will be deposited (i.e., the PEPS Dollar Special Account).

b. In coordination with BTr, prepare and submit to A.I.D., prior to dollar disbursements, statements of names, branches and U.S. Federal Reserve Bank branch numbers of the bank or banks with which the dollars disbursed will be deposited, together with statements of amounts of dollars to be deposited in separate accounts with those banks.

c. Disburse dollars from the PEPS Dollar Special Account to be paid directly to the specified creditors.

d. Obtain, maintain and certify to A.I.D., that evidence for the agreed upon payments have been made from the Dollar Special Account.

e. Prepare and submit to A.I.D. the required quarterly dollar disbursement reports, together with the required certifications related to those reports.

f. Coordinate with NEDA and DOF, in obtaining and providing inputs to the reform progress report.

4. <u>Bureau of Treasury</u>

The Bureau of Treasury (BTr) will:

a. Provide to DOF and CB required information on official debt obligations to be paid.

b. Provide information, as necessary, to CB for the required dollar disbursement reports.

IX. CONDITIONS AND COVENANTS

The following are the conditions and covenants proposed for PEPS:

A. <u>Conditions Precedent to Initial Disbursment</u>

Prior to initial disbursement, the GOP will, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

1. The Department of Justice opinion that the Grant Agreement has been authorized in behalf of the GOP and constitutes a valid and binding GOP obligation;

2. Signature certification of authorized GOP representatives and designation of additional representatives; and

3. Agreement on the scopes of work for PEPS monitoring and evaluation services for implementation by A.I.D.

B. Conditions Precedent to Dollar Disbursement for BOP Support

Prior to each A.I.D. disbursement, the GOP will, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

1. The name(s), branch(es) and U.S. Federal Reserve Bank branch number(s) of depository banks for the dollar disbursement and the amount of dollars to be deposited therein;

2. The Dollar Implementation Plan; and

3. Notification of satisfactory completion of policy action.

Prior to disbursement of the first tranche of $39,500,000 in BOP assistance, A.I.D. will be satisfied that the Government of the Philippines has put into effect a significant tariff reform.

Prior to disbursement of a second $39,500,000 of BOP assistance, A.I.D. will satisfy itself that the Government of the Philippines has put into effect implementing regulations for the Foreign Investments Act of 1991 which significantly increased the areas of the economy open to foreign equity participation of up to 100 percent.

C. Terminal Date for Conditions Precedent to A.I.D. Dollar Disbursements

The terminal dates for the above conditions precedent for A.I.D. disbursement are 60-days after grant signing for initial disbursement; December 31, 1991 for the first BOP support disbursement; and September 30, 1992 for the second. A.I.D. may agree in writing to a later date or terminate the agreement by written notice to the GOP.

D. Other Special Covenants

1. U.S. Dollar Account

U.S. dollars being held in the account identified by the GOP shall not be commingled with funds from any other source except that the account shall include interest, if any, earned on funds held in the account. This Account shall also include any GOP refunds for unacceptable disbursements from the account including interest on such GOP refunds. The GOP shall promptly furnish to A.I.D. in form and substance satisfactory to A.I.D.:

a. Documentation evidencing deposits into the account, and

b. Monthly statements of balances held in the account, including interest, if any, earned on funds held therein.

2. Disbursements from U.S. Dollar Account

U.S. dollars held in the account referred to above shall be disbursed by the Central Bank of the Philippines in accordance with the implementation plan specified in Section VIII to pay debt service obligations of the GOP (other than obligations incurred for public corporations) to official non-military debt to the United States Government, the International Monetary Fund, the IBRD, the International Development Association, or the Asian Development Bank, in accordance with the schedules of payments provided pursuant to the appropriate section of the Grant Agreement. Funds held in the account shall be used solely for the foregoing purpose, or for such other purposes as A.I.D. and the GOP may mutually agree upon, until all funds held in said account have been disbursed from time to time for such purpose.

ANNEX A

REQUEST FOR ASSISTANCE

ANNEX A

Republic of the Philippines
DEPARTMENT OF FINANCE
Manila

REC

JUN 13 7 17 AM '91
0564
USAID/C&R

June 11, 1991

Mr. Malcolm Butler
Mission Director
U.S. Agency for International
Development
1680 Roxas Blvd.
Manila

Dear Mr. Butler:

In August 1990, the National Economic and Development Authority (NEDA) conveyed a request for a $39.828 million grant assistance for the Private Enterprise Policy Support Program (PEPSP) in behalf of the Government of the Philippines (GOP) to support the Government's efforts towards private sector-led sustainable growth.

The GOP's need for grant assistance has substantially increased especially now that the Government is experiencing budgetary constraints. In this connection, we wish to convey our Government's request for an additional $40 million in MAI funds for a total program amount of $79.828 million for PEPSP.

We trust your Government would give favorable consideration on our request.

Very truly yours,

JESUS P. ESTANISLAO
Secretary

54

ANNEX B

REDELEGATION OF AUTHORITY FOR PAAD DEVELOPMENT AND AUTHORIZATION

ANNEX B-1

ACTION: AID-6 INFO: AMB DCM AA ECON/10

VZCZCML0028 10-MAY-90
RR RUEHML
DE RUEHC #8492/01 1291309
ZNR UUUUU ZZH
R 091309Z MAY 90
FM SECSTATE WASHDC
TO AMEMBASSY MANILA 8616
BT
UNCLAS SECTION 01 OF 02 STATE 148492

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: PRIVATE ENTERPRISE POLICY SUPPORT PROGRAM (PEPS) (492-0475), APPROVAL OF PROGRAM ASSISTANCE INITIAL PROPOSAL (PAIP)

DIV	ACT	INF
OD		✓
PE	–	✓
OLA	✓	
PESO	✓	✓
CSO		✓
DRM	✓	✓
EXO		
A/EXO		
PROC		
PER		
C&R		
DMO		
CMD		
GSO		
TRV		
OFM		✓
OCP		
ORAD	–	
OPHN		
OFFPVC		
RIG/A		
RIG/I		
DUE DATE		
5-15-90		

1. SUMMARY. AA/ANE HEREBY APPROVES THE PAIP AND DELEGATES TO THE MISSION DIRECTOR AUTHORITY TO APPROVE THE PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD) SUBJECT TO THE GUIDANCE PROVIDED IN THIS CABLE. DUE TO THE NEED FOR FURTHER CLARIFICATION OF THE ISSUES OUTLINED BELOW, A SUMMARY OF THE NEXT TO FINAL REFORM PACKAGE, ALONG WITH JUSTIFICATION OF ECONOMIC WORTH, AND A TIME FRAME SHOULD BE SUBMITTED FOR AID/W REVIEW PRIOR TO PAAD AUTHORIZATION IN THE FIELD. THIS CABLE ALSO REQUESTS SUBMISSION OF SUPPLEMENTARY INFORMATION PRIOR TO SUBMISSION OF THE CN. END SUMMARY.

2. THE PROJECT REVIEW COMMITTEE (PRC) MET APRIL 19 TO REVIEW THE PAIP WITH USAID REPRESENTATIVES PAUL DEUSTER AND JOHN PATTERSON. THE BUREAU COMMENDS THE MISSION FOR THE HIGH DEGREE OF FIT BETWEEN ITS PROPOSED PEPS PROGRAM AND THE BUREAU'S OPEN MARKETS/OPEN SOCIETIES STRATEGY. THE FOLLOWING ISSUES AND CONCERNS WERE RAISED BY THE PRC FOR THE PAAD DESIGN.

3. THE MISSION NEEDS TO DISTINGUISH CLEARLY THE POLICY AREAS IN ITS PEPS PROGRAM FROM THOSE OF THE SUPPORT FOR DEVELOPMENT PROGRAM (SDP) AND OF OTHER DONORS SUCH AS THE WORLD BANK. THE BUREAU SUGGESTS THAT THE MISSION DEVELOP A MATRIX SHOWING DISTINCTIONS AND/OR COMPLEMENTARITY BETWEEN THE PEPS REFORM TARGETS AND THOSE OF SDP AND OTHER DONOR REFORM PROGRAMS WITH A SIMILAR FOCUS. WHILE THE BUREAU ACKNOWLEDGES THAT ESTABLISHING CAUSALITY BETWEEN AID ACTIONS AND PHILIPPINE REFORM IS DIFFICULT, A MATRIX WILL HELP TO TRACE CORRELATION AND HELP TO DEMONSTRATE THAT OUR POLICY AREAS ARE ADDITIONAL/REINFORCING/COMPLEMENTARY TO THOSE OF OTHERS.

4. THE BUREAU IS SUPPORTIVE OF THE THREE PEPS TARGET REFORM AREAS-- APPROPRIATE MARKET-BASED EXCHANGE RATE, ACCELERATED PRIVATIZATION, AND GREATER PROMOTION AND LESS REGULATION OF INVESTMENT BY THE BOARD OF INVESTMENT

ANNEX B-3

AND VALUES ASSIGNED TO THEM. HOWEVER, THE BUREAU EMPHASIZES THAT IF THE FUNDS ARE TRANCHED, THE MISSION SHOULD NOT REPEAT NOT RELEASE THE FIRST TRANCHE UNLESS THE GOP HAS IMPLEMENTED SOME PRE-DETERMINED, SPECIFIED, STEPS OR PORTION OF REFORM(S). IN THE EVENT THAT THE FUNDS ARE NOT TRANCHED, THE MISSION ALSO SHOULD DEVELOP CRITERIA AGAINST WHICH TO DETERMINE PAYMENT OF THE ENTIRE CASH TRANSFER AMOUNT. A TOTAL PAYMENT LESS THAN THE US DOLLARS 39.828 MILLION MAY BE APPROPRIATE DENDING ON THE REFORM PACKAGE IMPLEMENTED. BAKER
BT
#8492

NNNN

53

ACTION: A D-3 INFO: AMB DCM AA ECON RA/B RECEIVED

VZCZCML0203
PP RUEHML
DE RUEHC #9192/01 1612020 JUN 13 8 30 AM '91 11-JUN-91
ZNR UUUUU ZZH
P 102012Z JUN 91
FM SECSTATE WASHDC USAID/O&R
TO AMEMBASSY MANILA PRIORITY 8362
BT
UNCLAS SECTION 01 OF 02 STATE 189192

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: PRIVATE ENTERPRISE POLICY SUPPORT (PEPS) PROGR (492-0457) PAIP APPROVAL INCREASE AND APPROVAL OF POLIC AGENDA

REFERENCES: A. 90 STATE 148492; B. MANILA 4169; C. FAX BUTLER TO DEUSTER, 4/12/91; D. 87 STATE 325792 OF 20 OCT 87; AND E. 90 STATE 208563 OF 27 JUN 90

1. SUMMARY: AA/APRE APPROVES INCREASING THE FUNDING OF PEPS FROM THE PROGRAM ASSISTANCE INITIAL PROPOSAL (PAIP) LEVEL OF 39,828,000 DOLLARS IN FY 1990 TO ADD 40 MILLION DOLLARS OF FY 1991 FUNDS FOR A TOTAL OF 79,828,000 DOLLARS. WE AGREE WITH POLICY AGENDA AND COMMEND MISSIO EFFORT TO DEVELOP ECONOMIC RATE OF RETURN FROM POLICY BASED ASSISTANCE. SUBJECT TO THE UNDERSTANDINGS AND GUIDANCE BELOW, AA/APRE ALSO APPROVES THE MODIFIED POLIC AGENDA AND PROCEDURE FOR DOCUMENTING ACHIEVEMENT OF SIGNIFICANT REFORMS PROPOSED IN REFERENCE C. END SUMMAR

2. REVIEW: ENE BUREAU PROJECT REVIEW COMMITTEE (PRC) M WITH MISSION PROGRAM ECONOMIST PAUL DEUSTER APRIL 22 TO REVIEW THE POLICY AGENDA AND PROCEDURE FOR OBLIGATION AN RELEASE OF PEPS FUNDS PROPOSED IN REF C. ALTHOUGH THIS PROCEDURE IS A DEPARTURE FROM PAST PRACTICE IN PHILIPPIN POLICY REFORM RELATED ASSISTANCE, THE PRC CONSIDERED IT WORTH TRYING. HOWEVER, WE WILL CONTINUE THE STANDARD PROCEDURES FOR OTHER PROGRAM ASSISTANCE.

3. THE POLICY AGENDA: THE PRC AGREED WITH THE MISSION THAT THE TARIFF RESTRUCTURING AND INVESTMENT LIBERALIZATION REFORMS PROPOSED ARE IN KEEPING WITH AID AND MAI OBJECTIVES. WITH RESPECT TO BOTH REFORMS, WE WIS TO COMMEND THE MISSION ON ITS ATTEMPT TO DEVELOP ECONOMI RATE OF RETURN ESTIMATES TO CHARACTERIZE PAY-OFF FROM POLICY BASED ASSISTANCE PROGRAMS. YOUR EFFORTS SERVE AS AN EXAMPLE THAT MERITS REPLICATION ACROSS A.I.D. AS A WHOLE. KEEP UP THE GOOD WORK.

4. THE PEPS PROCEDURE: OUR UNDERSTANDING OF THE PROCEDURE PROPOSED FOR PEPS IN REF C AND REVIEW WITH DEUSTER IS AS FOLLOWS:

5. CONGRESSIONAL NOTIFICATION (CN): WE HAVE SUBMITTED CN FOR PEPS AS REVISED WITH DEUSTER (COPY FAXED TO DEUSTER). WE WILL USE THE DRAFT MEMORANDUM OF DISCUSSIONS (REF C) TO ANSWER ANY HILL INQUIRIES ABOUT THE POLICY AGENDA AND PROCEDURES FOR PEPS.

6. ACTION REQUESTED: THE MISSION SHOULD ADVISE US IF OUR UNDERSTANDING OF THE PROPOSED PEPS POLICY AGENDA AND PROCEDURE IS INCORRECT.

7. SPECIAL ACCOUNT: IN PROVIDING FOR A DOLLAR SPECIAL ACCOUNT IN THE PAAD, THE MISSION SHOULD BE GUIDED BY REFS D AND E. REF D, SECTION 5 (C) (IV) REQUIRES THAT USE OF SPECIAL ACCOUNT DOLLARS "FOR SERVICING DEBT OWED TO MULTILATERAL DEVELOPMENT BANKS AND THE IMF IS SUBJECT TO PRIOR CONCURRENCE OF THE APPROPRIATE REGIONAL ASSISTANT ADMINISTRATOR." PRC REVIEW WITH DEUSTER AGREED THAT THE PREFERRED ALTERNATIVES OF USING THE DOLLARS FOR U.S. IMPORTS OR DEBT TO THE U.S. ARE NOT PRACTICABLE OR ARE INCONSISTENT WITH OUR OBJECTIVES UNDER CURRENT CIRCUMSTANCES. ACCORDINGLY, THE AA/APRE CONCURS IN USE OF THE SPECIAL ACCOUNT DOLLARS FOR MULTILATERAL DEBT SERVICE. HOWEVER, THE MISSION SHOULD REVIEW CIRCUMSTANCES AT THE TIME OF THE PAAD AND BEFORE EACH DISBURSEMENT TO DETERMINE WHETHER USE OF SPECIAL ACCOUNT DOLLARS FOR IMPORTS FROM THE U.S. OR FOR U.S. DEBT IS APPROPRIATE AT THAT TIME.
BAKER

BT
#9192

NNNN

ANNEX C

NONPROJECT ASSISTANCE AND STANDARD ITEM CHECKLISTS

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to the eligibility of countries to receive the following categories of assistance: (A) both Development Assistance and Economic Support Funds; (B) Development Assistance funds only; or (C) Economic Support Funds only.

A. COUNTRY ELIGIBILITY CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUND ASSISTANCE

1. **Narcotics**

a. **Negative certification** (FY 1991 Appropriations Act Sec. 559(b)): Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances 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

b. **Positive certification** (FAA Sec. 481(h)). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly

Philippines is not a "major illicit drug-producing country" or a "major drug-transit country."

54

affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government):

(1) does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement?

(2) has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (b) the vital national interests of the United States require the provision of such assistance?

c. Government Policy (1986 Anti-Drug Abuse Act of 1986 Sec. 2013(b)). (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

2. **Indebtedness to U.S. citizens** (FAA Sec. 620(c): If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

No

3. **Seizure of U.S. Property** (FAA Sec. 620(e)(1)): If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

No

4. **Communist countries** (FAA Secs. 620(a), 620(f), 620D; FY 1991 Appropriations Act Secs. 512, 545): Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable

No

61

restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?

5. **Mob Action** (FAA Sec. 620(j)): Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property?	No
6. **OPIC Investment Guaranty** (FAA Sec. 620(l)): Has the country failed to enter into an investment guaranty agreement with OPIC?	No
7. **Seizure of U.S. Fishing Vessels** (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 vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made?	(a) No (b) No
8. **Loan Default** (FAA Sec. 620(q); FY 1991 Appropriations Act Sec. 518 (Brooke Amendment)): (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (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 FY 1990 Appropriations Act appropriates funds?	
9. **Military Equipment** (FAA Sec. 620(s)): If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment?	Yes, taken into account by the administrator at the time of approval of Agency OYB.

(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.)

10. **Diplomatic Relations with U.S.** (FAA Sec. 620(t)): Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? — No

11. **U.N. Obligations** (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 A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.) — Not in arrears

12. **International Terrorism**

a. **Sanctuary and support** (FY 1991 Appropriations Act Sec. 556; FAA Sec. 620A): Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons? — (a) No (b) No

b. **Airport Security** (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

13. **Discrimination** (FAA Sec. 666(b)): Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?	No
14. **Nuclear Technology** (FAA Secs. 669, 670): Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? 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? If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)	No
15. **Algiers Meeting** (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. on Sept. 25 and 28, 1981, and did it fail 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.)	No
16. **Military Coup** (FY 1991 Appropriations Act Sec. 513): Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance?	No

17. **Refugee Cooperation** (FY 1991 Appropriations Act Sec. 539): Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

Yes

18. **Exploitation of Children** (FY 1991 Appropriations Act Sec. 599D, amending FAA Sec. 116): Does the recipient government fail to take appropriate and adequate measures, within its means, to protect children from exploitation, abuse or forced conscription into military or paramilitary services?

No

B. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO DEVELOPMENT ASSISTANCE ("DA")

1. **Human Rights Violations** (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

2. **Abortions** (FY 1991 Appropriations Act Sec. 535): Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, 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?

No

COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO ECONOMIC SUPPORT FUNDS ("ESF")

Human Rights Violations (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 President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?	No

C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

1. **Economic and Political Stability** (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?	Yes
2. **Military Purposes** (FAA Sec. 531(e)): Will this assistance be used for military or paramilitary purposes?	No
3. **Commodity Grants/Separate Accounts** (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
4. **Generation and Use of Local Currencies** (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 at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?	N/A
5. **Cash Transfer Requirements** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 575(b)). If assistance is in the form of a cash transfer:	
a. **Separate account:** Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds?	Yes

b. **Local currencies:** Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements?	No local currencies are generated under the program.
c. **U.S. Government use of local currencies:** Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available?	N/A
d. **Congressional notice:** Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?	Yes CN still on hold

DRAFTER:GC/LP:EHonnold:4/11/91:2169J

ANNEX D

CERTIFICATION PURSUANT TO UTILIZATION OF GRAY AMENDMENT ORGANIZATION

ANNEX D

CERTIFICATION PURSUANT TO UTILIZATION OF GRAY AMENDMENT ORGANIZATIONS

I, MALCOLM H. BUTLER, principal officer of the Agency for International Development in the Philippines, have fully considered the potential involvement of small and/or economically and socially disadvantaged enterprises, and do hereby certify the U.S. technical assistance required under the program will be provided through open competition, with special consideration given to firms submitting proposals which utilize the resources of small and disadvantaged firms. In addition, for program evaluation, efforts will be made to award contracts to small and/or disadvantaged firms. My judgment is based on the recommendations of the Program and Mission Review Committees.

MALCOLM H. BUTLER
Director, USAID/Philippines

10

ANNEX E

ECONOMIC ANALYSIS OF PEPS SUPPORTED REFORMS

ECONOMIC ANALYSIS OF PEPS SUPPORTED REFORMS

Foreign Investment Liberalization

1. Background

The President signed into law the Foreign Investment Act (FIA), i.e, Republic Act no. 472: "An Act to Promote Foreign Investments, Prescribe the Procedures for Registering Enterprises Doing Business in the Philippines, and for Other Purposes," on June 13, 1991. The FIA should have been in effect by the end of June and the implementing rules and regulations (IRR) will be issued within 120 days of the FIA's effectivity or by end October 1991. The IRR are expected to be in effect by mid-November.

The FIA has an initial transitory period of three years during which full foreign equity participation will be allowed in export industries, where industries are defined as those exporting at least 60 percent of production, and in all economic activities producing for the domestic market excluding banking and financial institutions, areas restricted under the Philippine Constitution and nationalization laws, and other minor exceptions. Within 18 months of the FIA effectivity, the law provides that the GOP will formulate and publish a list of industries strategic to the development of the economy. The list will specify, as a matter of policy, and not as a legal requirement, the desired equity participation by Government and/or private Filipino investors in each strategic industry. After the transitory period, a regular negative list will be implemented and which will be reviewed and revised "not more often than once in two years." The regular negative list will include most of the exclusions under the transitory list with provisions for amendments and additional exclusions for investment activities which meet all of the following criteria:

a) The industry is controlled by firms owned at least sixty percent by Filipinos;

b) Industry capacity is ample to meet domestic demand;

c) Sufficient competition exists within the industry;

d) Industry products comply with Philippine standards of health and safety or, in the absence of such, with international standards, and are reasonably competitive in quality with similar products in the same price range imported into the country;

e) Quantitative restrictions are not applied on imports of directly competing products;

f) The leading firms of the industry substantially comply with environmental standards; and

g) The prices of industry products are reasonable.

2. Approach Used for FIA Initial Economic Impact Assessment

In the absence of the IRR and the difficulty of obtaining quantitative outcome indicators of the FIA for foreign investment, the approach used in this analysis is to assume some levels of increased direct foreign investment above official projected levels in the next several years with part of these increases expected to increase domestic investment expenditures, and determine their impacts on output, i.e. real gross domestic product (GDP).

The counterfactual analysis is made possible by using the 1989 version of the Philippine Institute for Development Studies (PIDS) and the National Economic and Development Authority (NEDA) annual macroeconometric model.1/ The 1989 version of the PIDS-NEDA model is based on a combination of classical, Keynesian, structuralist and monetarist concepts. The model determines output from the supply side. Aggregate demand also plays an important role in determining output. Supply bottlenecks are taken into account as affecting certain sectors of the economy. Money has a prominent role in determining prices. The mixture of concepts reflects current developing country realities

1/ Winnie M. Constantino, Josef T. Yap, Ronald Q. Butiong and Aleli S. dela Paz, "The PIDS-NEDA Annual Macroeconometric Model Version 1989: A Summary," Working Paper Series No. 90-13, Philippine Institute for Development Studies, 1990.

17

in the structure of the model. For instance, in developing economies, especially those which are agriculture-based, it is more appropriate to highlight the role of aggregate supply in the determination of output to capture the effects of supply bottlenecks. Other institutional constraints are also reflected in the model such as a nonmarket clearing wage arising from persistent unemployment and underemployment. Chronic budget deficits and other macroeconomic imbalances are corrected with appropriate fiscal and monetary policies. Added to this is the effect of policy on economic activity through the influence on aggregate demand.

Interaction of aggregate demand and supply will not necessarily result in full employment equilibrium. In the context of developing economies, it is not imperative that macroeconomic balance be achieved by automatic price adjustments. This immediately rules out the market clearing process inherent in the classical system, noted in the model via the specification of "fixprice" and "flexprice" sectors. The flexprice sector is assumed to have an adjusting price while the fixprice sector is assumed to have an adjusting output level. The former usually pertains to agriculture while the latter to industry.

The model consists of 114 behavioral and structural equations and 53 identities. It is divided into four major blocks: (1) the real sector consisting of production, expenditure, employment, wages and prices, (2) the fiscal sector, (3) the financial sector, and (4) the external sector.

The linkage between the production sector and expenditure sector comes mainly in the form of aggregate expenditure categories appearing as arguments in the demand functions in the production sector. Output as determined then enters into the employment equation. The financial and real sectors interact through the interest rate and through the price variables as some monetary aggregates affect prices. The fiscal sector is essentially exogenous in the basic model, specifically with respect to government expenditures. However, tax revenues are linked to the level of economic activity or output. To the extent that it is monetized, the government budget deficit serves as the link with the financial sector. The external sector links with the rest of the economy through the financial variables, specifically, net foreign assets. This is in addition to the link between the expenditure/production side, i.e., exports and imports with the current account components.

Because many exogenous variables in the model are policy-oriented, it is particularly suitable for short term policy analysis. It should be noted however, that the statistically estimated structural parameters of the economy, given the model's functional specification, are defined by the estimation period, covering 1968 to 1987 or subperiods thereof. In this respect, it is not appropriate to use the model if the exercise involves policy changes aimed at changes in the structure of the economy itself.

3. Economic Analysis of Foreign Investment Act[2/]

The most direct effect of the FIA is on the level of net direct foreign investment that enters the balance of payments account and on aggregate expenditure through total gross domestic capital formation (GDCF). Subsequent indirect effects will be on other macroeconomic variables. The exact magnitude of the expected change in the level of foreign direct investment (FDI) is truly difficult to pin down. However, interviews with some members of various foreign chambers of commerce and other members of the international business community currently engaged in the Philippines indicate that the direction of the change would be positive. Also, anecdotal reports on the adoption of a short negative list of nonpermissible foreign investments in Indonesia in May 1989 suggests that there has been a significant increase in the level of FDI inflows as a result of the liberalized investment climate in that country.

In the following analysis, it is assumed that the increase in FDI over GOP projected reference levels will be 5 percent in the first three years of implementation when the transitory provision would be effective and increases in FDI over projected levels of half that amount in the next three years. This is a conservative estimate of the positive response expected from the FIA. The increased GDCF expenditure is assumed to be only half of the assumed increase in net direct foreign investment will be spent on GDCF. Counterfactual simulation using the PIDS-NEDA macroeconometric model is then performed. Reference FDI projections used are those of the Central Bank of the Philippines. Assumptions for other exogenous variables are the latest available used by the GOP in its forecasting exercises.

2/ Based on a note prepared by Dr. Rosario G. Manasan

If the net FDI inflow were to grow by 5 percent higher than the projected reference value in the first three years and 2.5 percent in the next three years of implementation of the 1991 FIA, the counterfactual exercise reveals that real GDP will be 0.01 percent, 0.02 percent and 0.05 percent higher than the projected value in the first, second and third year, and 0.08 percent, 0.11 percent and 0.13 percent in the next three years. Because of cumulating effects due to dynamic and/or lagged responses, the impact on real GDP in the next three years is larger than that in the first three years even if the increase in FDI (and GDCF) is lower in the latter period. On the other hand, the full time equivalent total employment level is projected to rise by 0.02 percent, 0.05 percent, and 0.06 percent relative to reference values in the first three years.

The effect of the policy change on total tax revenues is positive and the fiscal deficit declines relative to reference levels by 0.28 percent, 0.70 percent and 0.72 percent in the same period. In turn, this leads to a reduction in the rate of inflation of 0.23 percent and 0.73 percent in the third and fourth years. It may be noted that the inflation rate actually goes up relative to reference levels in the first two years (by 0.41 percent and 0.53 percent) due perhaps to some supply bottle necks in those years.

The impact of the liberalized investment regime on the overall balance of payments position is positive (3.13 percent, 2.61 percent and 2.02 percent in the first three years) although the effect on the current account is negative (-0.26 percent, -0.53 percent and -0.60 percent). This might be explained by an increase in capital equipment importation as a result of increased FDI. However, the direct impact on the BOP capital account swamps the indirect effect on the current account.

PEPS funds of $40 million, or valued at the shadow exchange rate, ₱1.44 billion, may be thought of as the economic cost of the reform. The change in output (GDP) arising from the implementation of the FIA represents the benefits. With a five percent increase in FDI over reference projections, the resulting economic internal rate of return (EIRR) is 56.9 percent, as shown in the table below.

For a sensitivity test, two cases are considered: an assumed doubling of the expected increases in FDI, and a reduction by half of the expected increases in the base case. In both cases, the increase in real GDCF also is half the increase in FDI. The results also are shown in the table below. If a 10 percent increase in net FDI inflows over projected reference values is assumed, the counterfactual simulation shows a 0.03 percent, 0.05 percent and

0.11 percent increase in real GDP over reference projections in the first three years. The resulting EIRR is 124.7 percent. The second alternative case, or the "worst" scenario, shows a 0.006 percent, 0.007 percent and 0.025 percent increase in real GDP over projected values in the first three years, with an EIRR of 22.4 percent. The results for the other variables are in the same directions as discussed in the base case of a five percent change in FDI for the first three years.

Year	Cost of Reform	Benefits: Increase in Real GDP		
		Base Case	Alternative Scenarios I	II
	(in million pesos, 1991 prices)			
1991	-1,440	183	420	79
1992		243	646	92
1993		749	1,582	355
1994		1,167	2,404	567
1995		1,675	3,407	823
1996		2,082	4,213	1,028
EIRR (%)		56.9	124.7	22.4

Tariff Reform

1. Background

The GOP issued in July 1990 Executive Order No. 413 (E.O. No. 413) to implement the next step of its tariff reform program. E.O. No. 413 provided for reducing the number of tariff categories from seven to four, reducing the maximum tariff level from 50 percent to 30 percent and increasing the minimum tariff level from zero to three percent. The E.O. in its entirety would have taken effect in September of the same year. However, Philippine Congress and certain sectors in the business community raised concerns and called for suspension of the E.O.'s implementation until sufficient consultations with interested parties were completed and the specific concerns were addressed. The Executive Branch suspended implementation of E.O. No. 413 just before it was to be effective to allow for fuller consultations with business and the Congress. Those consultations have now been completed and the issuance of a revised E.O. No. 413 is expected anytime.

2. Assessment of E.O. No. 413

Estimated effective protection rates as a result of E.O. No. 413 indicate both reduced and more-neutral protection across sectors. Clarete[1] estimates that E.O. No. 413 would have reduced the simple average effective protection rate from 70.46 percent to 43.01 percent or by 36 percent for all sectors, by 40.8 percent for processed agriculture, 39.4 percent for industry and 26.4 percent for primary agriculture. The Philippine Institute for Development Studies (PIDS) and the Tariff Commission calculated weighted average effective protection rates (excluding effects of quantitative restrictions) to decline from 22 percent to 17 percent or by 23 percent for all sectors, by 50 percent for the agricultural sector, by 25 percent for all importables, and by 28.3 percent for manufacturing sector importables.

Clarete conducted a counterfactual analysis of the economic impacts of E.O. No. 413, using a general equilibrium approach. The model used is for a small open economy. The country is represented as a price taker in world markets. Local products are import substitutes and exported to the world at their going world prices. They are produced using a production technology represented by production functions in which the arguments are the various factors and inputs of production. Products which are locally used become intermediate inputs in production and used by consumers for personal consumption and investment. Consumers in the model are featured as endowed by the various resources of the economy. They earn their personal income from selling the services of these resources to the various producers in the economy. In turn, these incomes are spent on personal consumption. Producers then earn cash receipts from selling their products which they in turn use to hire the services of resources or factors of production.

A transformation function is applied to the production of local import substitutes and exportables. A transformation function is specified to take into account, that in each sector of the economy, local producers have to decide on how to allocate resources between import substitutes and exportables. This decision is guided by a parameter calleo the elasticity of product transformation, which is fixed for purposes of the model.

1/ Dr. Ramon L. Clarete, "A General Equilibrium Analysis of EO 413 Tariff Reforms," 1991 (unpublished paper)

A transformation function is applied to the production of local import substitutes and exportables. A transformation function is specified to take into account, that in each sector of the economy, local producers have to decide on how to allocate resources between import substitutes and exportables. This decision is guided by a parameter called the elasticity of product transformation.

Import substitutes and imports are assumed to be imperfect substitutes of each other. Under this specification, goods are distinguished by place of origin. Although assumed to be different, they are close substitutes for each other. The substitution possibilities between them are defined by a set of parameters called Armington elasticities. For modelling purposes, a set of so-called aggregate consumer goods are defined which take as inputs the imports and their local substitutes. These aggregate consumer goods are the ones purchased by producers for use as intermediate inputs and by consumers for final consumption.

Consumers are represented by an aggregate representative consumer. The representative consumer derives his income from wages, earnings from capital and rent from fixed factors of production. Using his income, the consumer purchases exactly the same set of goods as producers. The goods purchased are used as inputs in producing the consumer's well being indicator, i.e., the utility function. Substitution is allowed among the consumer goods. The scope of such a substitution process is given by the elasticity of substitution - which is assumed to be equal to one in the model. The government draws its income mainly from tariff and excise revenues and spends these on the consumer goods as in the case of private consumers. Other taxes are features in the model as incomes given by consumers to the government in a way which does not distort the relative prices in the economy.

The general equilibrium conditions in the basic model consists of the following:

(a) zero profit conditions in all production activities in the economy;

(b) market clearing conditions for all goods and services produced; and

(c) balance of payments condition.

These conditions total 9N+7 equations distributed as follows, where N is the number of sectors. There are 4N+2 zero profit conditions, 5N+4 market clearing conditions, and the balance of payments condition. This system of equations is solved for the following endogenous variables: 4N+2 production activity levels, 5N+4 prices, and the exchange rate.

The specific computable general equilibrium (CGE) model is that of the Philippine Tariff Commission which is defined specifically for analyzing tariff policies. The model has 20 sectors based on the 1983 and 1985 Philippine input-output tables. The choice of these sectors is based on the Philippine Tariff and Customs Code. The Code has about 96 chapters altogether. However, the computer software used is unable to solve the model at this scale. Thus the chapters were aggregated to form the 20 sectors.

The model has three factors namely, labor, variable capital and fixed factors. Labor is assumed to be fully mobile and homogeneous. Variable capital is represented by the amount of capital which replaces the stock worn out during the production process in a given period. The fixed or sector specific factors is a composite of all the other factors which in the short run is assumed to be unable to move to other sectors.

Clarete's analysis of E.O. No. 413 estimates that real output will increase b .45 percent from the reference case, domestic resource use by .15 percent, imports by 1.92 percent, and exports by 2 percent. Most prices of factors of production, producer and consumer prices, and imports will decline. Since th exchange rate is used as the numeraire in the model, the prices of exported goods will not change. Private sector real income will increase by 1.2 percent while that of government will decrease by 8.55 percent. Aggregate real income will increase by 0.09 percent or by 900 million pesos in 1989 prices.

3. Economic Analysis of the Present Tariff Reform

Since it is expected that the revised E.O. No. 413 when issued and fully implemented will mirror the results of E.O. No. 413, but to a somewhat lesser degree, the economic analysis of the former may be based on that for the latter. Clarete's real income increase estimate is equivalent to ₱1.176 billion pesos or $39 million in 1991 prices. This estimate may be understate since the analysis, while using a general equilibrium approach, does not reflect the dynamic adjustment into a more competitive and efficient production structure. On the other hand, the estimate results from certain assumptions on relatively more flexible prices, which may not be actually the case, such as in wages and the exchange rate. Also, there are longer term costs of adjustment, such as displacement of factors of production and the required new investments in capital and technology. In this sense, the estimated real income increase could be overstated. For purposes of this economic analysis, it appears reasonable to assume, especially since the revised E.O. is expected to be less bold, that the estimated real income increase will be less, e.g. three-fourths of $39 million or $29.25 million per year as a result of full implementation of the revised, weaker E.O. No. 413.

It is expected that the revised E.O. No. 413 will be implemented over two two-year stages beginning in September, 1991. For the base case scenario, it is assumed that two-thirds of the real income increase of $29.25 million or ₱877.5 million will be realized during the first two years of reform implementation, and three-fourths during the next two years. The full increase could take place indefinitely. However, only a fifteen year economic life of the reform is used. The direct economic cost of the reform is the $40 million of PEPS assistance or ₱1.44 billion, adjusted for the shadow exchange rate. The base case economic internal rate of return (EIRR) is calculated to be 45.9 percent.

Sensitivity analysis uses five different scenarios, the results of which are shown in the table below. The first alternative scenario assumes a slower pace of implementation, where only half of the annual real income increase takes place in the first two years and two-thirds in the next two years. The second scenario assumes that only the first phase of the tariff reform is implemented, with two-thirds of the real income increase continuing for the fifteen year period. The third scenario is the same as the base case with a lagged effect of eighteen months for each phase of reform action. The fourth scenario assumes that impacts are not as deep, e.g. real income increases are only half of that of the base case. The last scenario, or the "worst" case, combines the assumptions used for the first, third and fourth scenarios, .i.e, a slower pace of implementation, a lagged impact of eighteen months for each phase, and less deep impacts.

Year	Base Case	Alternative Scenarios I	II	III	IV	V
		(in million pesos, 1991 prices)				
0	-1,440	-1,440	-1,440	-1,440	-1,440	-1,440
1	579	439	579	0	290	0
2	579	439	579	290	290	110
3	658	579	579	579	329	219
4	658	579	579	619	329	254
5	878	878	579	658	439	290
6	878	878	579	768	439	364
7-15	878	878	579	878	439	439
EIRR (%)	45.9	40.4	40.0	31.5	23.9	16.4

ANNEX F

INITIAL ENVIRONMENTAL EXAMINATION

ANNEX F

TEL No. Aug 8.91 13:08 No.015 P.02

*** FAX CENTER MESSAGE *** 210204-417 AUG07 0727G 91 TOTAL: 03-PAGES

AUG 07 '91 14:55 USAID/MANILA 632 521524 P.2/3

INITIAL ENVIRONMENTAL EXAMINATION

A. COUNTRY: Republic of the Philippines

B. ACTIVITY: PRIVATE ENTERPRISE POLICY SUPPORT PROGRAM (492-0457)

C. TOTAL A.I.D. FUNDING: $79,328,000 (SAI Grant)

D. LIFE OF PROGRAM: August 1991 - September 30, 1995

E. STATEMENT PREPARED BY: JAY R. NUSSBAUM
Office of Development Resources Management
USAID/Philippines

F. ENVIRONMENTAL ACTION RECOMMENDED: Categorical Exclusion

G. USAID ENVIRONMENTAL OFFICER'S CONCURRENCE: KEVIN A. RUSHING
Office of Natural Resources, Agriculture and Decentralization

H. USAID/PHILIPPINES DIRECTOR'S DECISION:

APPROVED: Malcolm Butler

DISAPPROVED: ________

DATE: AUG 8 1991

I. APRE ENVIRONMENTAL OFFICER'S DECISION:

APPROVED: M. Kuk APRE/DR

DISAPPROVED: ________

DATE: Aug 8, 1991

84

ANNEX G

DRAFT SCOPE OF WORK FOR MONITORING AND EVALUATION

ANNEX G-1

draft 8/02/91

Statement of Work
Private Enterprise Policy Support Program (PEPS)
Monitoring and Evaluation Services

I. Background

The objective of PEPS is to support the Government of the Philippines (GOP) significant efforts in creating a business environment conducive for private sector led, sustainable economic growth.

PEPS will provide a $79 million balance of payments (BOP) support grant to the GOP to assist in the implementation of reforms for tariff reduction and restructuring and for encouragement of investments. $828,000 will be used for PEPS monitoring, evaluation, technical assistance and policy studies to support the basic objectives of the program.

A.I.D. will employ directly one or more contractors to provide the services requested under this statement of work.

II. Objectives

The requested services are intended to:

1. Provide assistance to A.I.D. in monitoring the policy implementation actions.

2. Conduct an evaluation of PEPS.

3. If necessary, conduct a nonfederal audit of PEPS.

III. Scope of Work

A. Objective - Policy Implementation Monitoring

The Contractor shall provide assistance to A.ID. in monitoring implementation of the PEPS supported reform actions. Estimated level of effort is five person months.

Specific tasks include the following:

1. Review the status of accomplishments, expected impact, relevant economic variables, and developments in related policy areas and the environment which could affect directly or indirectly the PEPS supported implementation actions or their impact.

2. Submit to A.I.D. (with a copy furnished to the GOP) a report prior to each expected disbursement on the status of each implementation action, expected impact, relevant current and prospective developments affecting progress on the implementation action and its impact.

3. Provide short briefings at the time of report submissions and as requested by A.I.D. and the GOP.

B. Objective - Conduct PEPS evaluation

PEPS evaluation will include evaluation of PEPS itself and recommendations for follow on program assistance of similar nature. Estimated level of effort is twelve person months.

The Contractor shall review the design, implementation, and, to the extent possible, impacts of PEPS in relation to U.S. foreign policy objectives, the Multilateral Assistance Initiative, A.I.D. and Mission Philippine Assistance Strategy Statement, private sector strategy and other initiatives, GOP requirements and sensitivities and Philippine macroeconomic stabilization management, structural adjustment and economic development. A.I.D. Evaluation Handbook, A.I.D. Evaluation Guidelines for Nonproject Assistance and CIP-like Activities; and A.I.D. Evaluation Occasional Paper No.13: Information Planning for Policy Reform Programs set forth the general policies and requirements to prepare evaluation plans and conduct program evaluations.

Specific tasks include the following:

1. Assess the appropriateness of PEPS design given the various relevant factors at the time of design.

2. Review PEPS implementation and the attainment of PEPS objectives.

3. Evaluate the implementation process, taking into account organizational and management as well as external aspects affecting PEPS implementation.

4. Quantitatively and qualitatively assess, including standard benefit cost analysis, the impacts of PEPS resources and the supported policy implementation actions on the economy.

5. Review and assess the status of Philippine macroeconomic management, development, structural adjustment, and economic prospects.

6. Prepare overall lessons learned summary.

7. Prepare recommendations on the appropriate foci and procedures for future program assistance in relation to the expected status of Philippine structural adjustment, economic prospects, and GOP development efforts and macroeconomic management in the medium term.

8. Provide briefings as requested to A.I.D. and the GOP.

9. Prepare and submit to A.I.D. (with a copy furnished to the GOP) a report. The following outline is suggested in preparing the report for this activity.

a) Executive Summary

b) PEPS Description

c) PEPS Design Assessment

d) Evaluation of Implementation Progress and Procedures

e) Assessment of Program Achievements and Impacts

f) Assessment of Philippine Macroeconomic Management, Economic Development, Structural Adjustment and Prospects

g) Lessons Learned

h) Recommendations for Future Program Assistance

C. Objective - PEPS Nonfederal Audit

If subsequently determined to be required, A.I.D. will contract for nonfederal audit of part or all of PEPS activities in accordance with USG and A.I.D. rules and regulations. Funding equivalent to four person months of effort is being reserved for this activity.