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

PROGRAM ASSISTANCE APPROVAL DOCUMENT

DEVELOPMENT SUPPORT PROGRAM (DSP)

492-0400

SEPTEMBER 1985

USAID/MANILA

UNCLASSIFIED

CLASSIFICATION:

AID 11-20-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 492-0400 492-K-602
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		4. DATE September 30, 1985
5. TO: Frederick W Schieck, Director	6. OYB CHANGE NO. N/A	
7. FROM: John S. Blackton, Deputy Director	8. OYB INCREASE None TO BE TAKEN FROM:	
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$45,000,000.00		10. APPROPRIATION EPC HESA-85-37492-KG-31
11. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT	12. LOCAL CURRENCY ARRANGEMENT <input checked="" type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input type="checkbox"/> NONE	13. ESTIMATED DELIVERY PERIOD December 1985
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16. PERMITTED SOURCE U.S. only: _____ Limited F.W.: _____ Free World: _____ Cash: \$45,000,000.00	17. ESTIMATED SOURCE U.S.: _____ Industrialized Countries: Local: \$45,000,000.00 Other: _____
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18. SUMMARY DESCRIPTION

Since the latter months of 1983, the Philippine economy has been in a severe crisis which continues to manifest itself through debilitating deficits in both domestic and foreign exchange resources. The availability of foreign exchange to meet balance of payments and other financing requirements will continue to be insufficient over the medium term and severe budget cutbacks are having a detrimental effect on numerous development efforts. The primary objective of the proposed \$45 million Economic Support Fund Program Assistance for the Development Support Program (DSP) is to provide Balance of Payments (BOP) support to the Government of the Philippines (GOP). A secondary objective is to provide support to selected on-going foreign-assisted activities. The GOP has agreed that the local currency generated from the dollar transfer under the DSP will be used to meet a portion of its counterpart requirements for these development activities.

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

Prior to disbursement of dollars for the Program, the GOP will certify that obligational authorities for expenditures based on the 1986 Budget of Receipts and Expenditures will be issued, and will provide a list of projects included in the Program. Prior to release of pesos from the special account, the GOP will provide A.I.D. with a certification from the Office of Budget & Management that Advices of Allotment have been issued with respect to projects in the Program.

19. CLEARANCES RLA: <u>EMiller</u> <i>EM</i> PO: <u>WToliver</u> <i>WT</i> CO: <u>LEckersley</u> <i>LE</i> OD/PE: <u>SKRiley</u> <i>SK</i>	DATE 9-28-85 9-29-85 9-28-85	20. ACTION <input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED <i>Frederick W. Schieck</i> 9/30/85 AUTHORIZED SIGNATURE DATE Director, USAID/Philippines TITLE
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Table of Contents

	<u>Page</u>
Program Authorization	
List of Abbreviations/Acronyms	
I. Summary and Recommendation	1
II. Introduction.....	2
III. The Economy.....	3
A. Background and Overview.....	3
B. Recent Developments.....	5
IV. Problem Analyses.....	8
A. Balance of Payments Problems.....	8
B. Budgetary Problems.....	12
V. The Program.....	18
A. Program Rationale and Objectives.....	18
B. Program Description.....	19
C. Project Eligibility.....	20
D. Relationship to the Rural Productivity Support Program.....	22
VI. Implementation Procedures.....	25
A. Implementing Process.....	25
B. Implementing Entities.....	26
C. Reports.....	28
VII. Conditions and Covenants.....	29
A. Conditions Precedent to Dollar Disbursement.....	29
B. Conditions Precedent to Release of Pesos.....	29
C. Covenants.....	30
 Annexes	
A. PAIP Approval	
B. Economic Tables	
C. Description of GOP Budget Procedures	
D. Statutory Checklists	

List of Abbreviations/Acronyms

A/A	Advice of Allotment
ADB	Asian Development Bank
BOP	Balance of Payments
BRE	Budget of Receipts and Expenditures
BTR	Bureau of Treasury
CB	Central Bank
CDC	Cash Disbursement Ceiling
COA	Commission on Audit
CPA	Certificate of Program Availability
CPI	Consumer Price Index
DSP	Development Support Program
ESF	Economic Support Fund
ESFS	Economic Support Fund Secretariat
GAA	General Appropriations Act
GDP	Gross Domestic Product
GNP	Gross National Product
GOP	Government of the Philippines
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
MBA	Military Bases Agreement
MOF	Ministry of Finance
MOTC	Ministry of Transportation and Communication
MPWH	Ministry of Public Works and Highways
NAO	National Accounting Office
NEDA	National Economic and Development Authority
OBM	Office of Budget and Management
ODA	Official Development Assistance
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Initial Proposal
PWA	Public Works Acts
RPSP	Rural Productivity Support Program
SDR	Special Drawing Rights
USAID	United States Agency for International Development
USG	United States Government

11

I. Summary and Recommendation

1. Program Title : Development Support Program (DSP)
2. Grantee : The Government of the Philippines (GOP)
3. Grant Amount : \$45 million
4. Funding Source : Economic Support Fund (ESF)
5. Initial Obligation : FY 1985
6. Program Objectives : The primary objective of the DSP is to provide foreign exchange for balance of payments support to the GOP. A secondary objective is to provide support to selected ongoing USAID, Asian Development Bank (ADB) and International Bank for Reconstruction and Development (IBRD) development projects.
7. Program Description : Upon satisfaction of all conditions precedent, AID will transfer \$45 million to the GOP Treasury. Upon receipt of the grant dollars, the GOP will establish a special account containing an equivalent amount of pesos. The GOP will then utilize these pesos as counterpart pesos, over and beyond the already budgeted counterpart contributions, to selected foreign-assisted projects.
8. Estimated Completion Date: The disbursement of the \$45 million is expected to take place during the fourth quarter of CY 1985.
9. Statutory Requirements : All statutory requirements have been met. See Annex D.
10. Recommendation : That a \$45 million ESF grant be authorized to the GOP based on terms and conditions described in the attached authorization.

Program Committee

- | | | |
|----------------------|---|-----------------------------------------------|
| Marlon T. Alicando | - | Program Specialist (Economics), OD/PE |
| B. Loc Eckersley | - | Controller |
| Brian M. Miller | - | Regional Legal Advisor |
| William T. Oliver | - | Chief, Program Office |
| Susan K. Riley | - | Acting Chief, OD/PE |
| William L. Riley | - | Assistant Project Development Officer, OCD |
| Arturo Q. Villanueva | - | Senior Economist, OD/PE |
| Ronnie D. Woody | - | Finance and Development Officer, U.S. Embassy |

II. Introduction

The Philippines has been in a serious economic crisis for the past two years. Economic growth, which had been decelerating since 1979, turned negative in 1984, and continues to be negative in 1985. Industries producing for the domestic market have been operating far below capacity and the agricultural sector has been impacted by unfavorable terms of trade and weather conditions. Private investment has declined, reducing employment generation so that the already high under- and unemployment rates have increased further. In comparison with most of its neighbors, which have faced many of the same external economic problems, the Philippine economic performance has been poor.

The Philippine economic crisis continues to manifest itself through debilitating deficits in both foreign exchange and domestic resources. Foreign exchange for balance of payments and other financing requirements to meet the country's external debt obligations will continue to be insufficient over the medium term. In line with the economic recovery program associated with the IMF Standby Agreement, GOP budgetary expenditures have been reduced to contain the fiscal deficit. This has led to a critical lack of local currency resources and consequently delayed the implementation of many important foreign-assisted development projects.

This program is designed to address these two major problems. By providing free foreign exchange, the program will provide balance of payments support. The local currency which will be generated as a result of the dollar transfer will be used to provide support to selected ongoing USAID, ADB and IBRD development projects.

III. The Economy

A. Background and Overview

Philippine economic performance during the postwar period has been characterized by a moderate, if irregular pattern of growth. Throughout most of the 1950's and 1960's, the policy environment created by an import-substituting industrialization strategy produced a satisfactory growth performance of about 6.5 percent per annum in real terms which was carried over until the early part of the 1970's. However, during this period, industrial expansion became limited by the size of the domestic market, while the agriculture sector was becoming less able to provide sufficient exports and domestic food supplies because of the bias in the flow of investment resources favoring industry. This resulted in some balance of payments (BOP) difficulties, despite the imposition of import controls. Moreover, the use of an overvalued exchange rate, low interest rates and fiscal incentives in support of the policy thrust failed to reduce the country's dependence on imports, and instead created an industrial sector which tended to be highly import-dependent and capital-intensive.

The minor export boom in the early 1970s plus the large external borrowings that became attractive because of low or even negative real interest rates helped cushion the adverse impact of growing balance of payments deficits during the 1970s. Until 1978, the economy grew annually at almost 7.0 percent in real terms. However, because of the unfavorable external developments as a result of the second oil crisis in 1979, the GOP had to finance its overly expansionist policies with excessive foreign borrowings, this time from commercial sources. While foreign debt and the GOP's deficit spending policies provided some countercyclical influence to the country's economic performance, the growth in national production decelerated to less than 3.0 percent between 1980-1983.

To correct the import-substitution and capital-intensive biases of postwar trade and industrialization policies, which were responsible for the relatively weak performance of the economy in creating productive jobs, the GOP took steps toward structural reform in 1979. However, the reform measures appeared to be limited in scale to counteract the drying up of cheap foreign capital and the sluggishness of the world economy during that time, and were ineffective in correcting the industrial inefficiency already in place.

When the political situation deteriorated after August 1983 as a result of the assassination of former Senator Aquino, an abrupt reduction in commercial fund sources followed. With business confidence badly shaken, the flight of capital depressed the country's foreign reserve position from over \$2.0 billion to less than a month's level of imports (some \$430 million). A severe BOP deficit which could no longer be offset by drawing down from almost depleted foreign reserves ensued, forcing the GOP to declare a moratorium on all commercial debt payments on October 17, 1983.

In 1984, the entire economy plunged into a severe recession with real GNP recording a negative growth of 5.3 percent. With the population growing at 2.5 percent a year, this meant an almost 8 percent decline in per capita income from the previous year's level. Thus, per capita income in real peso terms fell between 1979 and 1984, respectively, from some ₱4,625 to ₱4,165 (in 1979 pesos). In dollar terms, current GNP per capita in 1984 was equivalent to only \$655, a dramatic drop from the 1982 level of \$820 and only slightly higher than the 1979 level of \$600.

Unemployment increased considerably as a result of the recession. Official GOP figures indicate an unemployment rate of 6.2 percent in 1984 (up from 4.6 percent in 1983), equivalent to over 1.2 million people without jobs and looking for work. (This figure is even deemed understated as the GOP data consider those who have worked at least one hour during the quarter as employed.) Inflation remained very high during the year, reaching a peak of 65 percent in October 1984 while the average for the year registered a record high of 50.5 percent.

By year-end 1984, the country's total foreign exchange liabilities amounted to \$25.4 billion, equivalent to almost 90 percent of the country's GNP. With still limited foreign exchange reserves, the country was unable to fully service its external obligations, forcing the extension of the debt payment moratorium that had been in place since October 1983.

In retrospect, the crisis that started in 1983 and the problems that ensued were the culmination of developments and the effects of policy choices that preceded the crisis. The shift toward import-substituting and debt-financed growth strategies introduced several additional features to the country's economic structure during the past two decades. The most pronounced of these was the substantial acceleration of public sector investment in infrastructure and direct participation in productive activities which entailed larger GOP deficits that necessitated international borrowings and domestic credit expansion in view of an inadequate domestic savings base. Second, commercial bank lending, justified principally by GOP guarantees, was part of the same spending activity and ultimately resulted in government take-overs or bail-outs of failed corporations. Third, the eagerness of foreign banks to lend and the equal eagerness on the part of the public and private sectors to borrow have weakened whatever initiatives were taken toward a change in development strategy. Fourth, the GOP's aggressive interventionist attitude stifled the development of a competitive atmosphere for private sector growth. As a consequence of such posture, there has been pervasive disenchantment with the government's management of the economy.

The present crisis conditions have necessitated the implementation of measures to stabilize the economy and bring it back toward a sustainable growth path. In general, the stabilization measures require a slower monetary growth to minimize inflation and pressure on the exchange rate, a reduction of budget deficits through tax reforms to increase revenues and through expenditure cutbacks, and a more flexible exchange rate to stimulate

exports and minimize unessential imports. To support GOP implementation of these measures, the IMF approved the GOP's request for an 18-month Standby Credit Arrangement amounting to SDR 615 million in late 1984. After the initial drawing when the loan was approved, subsequent drawings have depended on the IMF's favorable periodic reviews on GOP performance on a set of performance criteria and policy reforms agreed upon by the GOP and the IMF.

The approval of the IMF Standby Facility cleared the way for the rescheduling of a portion of the country's debts to commercial banks and to bilateral official creditors. The commercial banks' restructuring agreement was completed in May 1985. This package includes rescheduling of \$5.3 billion of non-trade short-term obligations and principal payments on medium and long term maturities due between October 1985 and December 1986, \$925 million in new money and a revolving trade facility amounting to nearly \$3.0 billion. The "Paris Club" agreement reached by official creditors in December 1984 will reschedule around \$875 million of payments due between January 1, 1985 and June 30, 1986.

B. Recent Developments

1. Income and Prices

The effects of the present crisis continue to inhibit any growth in the country's overall domestic production. During the first half of 1985, real gross national product (GNP) was estimated to be 4.6 percent lower than its level during the same period in 1984. The industrial sector registered an output decline of 12.6 percent with the construction subsector's value added declining by 28.0 percent. Manufacturing activity went down by 9.7 percent as weak domestic and export markets resulted in production slowdown. Mining and utilities subsectors managed to post positive increases in value added by 3.4 percent and 2.6 percent, respectively, but these were outweighed by the larger setbacks in the other subsectors.

The service sector, which had slumped by 2.5 percent in 1984, managed a smaller decline of just over one percent in output during the first semester of 1985. Agriculture, which is considered the lead sector in the recovery program, also had a modest one percent growth in output during the first half of 1985. This growth in agricultural output reflects zero growth during the second quarter of 1985 as a result of weather-induced crop destruction. The first quarter growth in agriculture was higher at 2.1 percent.

With the continuing unfavorable business climate, investment activity, as measured by gross domestic capital formation, fell by 16 percent during the first half of 1985. Poor investment growth was matched by a continued slack in employment opportunities as reflected by a 5.8 percent unemployment rate during the first quarter of 1985. This estimated level still appears conservative as independent estimates based on more conventional definitions place the unemployment rate for the quarter at around 15 percent.

Because of the weak domestic demand for both imported raw materials and finished goods due to foreign exchange shortages and declining consumer purchasing power, total imports during the first semester of 1985 fell by 12 percent from the same period last year. The country's export performance during this period suffered from weak international demand in some major markets. The country's outstanding external liabilities amounted to \$25.2 billion by the end of the second quarter of 1985, while outstanding external payment arrears stood at \$1.1 billion.

Inflation, as measured by the annual change in the Consumer Price Index (CPI) has decelerated steadily from a peak of 64 percent last October to below 16 percent in August of this year. This dramatic reduction is mainly the result of continued fiscal and monetary restraint, the slack in both consumer demand and industrial activity, and an anomalous stability of the peso vis-a-vis the US dollar. The initial downward pressure on prices was also assisted by the oil price adjustments made during the early part of the year. The declining price trend experienced so far should allow the GOP to achieve its targetted 25 percent average inflation rate for 1985.

2. Monetary Policy

During the first quarter of 1985, the Central Bank pursued a contractionary policy, reducing reserve money by some P3.0 billion. During the second quarter, reserve money was held steady at around P31.0 billion. In recent weeks some modest expansion has occurred, but well within program ceilings. The offered rates for T-bills and CB-bills, though, have been steadily reduced from the peaks of 43 percent (91 days) at end of last year to less than 20 percent in late August as inflationary pressures have abated. Bank rates on deposits and deposit substitutes have also declined. Average bank lending rates have declined as well, but have not fallen as far, due in part to high intermediation costs from continued high reserve requirements.

3. Structural Reforms

In the area of structural reforms, the GOP has defined a comprehensive agricultural policy reform program to enable the sector to contribute more fully to immediate and long-term economic growth prospects. Significant attention is being given to agriculture for efficient import substitution, export diversification, and increased earnings from traditional crops. These policy reform initiatives are being supported by the multilateral development banks and by the U.S Government. Some progress has been achieved, with most of the required agricultural policy reform studies either completed or near completion. In agricultural pricing and market intervention, the announced deregulation of wheat and flour trade, the lifting of rice price controls by October 1985 and other such measures to liberalize trade in agricultural commodities are important developments for removing disincentives to increased agricultural production and productivity. Moreover, these policy pronouncements must be promptly implemented if there is to be significant reform of institutional and marketing arrangements in agriculture.

For the country's short-term economic stabilization and medium-term recovery, it is also essential that there be some improvement in the management of public resources, particularly those involving public investment programs and public corporations. This concern is of utmost significance considering the limited budgetary resources available to the GOP. Moreover, government participation and intervention in productive activities has stifled private initiative and productivity. Under the present economic conditions, efficient private investment supported by appropriate public infrastructure investment is essential.

In order to rationalize the role of public corporations, several technical studies have been completed or are being prepared which will provide recommendations for reforming individual corporations. Also, in line with the adjustment process and to assist in domestic resource mobilization, the GOP has undertaken several tax measures including selective increases in excise, sales and percentage taxes, simplification of the tax rate structure and broadening of the tax base.

4. GOP Performance Under the IMF Stand-by Arrangement

The Program's quantitative performance criteria involve nine selected indicators in the monetary, fiscal and external sectors. (Details are provided in Table 2 of Annex B.) With the end-December 1984 performance targets, the GOP exceeded the ceilings set for reserve money and short-term external debt. These ceilings were again exceeded in the end-March data along with two other criteria, namely the ceilings for net banking system credits to the national government and to the public sector. The other target ceilings were satisfactorily met during these two test-date periods. Since the GOP failed to fully comply with the end-December 1984 and end-March 1985 performance criteria, the drawdown for the second tranche was delayed for some time. An IMF team review in April later linked the release of the second tranche to favorable compliance with an end-May performance criteria. This involved the four criteria for which ceilings were exceeded in end-March, and an additional criterion for new borrowing approvals for which no end-March target had previously been set. Based on the results of the IMF assessment, the end-May performance targets were satisfactorily complied with, allowing for the release of the SDR 106 million second tranche in late July.

Succeeding releases of the remaining four tranches will be linked to GOP compliance of: (1) the end-July 1985 performance criteria and satisfactory second review; (2) end-September 1985 performance criteria; (3) end-December 1985 performance criteria and third review; and, (4) end-March 1986 performance criteria. Based on the latest available data, the GOP has satisfied all the quantitative limits set for end-July 1985. However, lower than expected revenue collections will likely result in a larger than programmed budget deficit in 1985, making it difficult for the GOP to meet the ceiling on net domestic financing for end-September. The GOP is presently negotiating with the IMF for a higher net domestic credit limit at year-end to ensure that the tight fiscal program will not disrupt efforts to help revive the domestic economy.

IV. Problem Analyses

A. Balance of Payments Problems

1. 1984 BOP Performance

The country's balance of payments deficit, excluding exceptional financing and the effects of rescheduling, stood at about \$1.46 billion (4.5 percent of current GNP) in 1984, a marked improvement from the previous year's shortfall of \$2.2 billion or 6.2 percent of GNP. A significant reduction in the trade deficit from \$2.5 billion in 1983 to only \$679 million more than offset an increase in the services deficit and reduced capital inflows.

The improvement in the trade balance was the result of a 7.7 percent export growth and a 19 percent decline in imports over the preceding year's corresponding levels. The fall in imports reflected the continued shortage of trade financing, and the effect of the foreign exchange allocation measures that were adopted in 1983. On the other hand, export performance in 1984, while still positive, may be viewed as less dramatic considering that there was a relatively strong world economic recovery during that period. The export performance was evidently affected by shortages of imported raw materials for export production and a lower supply of traditional primary exports.

For the first time in over ten years, the capital account showed a deficit in 1984. This is due to the nearly 70 percent decline in medium- and long-term capital inflows as a result of the protracted GUP debt restructuring negotiations with commercial banks and official creditors. Meanwhile, scheduled amortization payments for long-term loans remained at the same \$1.0 billion level as in the previous year.

At the end of 1984, the Central Bank's holdings of gross international reserves amounted to \$886 million, equivalent to a little less than two month's imports at current payment rates. This had increased to \$1.54 billion by end-August 1985, with GUP drawdowns from the IMF and disbursements of new money by commercial banks contributing to the higher reserves position.

2. BOP Outlook for 1985

During the first program review, the IMF estimated that the Philippine BOP deficit in 1985 would reach \$1.96 billion (6.5 percent of GNP), or some \$500 million greater than the 1984 shortfall without exceptional financing and debt relief. (See Table 1.) The increased deficit estimate is due to both a sharp increase in the amortization requirements for medium- and long-term loans and a net outflow of short-term capital from the repayment of excess oil financing facilities, resulting in a \$1.2 billion capital account deficit.

Table 1
Philippines: Balance of Payments, 1984-85
(In Millions of U.S. Dollars)

	<u>1984</u>	<u>1985 Revised Program</u>
Trade Balance	(679)	0
Exports	5391	5662
Imports	6070	5662
Services (net)	(975)	(1110)
Receipts	2626	2767
Payments	3601	3877
Transfers (net)	386	362
Receipts	387	363
Payments	1	1
Current Account	(1268)	(748)
(Percent of GNP)	(3.9)	(2.3)
Direct Investment (net)	6	34
Medium- and Long-Term		
Loans (net)	(271)	(629)
Inflows	730	842
Outflows	1001	1471
Short-Term Capital (net)	18	(780)
Errors and Omissions	(94)	--
Monetization of Gold	169	165
Revaluation	(15)	--
Capital Account	(187)	(1210)
Overall Balance of Payments	(1455)	(1958)
(Percent of GNP)	(4.5)	(6.0)

Source: IMF

(Note: The IMF's BOP figures are significantly different from the published GOP data which in 1984 showed a slight BOP surplus of \$258 million. This is because the GOP data take into account the system's recourse to exceptional financing such as the rollover of short-term loans, new money, deferred import payments and arrears on official loans and interest payments, all of which have the effect of reducing the BOP deficit. In assessing financial requirements, the IMF considers exceptional financing separately from the normal BOP transactions, as shown in Table 2.)

On the other hand, the deficit in the current account is projected to fall by some \$500 million to a level of \$748 million (2.3 percent of GNP) in 1985. However, the projected balance in the trade account assumes a 5 percent growth in exports. This is highly optimistic considering that exports dropped by 11.8 percent during the first six months of 1985. With the slowdown in the U.S. economy, the depressed world market for semiconductors, and the low world prices for sugar, coconut and copper, export earnings for 1985 are likely to decline rather than increase over the 1984 level. This may be offset to some extent by a sharper than projected decline in imports, which had already declined by nearly 12 percent in the first semester. The services account deficit in 1985 is expected to remain around the same level as in the previous year.

The external financing requirements are also affected by the need to make scheduled loan amortization payments of the financial sector (\$3.18 billion), and the outstanding external arrears (\$2.07 billion) that have to be liquidated by year-end. The country's total foreign exchange requirements in 1985 are thus estimated at \$7.0 billion. About \$5.0 billion of the total financing needs will be met through the rescheduling of both public and private sector debt with the Paris Club, the commercial banks and the suppliers of trade credits.

The GOP expects about \$1.5 billion in new money, of which \$925 million will come from commercial banks and the remainder from multilateral and bilateral development assistance. In addition, in 1985, the GOP is expected to draw down from the IMF some \$318 million as part of the stand-by credit arrangement. After taking into consideration all expected assistance, a financing gap of approximately \$134 million remains. (See Table 2.) Delays in the second IMF program review could also lower the disbursements for the year from both the IMF and commercial banks. The first semester results indicate that the estimates for official disbursements may also be optimistic.

Recent IMF/CB revisions to the BOP projections for 1985 show a much lower deficit in the overall balance of payments position (i.e. \$1.3 billion as compared to previous estimate of \$1.96 billion) in 1985. The change in the projected BOP position is based on improvements in both the current and capital account balances. While the new estimates show a negative trade balance (\$200 million) from the equilibrium position projected earlier, a substantial \$419 million reduction in the services account deficit, and a slight increase in net transfers have contributed to the now expected lower current account deficit. On the other hand, the capital account deficit is expected to narrow down to \$850 million from some \$1.2 billion in the earlier estimates. This is due to a smaller net outflow of short-term capital, a slight increase in the flow of direct investments plus some positive adjustments for previously unaccounted flows (errors and omissions).

With the projected 1985 BOP deficit reduced to \$1.3 billion, it would appear that the remaining financing gap will be eliminated after considering all the expected assistance. However, as noted above, the estimated financing assistance is optimistic. Moreover, given current worldwide trends for the country's major export commodities, plus the below target performance for exports during the first half of 1985, it is likely that the trade balance deficit will be higher than the revised projections indicate.

Table 2
Philippines: 1985 Financing Gap
(In Million U.S. Dollars)

Overall BOP Deficit on Scheduled Payments		1,958
Scheduled Payments Below the Line		
Central Bank	1,033	
Commercial Banks	2,147	3,180
Arrears at end-1984		
Non-Monetary	1,798	
Monetary	268 <u>1/</u>	2,066 <u>1/</u>
Change in Banking System Gross Reserves		
Central Bank	99	
Commercial Banks	-263	-164
Total Financing Needs	7,040	
Rescheduling Affecting the NIR <u>2/</u>		
Paris Club	684	
Commercial Banks	2,352	
Suppliers' Credits	110	3,146
Rescheduling of Domestic Commercial Bank Liabilities <u>2/</u>		1,928
Financing Gap	1,966	
New Money		
Official	589 <u>3/</u>	
Commercial Banks	925	1,514
IMF Drawings in 1985		318 <u>4/</u>
Remaining Gap		134

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- 1/ Excludes \$624 million of arrears to be eliminated by the trade facility.
2/ Rescheduled liabilities of domestic commercial banks remain within NIR of the banking system.
3/ Estimated disbursements for the year.
4/ Represents three tranches of the IMF stand-by credit arrangement amounting to SDR 106 million per tranche.

B. Budgetary Problems

1. Recent Budgetary Developments

Greater expenditure restraint in recent years has enabled the GOP to keep the budget deficits well below the 1982 record level of ₱14.4 billion (4.3 percent of GNP). As a result, the GOP was able to hold the overall budgetary deficit down to ₱10.0 billion (1.9 percent of GNP) in 1984, slightly lower than the program target of ₱10.9 billion (2.0 percent of GNP) agreed upon with the IMF (see Table 3). The austerity measures, however, have had some negative impacts. While the additional restraint reflected some savings on public sector wages, the GOP relied largely on sharp controls on outlays for maintenance and other operating expenditures affecting efficient utilization of existing infrastructure to reduce current expenditures. Furthermore, actual GOP expenditures for its capital investment program in 1984 were reduced 15.5 percent in nominal terms below the 1983 level because the GOP was required to provide substantial budgetary assistance to government financial institutions that were unable to meet maturing external obligations with government guarantees. Thus, the GOP's capital budget in real terms was only 42 percent of what it was in 1982.

GOP revenue collections have also been below expectations, highlighted by the decline of the tax/GNP ratio to 9.3 percent in 1984 from over 10 percent in 1982-83. The poor revenue performance in 1984 was mainly due to the sharp contraction in real economic growth compounded by the significant drop in imports, and the delayed implementation of new tax reform measures.

Significantly, foreign financing of the budget deficit dropped to less than ₱2.0 billion in 1984 from over ₱5 billion in 1983. This was mainly the result of lower official development assistance (ODA) disbursement levels due to the reduced availability of GOP counterpart pesos. With external funding of the budget deficit falling sharply, the GOP resorted to substantial borrowings from domestic sources, primarily through sales of high-yielding Treasury bills. This caused the outstanding stock of Treasury bills to increase by more than three times to ₱20 billion in 1984. While the T-bills were also used by the CB as an instrument for controlling liquidity in the economy, the increase in domestic borrowing resulted in the doubling of GOP interest payments during the year.

For 1985, the GOP's revised budgetary target is to limit the overall deficit to some ₱6.4 billion or to almost 1.0 percent of GNP. Although further expenditure restraints are planned, total budgetary expenditures have been projected to be 24 percent higher than the 1984 level, approximating the expected average inflation rate for the year. However, the expenditure increase is allotted mostly for current operations, notably for maintenance and other operating expenses and for interest payments, both of which are projected to increase by over 40 percent. In contrast, the capital budget is projected to decline by 7.5 percent in nominal terms so that its real value is reduced further to less than one-third of the 1982 level. Specifically, this involves 12 percent and 40 percent cutbacks in outlays for large infrastructure projects and corporate equity investments, respectively, but a 33 percent hike for other smaller capital projects.

Table 3
Summary Operations of the National Government
Cash Basis, 1982-86
(In billion pesos)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> (revised program)	<u>1986</u> (proposed program)
Revenue	38.2	45.6	57.1	76.7	80.7
Tax revenue	33.8	39.5	50.0	69.3	72.5
Non-tax revenue	4.4	6.1	7.1	7.4	8.2
Expenditure	52.6	53.1	67.3	83.2	87.6
Current operating expenditure	31.0	34.6	43.6	59.2	62.0
Capital outlays	19.4	15.1	13.6	12.5	15.4
Net lending	2.2	2.4	10.1	11.5	10.2
Deficit	-14.4	-7.5	-10.0	-6.4	-6.9
% of GNP	4.3	2.0	1.8	0.9	0.9
Financing of the Deficit:					
Foreign	4.6	5.4	1.9	3.2	1.0
Domestic	9.8	2.1	7.8	3.2	5.9

Note: See Table 3 of Annex B for more details.

Source: OBM

The 1985 budgetary targets assume a revenue performance of P76.7 billion (10.2 percent of GNP), or 34 percent greater than the previous year's total receipts. This increase was to be achieved through a substantial 60 percent growth in revenues from international trade, primarily from the one percent gross receipts tax on all foreign exchange transactions and the five percent import surcharge. However, a substantial shortfall on international trade tax receipts is now anticipated, due partly to a stronger peso than was assumed in the program, and partly to the sharper than expected drop in imports. Revenues from domestic-based taxes were initially projected to grow by some 26 percent with the implementation of the full 1985 tax package intended to enhance the elasticity of the revenue system. It is likely, though, that total local tax receipts will be slightly lower than projected due to lower major specific and excise tax collections from reduced levels of economic activity.

With the current levels of GOP tax collections well below target, the actual budget deficit for 1985 is likely to be substantially higher than the target. As of end-August, the overall budget deficit already reached P5.0 billion. With expenditures normally higher than revenues during the last quarter of the year, the budgetary shortfall is expected to rise further by year-end. Thus, the GOP reportedly is seeking agreement from the IMF on a much higher program budgetary deficit of around 1.5-2.0 percent of GNP, implying that the 1985 shortfall may reach some P10-P14 billion.

The financing of the 1985 budget deficit, originally expected to be met entirely from external sources, is now expected to rely equally on domestic borrowing. The estimate for foreign borrowing has been significantly reduced, reflecting a revised assessment of World Bank and ADB program assistance in 1985 and a more modest expectation of UDA projects financing disbursements on capital projects.

2. 1986 Budget Program

The GOP's near-term budgetary program is aimed at bringing the budget deficit down to a sustainable level. Thus, the target in 1986 is to keep the deficit to P6.9 billion or only 0.9 percent of GNP. This indicates that the proposed fiscal budget for next year will be even more stringent than the already tight budgets of the past two years. Total cash budget disbursements are projected to reach P87.6 billion, or about 4 percent lower in real terms than in 1985. As a proportion of GNP, the projected GOP budget expenditures will drop to only 11.4 percent from 12.2 percent the previous year.

The 1986 budget reflects nominal increases of 4.8 percent in current operating expenses and 22.6 percent in capital expenditures, and a decline of almost 11 percent in debt-servicing. Within current operations, the only positive real growth in expenditures in 1986 are programmed for maintenance and other operating expenses and for allotments to local government units. The increase in the former is attributed to the GOP's renewed emphasis on improved maintenance of existing infrastructure rather than new construction.

On the other hand, the improvement in the capital budget in 1986 is due largely to the 66 percent increase in funding for other capital projects. Projected infrastructure expenditures will be 8.2 percent higher in 1986, but will still be below the actual 1984 level. Equity contributions to public corporations are being reduced further by 31 percent to P1.6 billion.

Total GOP revenue collections in 1986 are projected to grow by only 5.2 percent to P80.7 billion, marked by a decline in the tax/GNP ratio from the program level of 11.3 percent in 1985 to 10.5 percent. Significantly, a 6.7 percent reduction in taxes derived from international trade and transactions is projected next year. This is primarily due to the decline in the import duties resulting from the expected reduction in volume and unit price of oil imports. Domestic-based tax receipts will be 12 percent higher in anticipation of an acceleration in economic activity next year. GOP non-tax revenues will expand by around 11 percent, mainly from proceeds of the Economic Support Fund.

3. Budget Resource Gap and the Capital Investment Program

Large budgetary cutbacks and other austerity measures have characterized the GOP's fiscal program in recent years. This is reflected by the substantial reductions in budget levels from those requested by Ministries and GOP entities. (See Table 4.) Total budgetary funding requests to OBM by the operating entities exceeded appropriations by P31 billion in 1984, P24 billion in 1985 and, reflecting a little more realism, P19 billion in 1986. The GOP's capital investment program has suffered the largest cuts. Of the P76 billion total shortfall between budgetary requests and appropriated levels for the 1984-1986 fiscal programs, capital investment expenditures account for P48 billion or 63 percent. Corporate equity contributions and outlays for smaller capital projects have received the largest reductions.

The budgetary cutbacks are unavoidable given the current economic situation and competing demands for scarce GOP resources. However, the lower funding levels involve substantial economic and social costs. Considerable reductions in the capital budget have led to the deceleration in the implementation of many worthwhile ongoing projects, the postponement of a few others, and severe limits on the number of new development projects since 1984. The failure to complete projects delays the realization of project benefits, and increases the carrying costs of the loans as interest payments are extended over a longer period of time. Moreover, disbursement problems and delays in fund releases contribute to project cost overruns, given the prevailing high inflation and interest rates.

The adverse effects of the reduced capital budget on the GOP's investment program is vividly demonstrated by the fact that public sector investments in real terms have been reduced to about half of the levels obtained during the early 1980s. From a peak of about 9 percent of GNP in 1980-81, investments of the national government and public corporations were reduced to 7.5 percent of GNP in 1983 and further down to some 3.4 percent of GNP in 1985. While it is difficult to judge what level of public investment

Table 4
National Government Budget
Obligation Basis, CY 1983-1986
(in million pesos)

	1 9 8 4			1 9 8 5			1 9 8 6	
	Budgetary Request 1/	Original Program 2/	Revised Program 3/	Budgetary Request 1/	Original Program 2/	Revised Program 3/	Budgetary Request 1/	Original Program 2/
Current Operating Expenditures	55.3	41.5	43.1	57.0	50.8	56.2	71.4	62.0
Capital Outlays	29.4	14.4	11.6	29.8	12.1	10.6	23.3	12.1
Infrastructure (MPWH/MOTC)	9.2	5.4	4.8	4.9	3.6	3.6	4.8	4.1
Corporate Equity	12.4	4.5	3.0	10.2	2.5	1.7	3.7	1.2
Other Capital Outlays	7.8	4.5	3.8	14.7	6.0	5.3	14.8	6.8
Debt Amortization	5.4	3.6	4.1	4.5	4.4	5.4	9.0	8.6
Total <u>4/</u>	90.1	59.5	58.8	91.3	67.3	72.2	103.7	82.7

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

2/ Approved GOP budget on an obligation basis for 1983 and 1984 and Proposed Budget for 1985 and 1986.

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

4/ Net of Lending Account.

Source: OBM

is required overall, the current level is low by historical standards, and appears to be below the level necessary in the long-run to sustain economic development. The present low level perhaps can be tolerated on a temporary basis given the high level of investment in the past, which has built up a considerable capital stock, and the current low level of growth which has reduced demand. On the other hand, in the longer term, greater efforts in domestic resource mobilization are essential to bring investment up to a more appropriate level to provide the necessary infrastructure for economic growth.

An equally important concern is the adverse effect of reduced funding for the operation and maintenance of existing investments. The estimated level of maintenance and operating expenditures in the 1985 budget represented a real decrease of about 34 percent over the level that existed in 1979. Since the number of facilities (roads, schools, etc.) or projects that require maintenance has expanded greatly during the last five years, the unit operating and maintenance expenditures would have declined even further. Moreover, there also may have been significant reductions in the ability of local governments to viably maintain and operate infrastructure under their responsibility. This places an additional burden on the GOP to avoid higher rehabilitation costs in the future. The proposed budget for 1986 allows for only a 2 percent real increase in maintenance and operating expenditures, which assumes that the budget allocations are actually met with cash allotments, and that the rate of inflation is no more than 10 percent.

4. Support for Foreign-Assisted Projects

There has been a general slowdown in loan disbursements for foreign-assisted projects due to constraints on GOP counterpart support for these projects. A further decline is projected for 1986 to a level of less than half of the 1983 level (see Table 4 in Annex B). About 80 percent of the budget for foreign-assisted projects is for capital investments, which have received the sharpest GOP expenditure reductions. Recent reviews by the World Bank and ADB indicate that the level of counterpart funding for projects is roughly 50-70 percent of the required level to meet project schedules. The alleviation of budgetary constraints in the near-term will help ensure project completion, although still at a much slower pace than was originally scheduled because of the persistent under-funding in recent years and the impact of inflation.

Since existing projects cannot be fully supported, the GOP has initiated a limited number of new projects with foreign funding since 1984. A review of the public investment program is being undertaken by NEDA, in cooperation with the line agencies and public corporations, to determine the priority projects that should be fully funded over the next five years, and to decide which ongoing projects should be reduced or even cancelled. To date, the public investment program review has not been completed. However, the GOP has indicated that the ADB, IBRD and AID development projects to be supported by this ESF program have high priority.

V. The Program

A. Program Rationale and Objectives

1. U.S. Interests

The United States has important political, economic and strategic interests in the Philippines, with the military facilities at Olongapo and Angeles City being the most prominent. In recognition of these interests, the U.S. Government (USG) has fostered one of its longest, uninterrupted development assistance programs in the Philippines. Additionally, in connection with the 1947 Military Bases Agreement (MBA) amendment in 1979 and review in 1983, the U.S. Government agreed to seek, on a best efforts basis, special economic and military assistance totaling \$450 million for the 1980-84 period and \$900 million for the 1985-89 period. The former amount included \$200 million in economic aid which was appropriated by Congress over the years in the form of Economic Support Funds. These funds were obligated by the U.S. Government to support various development activities in the Philippines. In connection with the 1983 review of the MBA, the administration agreed to make a best efforts undertaking to obtain appropriations of \$475 million of ESF. For FY 1985, the Administration requested that Congress appropriate \$95 million in ESF for the Philippines. Congress, however, increased the amount appropriated by \$45 million, so that ESF funding to the Philippines for FY 1985 totals \$140 million. This additional \$45 million is the source of funds for DSP. According to the legislative record, Congress took the above action in recognition of the economic situation in the Philippines.

Late in FY 1984, USAID initiated an extensive policy dialogue with the GOP in support of agricultural policy and institutional reforms. As part of this dialogue, USAID agreed that in exchange for specified reforms, the additional \$45 million ESF grant would be provided in the form of program assistance rather than project assistance. The specified reforms have been agreed to as set forth as self-help conditions in the FY 1985 PL 480 Title I Loan Agreement.

2. Program Rationale

Given our interests in the country, the Mission proposes to address two of the major problems which have resulted from the current economic crisis in the Philippines as described in Section IV:

a. the availability of foreign exchange being insufficient to meet balance of payments and other financing requirements of the Philippines in the medium term; and

b. the lack of sufficient budgetary resources to continue the implementation of foreign-assisted development projects at or near their originally planned pace.

The provision of Program Assistance will enable AID to address both of these problems. By providing free foreign exchange, the program will be addressing the BOP problem. The pesos generated as a result of the dollar transfer will assist the GOP with its counterpart shortage problems which are affecting foreign-assisted projects.

3. Program Objectives

In view of the current economic difficulties and our interests in the country, the Mission proposes to assist the Government of the Philippines in a way that is consistent with the USAID/Philippine Country Development Strategy Statement and the Philippines' economic recovery program. We propose an Economic Support Fund program assistance grant of \$45 million to accomplish the following program objectives:

- a. the primary objective is to provide foreign exchange for balance of payment support.
- b. a secondary objective is to provide support to selected ongoing AID, ADB and IBRD development projects.

The transfer of the ESF dollar resources will provide free foreign exchange to help the GOP meet its external financial requirements.

The local currency generated from the dollar transfer will provide support to selected foreign-assisted projects which have been affected by the country's current budget difficulties. The projects and the associated funding will form the Development Support Program (DSP). Program implementation will be consistent with the principles of ESF programming contained in the FY 1987 CDSS. DSP will be executed in accordance with AID Handbook 4.

The support to selected foreign-assisted projects is intended to be over and above the support already being provided for each of the projects through the GOP budget. In order for this support to be considered additional, and to prevent it from substituting already budgeted funds, the program is designed to consider the 1986 GOP budget for the group of projects as a base, and the ESF pesos as additional to that base. Because this assistance is being provided as program assistance (rather than project assistance) monitoring will be done on a global basis, based on the group of projects as a whole rather than on an individual project basis.

B. Program Description

In order to accomplish the above objectives, the USG will, upon the GOP's satisfaction of all conditions precedent to dollar disbursement, transfer to the GOP the ESF grant amount of \$45 million which will be available as free foreign exchange. The GOP shall, within twenty four hours, establish a Special Account containing an equivalent amount of pesos. Upon satisfaction of all Conditions Precedent to release of the pesos, the pesos will be released from the Special Account to the General Fund and the Special Account

may then be closed. The pesos will be used to provide a portion of the counterpart funds for selected projects of ADB, IBRD and USAID. These additional pesos will be allocated by the GOP to the projects included in the program in amounts over and beyond what each project will be allocated in the 1986 budget. The GOP may reallocate these additional pesos from slower to faster moving activities among the preapproved projects in DSP to ensure that they are expended on a timely basis.

The program budget for DSP will consist of three components:

1. The sum of the GOP counterpart as budgeted for each of the projects in DSP;
2. The sum of the budgeted loan/grant proceeds as budgeted for each of the projects in DSP; and
3. The peso equivalent of the \$45 million ESF dollar transfer.

The GOP will indicate the numerical values of each of these components on a Certificate of Program Availability (CPA) which will be required as a condition precedent to dollar disbursement. (See Exhibit 1 for an illustrative CPA.) In addition to indicating the DSP budget and the base from which additionality will be measured, the CPA also provides the GOP's commitment to release obligational authorities for expenditures for the three components.

It should be noted, however, that the GOP budget on which the CPA is based, is, like any national budget, only an estimate of intended expenditures. To the extent that expected revenues do not materialize, expenditures will have to be reduced. For this reason, the 1986 budgeted amount for the group of projects, that is, the base of DSP, may have to be adjusted downward should GOP expected revenues not materialize or other unexpected events occur.

On a quarterly basis, the GOP will provide reports which indicate the financial progress of the program as a whole. No reporting will be required on any individual projects in DSP. The final report will indicate that the full amount of the DSP budget, that is, the already budgeted counterpart and loan proceeds (or the adjusted amounts should the budget be revised) and the additional \$45 million ESF peso equivalent, was disbursed. Additionality of the \$45 million peso equivalent will be measured against the budgeted counterpart and loan proceeds.

C. Project Eligibility

A list of projects eligible for participation in the program and acceptable to AID will be required as a condition precedent to dollar disbursement. (An illustrative list of projects to be included in the program is provided in Exhibit 2.) An estimated budgetary shortfall amount for the basket of projects will also be submitted. This amount, which will indicate on a global basis, the difference between what the projects requested and what they were budgeted will be used to indicate a need for the \$45 million. For the list of projects, the budgeted funding levels for each project must be indicated and each project must meet the following criteria:

1. The project must be consistent with the Grantee's and AID's objectives of improving productivity and providing for basic needs;
2. The project must already be under implementation so that its benefits can be realized quickly after additional resources are provided; and
3. There must be a high probability that additional peso resources provided for the project can be expended promptly.

A satisfactory implementation plan will also be required as a condition precedent to dollar disbursement. It is expected that the implementation plan will essentially follow the indicative plan detailed in Section VI.

D. The Rural Productivity Support Program

Early in FY 1985, a program similar to DSP was provided through a \$47.5 million ESF grant. The Rural Productivity Support Program (RPSP), which is based on the same concept as DSP, is being monitored in the same way and consists of many of the same projects as DSP. While the RPSP is still in progress, the Mission is concerned with the slow disbursement rate of the program as indicated in the recently submitted first quarter's report. Although the reasons for the slow disbursement rate are not yet fully clear, it appears that lower than expected GOP revenue collections and the need to provide additional budgetary assistance to government financial institutions have had a negative impact on expenditures.

An adjustment to the budget base will most likely be required for RPSP as soon as the GOP revenue figures and other indicative figures are available. In the interim, the Mission intends to continue RPSP into CY 1986 since it does not at this time seem likely that RPSP will be fully disbursed by the end of CY 1985. The RPSP Grant Agreement will be amended to effect this change and to indicate that to the extent that projects, which are also part of DSP, receive ESF funding, the RPSP funds will be utilized before the DSP funds. Because the Mission is concerned with the timely submission of reports on RPSP, we are requiring that the third quarter report, based on the disbursement levels as of September 30, 1985, be submitted as a condition precedent to dollar disbursement under the DSP Grant Agreement.



REPUBLIC OF THE PHILIPPINES
Office of Budget and Management
MALACANANG, MANILA

CERTIFICATE OF PROGRAM AVAILABILITY

This is to certify that funds in the amount of PESOS:

and the peso equivalent of \$45 Million^{1/} have been set aside in calendar year 1986 for the activities under the Development Support Program (DSP). The obligational authority for expenditures for the various components of DSP shall be released by the Office of Budget and Management (OBM) on the basis of the 1986 Budget of Receipts and Expenditures adapted in accordance with the 1986 General Appropriations Act and Public Works Act as follows:

Loan/Grant Proceeds	P	
Peso Counterpart		_____
Sub-Total	P	_____
Economic Support Fund		<u>\$45,000,000</u>

Manuel S. Alba
MANUEL S. ALBA
Minister of the Budget

^{1/}Computed on the basis of the highest rate of exchange which is not unlawful in the Philippines on the date of US dollar receipts.

EXHIBIT 2

List of Projects in the
Development Support Program

Loan No. Projects By Donor Agency

I. Asian Development Bank (15 Projects)

531	Technical & Vocational Educ.
417/466	Second Laguna de Bay Irrig.
676	Phil. Forestry Development
528/529	Palawan Integrated Area Dev.
677	Philippine Aquaculture Dev.
491/597	Third Road Improvement Project
417	Bicol River Basin Integrated Area Development
548	Smallholder Livestock Dev.
363	Second Agusan Irrigation
580	Third Davao del Norte Irrigation
341	Allah River Irrigation
406	Bukidnon Irrigation
308	Luzon Roads Project
379	Mindanao Secondary & Feeder Road
477	Second ADB Roads

II. International Bank For Reconstruction and Development (17 Projects)

2200	Vocational Training
2360	Central Visayas Regional
2040	Agricultural Support Services
2156	National Fisheries Development
1786	Fishery Training
2030	Seventh Education Sector
IDA 923	Population Project II
2206	First Rural Water Supply & Sanitation
2169	Small & Medium Industries Development
1860	Rural Road Improvement
1815	Rainfed Agricultural Development
2201	Philippine Petroleum Exploration Promotion
1890	Watershed Management & Erosion Control
1772	Samar Integrated Area Development
2418	Fifth Highways
1772	Eastern Samar Road
2257	Regional Cities Development

III. U.S. Agency for International Development (7 Projects)

492-T-070	Primary Health Care Financing
492-T-068	Rainfed Resources Development
492-T-0406	Eastern Visayas Farming Systems
492-T-059	Barangay Water
492-U-063	Population III
492-T-071	Small & Medium Enterprise Dev.
492-W-052	Non-Conventional Energy Resources

VI. Implementation Procedures

A. Implementing Process

1. Transfer of Dollars

a. A Certification of Program Availability shall be issued by OBM prior to the disbursement of the grant assistance. This CPA shall cover the programmed amounts as contained in the 1986 Budget of Receipts and Expenditures adopted in accordance with the 1986 General Appropriations Act and the Public Works Act for the peso counterpart and grant/loan proceeds of approved DSP projects and the peso proceeds of the \$45 million ESF component of the DSP.

b. Upon receipt of the CPA, the aforementioned list of projects, a satisfactory implementation plan, and the satisfaction of any other conditions precedent to dollar disbursement, the United States Government through AID shall remit the ESF dollar proceeds to the Central Bank of the Philippines' account in the Federal Reserve Bank of New York in favor of the Treasurer of the Philippines.

2. Creation of the Special Account

The Philippine Bureau of Treasury (BTR) shall, within 24 hours, deposit the peso proceeds equivalent to the \$45 million ESF-component of the DSP, computed on the basis of the highest rate of exchange which is not unlawful in the Philippines on the date of dollar receipt by the Government of the Philippines, to a non-interest bearing Demand Deposit Special Account at an authorized government depository bank, to be labelled "DSP Fund Account".

3. Close-out of the Special Account

a. OBM shall furnish AID, in form and substance satisfactory to AID, the following:

i. A certification from OBM stating that Advices of Allotment in the total amount of the DSP Budget have been issued with respect to the projects included in the DSP.

b. Upon receipt of the notification that the above requirement and any other requirements as may be determined have been met in form and substance satisfactory to AID, BTR shall transfer the pesos contained in the Special Account to its General Fund Depository Accounts. The Special Account may then be closed.

4. Program Disbursement

a. The Cash Disbursement Ceilings (CDC's) shall be issued in a timely manner with respect to each quarter. The CDC's will enable the implementing agencies to disburse funds.

b. Allotments released to the implementing agencies for the DSP ESF component may be withdrawn as AID and the GOP jointly agree or under the following conditions:

- i. failure to submit on time the required reports prescribed herein;
- ii. the projects being funded having been found to be dormant or slow-moving;
- iii. the projects having become non-feasible or having declined in priority.

B. Implementing Entities

1. The President of the Philippines shall approve fund allocation guidelines, policies and procedures.

2. The Economic Support Fund Council shall, pursuant to Letter of Instructions 1030, as amended, exercise the following powers and functions:

a. Determine the eligible development programs and projects of the government which may, with AID's concurrence, avail of the ESF;

b. Program the allocation of the ESF among the priority programs and projects;

c. Represent the Philippine Government in dealing with AID or any instrumentalities of the USG dutifully authorized to handle ESF issues;

d. Submit to the President of the Philippines for final approval the utilization plan of the ESF program assistance;

e. Prepare and submit to the Minister of the Budget and Management the Philippine Government counterpart requirements to implement the programs/projects for approval by the President;

f. Submit regular Accomplishment Reports to the President of the Philippines and AID.

3. The Economic Support Fund Secretariat (ESFS) shall:

a. Formulate and recommend for the consideration of higher authorities DSP fund allocation policies with technical assistance from OBM and NEDA;

b. Implement fund allocation and management guidelines as approved by the President;

c. Take up in its books of accounts the receipt of the DSP fund proceeds and charge the account upon release of the AAs and CDCs to the Implementing Agencies;

d. Coordinate with other concerned agencies in formulating measures to effectively implement DSP;

e. Prepare and submit to AID the quarterly and final reports.

4. The Office of Budget and Management shall:

a. Release AAs and CDCs in accordance with fund allocation levels;

b. Require and cause the submission of the Work and Financial Plans and the Audited Financial Report of Operations of the implementing agencies as may be appropriate and necessary;

c. Enforce existing budgetary rules insofar as they are applicable to DSP.

5. The Bureau of Treasury shall:

a. Deposit the peso proceeds equivalent to the grant in a separate deposit account with the designated government depository bank;

b. Certify to the availability of DSP peso proceeds which will serve as basis for OBM to issue CDCs;

c. Effect transfer of DSP peso proceeds from the Special Account to the General Fund in accordance with conditions precedent.

6. The Inter-Agency Technical Working Committee shall be created to provide technical assistance to the ESFS towards ensuring the effective implementation of DSP. It shall be composed of duly designated senior-level officials from OBM, Ministry of Finance (MOF), BTR, NEDA, ESFS and Commission on Audit (COA). Its functions shall include, among others, the following:

a. Recommend to the ESF Council the detailed allocation of DSP resources consistent with the fund allocation guidelines of the President and within the framework of existing budgetary regulations as prescribed by OBM;

b. Assist the ESFS in formulating and recommending policies and procedures to effectively implement DSP;

c. Assist the ESFS in the preparation of necessary action papers, which may include position papers, legal issuances or memoranda to implement DSP policies and procedures;

d. Review the monitoring reports of DSP beneficiary agencies in order to determine operational bottlenecks; and

e. Upon program completion, conduct an evaluation of DSP and prepare appropriate recommendations, based on such evaluation, for an improved fund management system for the succeeding program assistance package, if any of a similar nature.

C. Reports

The implementation of DSP will be monitored with the quarterly reports, which are due within three months of the close of each quarter, and which will contain at least the following information:

The summarized status of DSP implementation covering financial progress of the entire DSP. This would be accomplished by summarizing DSP expenditures of all financial resources available for projects in the program, including additional pesos generated under this grant, GOP budgeted counterpart contributions, and the loan/grant proceeds by recipient and relating the expenditures to the funding levels provided under the AAs.

A final closeout report will be provided in the same format as discussed above. The report will provide a more definitive indication of the achievement of the DSP objectives and contain a Commission on Audit (COA) certified financial statement on the status of funds expended under the auspices of the DSP. This will indicate the actual level of disbursement related to the AAs under the DSP for all GOP counterpart and loan/grant proceeds.

VII. Conditions and Covenants

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

A. Conditions Precedent to Dollar Disbursement

1. The GOP shall submit to AID a duly authorized Certification of Program Availability (CPA) for the 1986 budget* that includes the following:

a. the amount of counterpart pesos in the 1986 budget for projects included in DSP.

b. the proceeds of loans and grants from the IBRD, ADB and AID in the 1986 budget for projects included in DSP.

c. an amount of pesos equivalent to the DSP grant.

2. The GOP shall formally submit to AID the list of projects, and the budgeted funding data, consistent with the agreed-upon criteria that will form the basis of the DSP.

3. The GOP will formally submit an implementation plan satisfactory to AID that explains how the GOP will monitor and report on the implementation of DSP. The plan should detail the organization of the monitoring, implementing and reporting functions, the responsibilities of each involved office, and the timing of actions.

4. The GOP shall submit the quarterly report for the quarter ending September 30, 1985 regarding the financial progress of the Rural Productivity Support Program as required by Section 7.3 of the Grant Agreement dated December 22, 1984 between the United States of America and the Republic of the Philippines.

B. Conditions Precedent to Peso Release from the Special Account

1. A certification from OBM's National Accounting Office that Advices of Allotment have been issued for all originally budgeted and additional peso counterpart and grant/loan proceeds for the DSP as defined by the project list submitted in A.2 above.

* Budget refers to the Budget of Receipts and Expenditures which is adopted in accordance with the 1986 General Appropriations Act and Public Works Acts as approved by the Batasan Pambansa.

C. Covenants

1. No changes will be made to the agreed-upon list of projects in DSP without the approval of AID or as AID may otherwise request.

2. The GOP will not amend, cancel or otherwise change the funding authorities issued by OBM for projects in DSP to free resources from DSP for other purposes.

3. That quarterly reports on the status of the DSP will be provided within three month of the quarter's end except in the case of the final report which may be within nine months of the end of the budget cycle.

4. The GOP will inform the donor and implementing agencies of the list of projects selected to participate in the DSP.

5. The GOP agrees to ensure that the funding for the DSP will be used solely for the purposes identified in the project agreements and implementation plans, and that the additional counterpart will not be used to substitute for the use of originally budgeted peso counterpart or loan proceeds.

UNCLASSIFIED

STATE 291076

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ACT: AID-6 INFO: AMB DCM ECON ADB CHRON/10

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UNCLAS STATE 291076

LOC: 36/37 129
21 SEP 85 0206
CN: 04497
CHRG: AID
DIST: AID

AIDAC

E.O. 12356: N/A

TAGS:

SUBJECT: DEVELOPMENT SUPPORT PROGRAM (DSP) (492-0400) -
DELEGATION OF AUTHORITY TO APPROVE PAAD AND AUTHORIZE
FUNDS

REFERENCE: STATE 294084

1. ON SEPTEMBER 19 THE ADMINISTRATOR APPROVED
DELEGATION OF AUTHORITY TO THE DIRECTOR,
USAID/PHILIPPINES TO APPROVE THE PAAD AND TO AUTHORIZE
45 MILLION DOLLARS ESF GRANT FOR DSP. YOU SHOULD
PROCEED WITH PAAD UNDER GUIDANCE REFTEL. WE ARE
POUCHING COPY OF ACTION MEMO APPROVED BY A/AID.

2. SEPTTEL(S) WILL COVER BUDGET ALLOWANCE AND EXPIRATION
OF CN SENT TO CONGRESS SEPTEMBER 12. SHULTZ

BT

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STATE 291076

ACT: AID-F INFO: AMB DCM ECON ADB CHRON/10

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DF RUEHC #4084 2591359
ZNR UUUUU ZZH
O 161859Z SEP 85
FM SECSTATE WASHDC
TO AMEMBASSY MANILA IMMEDIATE 3880
BT
UNCLAS STATE 284084

CALLED: (AID)

RECEIVED

SEP 17 8 43 AM '85

US

LOC: 27
16 SEP 85
CN: 02867
CPRG: AID
DIST: AID

348
1900

AID AC

E.O. 12356: N/A

TAGS:

SUBJECT: DEVELOPMENT SUPPORT PROGRAM (DSP) 492-0400;
PAIP REVIEW

REFERENCE: MANILA 27144

1. ON SEPTEMBER 10, 1985, THE PROJECT COMMITTEE (PC) REVIEWED THE PROGRAM ASSISTANCE INITIAL PROPOSAL (PAIP) CONTAINED IN REFERENCED CABLE. RECOMMENDATION WAS TO PROCEED TO PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD) WITHOUT REVIEW OF ANPAC. AA/ANE HEREBY APPROVES THE PAIP AND AUTHORIZES USAID TO PROCEED WITH THE PREPARATION OF THE PAAD (SUBJECT TO A/AID ACTION PARA 2 BELOW), TAKING INTO CONSIDERATION GUIDANCE PROVIDED IN PAPA 3 BELOW.
2. WE ARE REQUESTING DELEGATION OF AUTHORITY FROM ADMINISTRATOR TO USAID DIRECTOR SCHIEK TO APPROVE PAAD AND AUTHORIZE THE FUNDS. SEPTEL WILL ADVISE WHEN A/AID TAKES ACTION ON OUR REQUEST.
3. PC REVIEW OF THE PAIP FOCUSED ON ONE CENTRAL ISSUE - TO WHAT EXTENT COULD DISBURSEMENT OF DOLLARS 45.0 MILLION DSP FUNDS BE USED AS INSTRUMENT OF POLICY REFORM GIVEN (1) THE NATURE OF THE FUNDS (I.E. ESF PROMISED UNDER THE 1983 AMENDMENT TO THE 1947 MILITARY BASES AGREEMENT), (2) THE PRIMARY RATIONALE OF THIS PROGRAM IS ASSISTANCE TO PROVIDE CRUCIALLY NEEDED BALANCE OF PAYMENTS SUPPORT, AND (3) SHORTAGE OF TIME AVAILABLE IN CURRENT FY FOR OBLIGATION. CONCLUSION IS THAT USAID DIRECTOR SCHIEK SHOULD UTILIZE THIS PROGRAM TO SUPPORT MEANINGFUL PROGRESS IN POLICY REFORM (E.G. MEANINGFUL PROGRESS UNDER THE SELF HELP MEASURES AGREED TO IN THE MOST RECENT TITLE I NEGOTIATIONS) IF HE CONSIDERS IT APPROPRIATE.
4. WE SHARE YOUR CONCERN EXPRESSED PARA 2P AND 3E OF PAIP REFTTEL. CONSEQUENTLY WE BELIEVE PAAD SHOULD STIPULATE THAT TO THE MAXIMUM EXTENT PRACTICABLE UNDER CONDITIONS CITED ABOVE, DISBURSEMENT OF DSP DOLLARS SHOULD BE USED AS LEVER TO ACHIEVE ACCELERATED DISBURSEMENT OF COUNTERPART FUNDS FOR RURAL PRODUCTIVITY

SUPPORT PROGRAM.

5. CONGRESSIONAL NOTIFICATION SUBMITTED 9/12/85.
PLEASE NOTE THAT CN SUBMITTED TO CONGRESS HAS DROPPED
THE WORD PROJECTS FROM THE TITLE FOR THIS ACTIVITY.

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Table 1
Selected Philippine Economic Indicators

	1985	1984	% Change 1984-1985
I. Income and Expenditures^{a/} (P _M at constant 1972 prices)			
1. Gross National Product	45,800	48,010	(4.6)
2. Gross Domestic Product	47,027	49,264	(4.5)
a. Fixed Capital Formation	7,827	9,209	(15.0)
b. Increase in Stocks	300	450	(33.3)
c. GDP, By Industrial Origin			
Agriculture, Fishing and Forestry	12,960	12,831	1.0
Industry	15,026	17,183	(12.6)
Services	19,041	19,250	(1.1)
3. Personal Consumption Expenditures	31,270	31,094	0.6
II. Money and Banking			
1. Domestic Liquidity, M ₃ ^{b/} (P billion)	121.2	121.2	-
a. Money Supply	29.1	33.6	(13.4)
b. Quasi-Money	82.7	76.3	8.4
c. Deposit Substitutes	9.4	11.3	(16.8)
2. Interest Rates (%) ^{c/}			
a. Manila Reference Rate (MRR) 90 days	24.8	19.1	29.8
b. Time Deposits, All Maturities	26.0	17.3	50.3
c. Savings Deposit	11.4	9.7	17.5
d. Interbank Call Loan Rate	21.0	32.5	(35.4)
e. Treasury Bills	34.4	18.1	90.1
f. CB Bills, All Maturities	33.9	24.2	40.1
3. Exchange Rate (P/US\$) ^{b/}	18.473	17.402	6.2
III. Prices^{b/}			
1. CPI, All Items			
a. Philippines	351.1	275.2	27.6
b. Metro Manila	349.1	285.7	22.2
c. Outside Metro Manila	351.7	273.2	28.7
VI. External Sector Accounts (US\$M)			
1. Trade Balance ^{a/}	(262)	(314)	16.6
2. Balance of Payments ^{d/}	(1,958)	(1,455)	(20.2)
3. Net International Reserves ^{a/}	(2,638)	(4,656)	43.3
4. Total External Liabilities ^{a/}	25,195	25,418	(0.9)

a/ First semester estimates.

b/ June estimates.

c/ Second quarter averages computed on the following bases:

MRR: Weighted quarterly averages.

T/Bills: WAIR under negotiated basis.

CB Bills: Simple average of monthly weighted averages. Rates for other instruments are simple monthly averages.

d/ Annual estimates.

Sources: 1. National Economic and Development Authority (NEDA)
2. Central Bank of the Philippines (CBP)

Table 2
Quantitative Performance Criteria Under the IMF Stand-By Agreement

	December 1984		March 1985		May 1985		July 1985		Target Ceilings Sept 1985	Indicative Ceiling Dec. 1985
	Ceiling	Actual	Ceiling	Actual a/	Ceiling	Actual	Ceiling	Actual		
I. Money & Credit (P Billion)										
A. Reserve Money 1/	32.0	(34.3)	31.0	30.8	33.3	30.9	34.0	30.9	34.3	38.3
B. Net Banking System Credit to the National Government	17.9	17.0	17.9	(18.4)	5.0 2/	2.4 2/	4.7 2/	3.9	3.7 2/	3.1 2/
C. Net Banking System Credit to the Public Sector	27.4	25.6	27.7	(28.5)	7.9 2/	4.8 2/	8.6 2/	6.6	8.0 2/	9.1 2/
D. CB Credit to PNB 1/	5.0	4.6	5.1	4.9	---	4.7	5.2	4.7	5.3	5.3
II. External Sector (\$ Million)										
A. Net INT'L Reserves of the Monetary Authority (floor)	-4,410	-3,842	4,351 (-1,950) 3/	-4,070	-3,727 4/	3,528	1,355	-1,279	-1,307	-688
B. External Payment Arrears	2,744	(2,690)	3,161 (760) 3/	2,583	---	2,400	1,125	1,077	1,329	0.0
C. Short-term External Debt	9,649	(9,868)	9,649	(9,695)	9,850	9,456	9,649	9,389	9,649	9,649
D. New Borrowing Approvals: 1-12 years maturity	1,800	512	---	15	2,255	1,128	2,255	1,149	2,255	2,255
of w/c: 1-5 years maturity	300	177	---	15	400	200	400	220	400	400
III. Public Sector (P Billion)										
A. Combined Deficit of 13 GOP Corporations (End-of-period) 5/	13.0	11.6	2.4	---	---	3.4	---	---	---	---

() Means the target has not been met.

--- Means no established target for the period.

a/ Based on Central Bank data as of June 7, 1985.

b/ As of 5/29 for RM; as of 5/17 for net domestic borrowings of the GOP and of the public sector, for CB credit to PNB, and for the deficit of GOP corporations; as of end April for the external sector criteria.

1/ Average for the five working days before and after the end of the period.

2/ These ceilings refer to net domestic borrowings (i.e., from the Central Bank, banks and non-banking institutions) of the National Government, and of the Public Sector, in lieu of net banking system credit.

3/ Original target ceilings which were adjusted due to the delay in the commercial bank financing package.

4/ Reflects adjustments as prescribed after the first review.

5/ Will no longer be a separate performance criterion starting May since it will be included in the criterion on net domestic borrowing to the public sector.

ANNEX B

3

Table 3
Summary Operations of the National Government, Cash Basis 1982-86
(In billions of pesos)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> (revised program)	<u>1986</u> (proposed program)
Revenue	38.2	45.6	57.1	76.7	80.7
Domestic-based taxes	21.6	23.0	32.5	41.3	46.2
International trade taxes	12.2	16.5	17.5	28.0	26.3
Nontax revenue	4.4	6.1	7.1	7.4	8.2
of w/c: (foreign grants)	(N.A.)	(0.4)	(1.0)	(2.6)	(3.1)
Expenditure	52.6	53.1	67.3	83.2	87.6
Current operating expenditure	31.0	34.6	43.6	59.2	62.0
of w/c: (personnel services)	(11.3)	(13.9)	(16.8)	(21.2)	(22.6)
(maintenance and other					
operating expenses)	(11.7)	(12.0)	(12.4)	(17.8)	(20.0)
(interest payments)	(3.7)	(5.0)	(10.9)	(15.8)	(14.9)
Capital outlays	19.4	15.1	13.6	12.5	15.4
of w/c: (infrastructure MPWH/MOTC)	(7.5)	(6.9)	(6.3)	(5.5)	(6.0)
(other capital outlays)	(2.5)	(3.5)	(3.5)	(4.7)	(7.8)
(corporate equity invest.)	(9.4)	(5.7)	(3.8)	(2.3)	(1.6)
Net lending	2.2	2.4	10.1	11.5	10.2
of w/c: (to GFIs)	(N.A.)	(0.1)	(7.2)	(9.1)	(N.A.)
Deficit (-)	-14.4	-7.5	-10.0	-6.4	-6.9
Financing	14.4	7.5	9.7	6.4	6.9
Foreign (net)	4.6	5.4	1.9	3.2	1.0
New borrowings	5.4	6.7	4.6	7.2	---
Amortization (-)	0.8	1.3	2.7	4.0	---
Domestic (net)	9.8	2.1	7.8	3.2	5.9
Bank	7.3	-1.1	1.7	---	---
Nonbank	2.5	3.2	6.1	---	---
				(Percent of GNP)	
Tax revenue	10.1	10.4	9.3	10.2	9.4
Domestic based taxes	6.4	6.1	6.1	6.1	6.0
International trade tax	3.7	4.3	3.3	4.1	3.4
Non-Tax revenue	1.3	1.6	1.3	1.1	1.1
Expenditures	15.7	14.0	12.5	12.3	11.4
Current operating	9.2	9.1	8.1	8.7	8.1
of w/c: (interest payments)	(1.1)	(1.3)	(2.0)	(2.3)	(1.9)
Capital outlays	5.7	4.2	2.5	1.8	2.0
of w/c: (corporate equity invest.)	2.8	1.5	0.7	0.3	0.2
Net lending	0.7	0.6	1.9	1.7	1.3
Overall deficit	-4.3	-2.0	-1.8	-0.9	-0.9
Foreign (net)	1.4	1.4	0.3	0.4	0.1
Domestic financing	2.9	0.6	1.5	0.4	0.8

Source: OBM

Table 4
Budgetary Programs for ODA Foreign-Assisted Projects 1/
(In million pesos)

	<u>1983</u>	<u>% Distri- bution</u>	<u>1984 4/</u>	<u>% Distri- bution</u>	<u>1985 5/</u>	<u>% Distri- bution</u>	<u>1986 5/</u>	<u>% Distri- bution</u>
A. BY FUNDING SOURCE								
GOP Counterpart	5,067	68.2	3,199	60.2	2,961	50.0	2,472	38.8
Loan Proceeds	2,365	31.8	2,112	39.8	2,961	50.0	3,894	61.2
TOTAL	<u>7,432</u>	<u>100.0</u>	<u>5,311</u>	<u>100.0</u>	<u>5,922</u>	<u>100.0</u>	<u>6,366</u>	<u>100.0</u>
B. BY BUDGET TYPE								
Current Operating Expenditures	883	11.9	1,054	19.8	1,472	24.9	1,885	29.6
Capital Outlays	6,549	88.1	4,257	80.2	4,450	75.1	4,481	70.4
TOTAL	<u>7,432</u>	<u>100.0</u>	<u>5,311</u>	<u>100.0</u>	<u>5,922</u>	<u>100.0</u>	<u>6,366</u>	<u>100.0</u>
C. BY SECTOR								
Infra/Utilities	4,133 2/	55.6	2,830	53.3	2,456	41.5	2,715	42.6
Agriculture	1,105	14.9	381	7.2	555	9.4	478	7.5
Energy	1,143 2/	15.4	743	14.0	445	7.5	55	0.9
Industry	18	0.2	29	0.5	77	1.3	83	1.3
Social Services	842	11.3	1,137	21.4	2,249	38.0	2,258	35.5
Others 3/	191	2.6	191	3.6	140	2.3	777	12.2
TOTAL	<u>7,432</u>	<u>100.0</u>	<u>5,311</u>	<u>100.0</u>	<u>5,922</u>	<u>100.0</u>	<u>6,366</u>	<u>100.0</u>

1/ Excludes loan proceeds of government corporations.

2/ Equity contribution to National Power Corporation is now classified under the Energy Sectors; previously it was classified under the Infra/utilities sector.

3/ Includes provision for FAP Support Fund and Equity contribution to the Central Bank of the Philippines.

4/ Includes actual 1984 equity contribution to government corporations.

5/ Based on adjusted FAPs Program and Program for equity contribution to government corporation.

Source: OBM

DESCRIPTION OF THE GOP BUDGET SYSTEM
(As it Relates to Foreign Assisted Projects)

Overview of Program Funding

The GOP budget is a total resource budget, wherein, under the terms of Presidential Decree 1177 (PD 1177) all the resources and commitments of the government are to be considered at one time. It is the responsibility of the Office of Budget and Management (OBM) to prepare the budget documents after the overall levels have been established by the Development Budget Coordination Committee (DBCC). The DBCC sets the expenditure program for the year under the National Government Expenditure Program (NGEP) which is later transformed into what we call the General Appropriation Act and the Public Works Act. The national budget as presented and adopted must be balanced: planned deficits are not permitted. The gap between planned revenues and planned expenditures including capital outlays, must be met through a financing program from identified sources.

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

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

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

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

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

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

(1) Budget Preparation (Fiscal Year 1987 Appropriation)

BUDGET CALL (November to December 1985)

The National budget call is issued thru an OBM Circular to the various agencies/ministries for them to submit their fund requirements for the budget year.

Submission (January to March 1986)

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

Internal Review (March to May 1986)

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

An Inter-Office Coordinating Committee, usually chaired by the head of the OBM operations group meets to review the budget proposal.

Executive Review (May 1986)

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

(2) Legislative Review and Authorization (July 86 - September 86)

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

Appropriations

Appropriations provide the basis to expend funds for a specified purpose, and are very important in the GOP system of budgetary control. The appropriation language must set forth the authority, specific purpose, activities, amounts and sources of funds for the programs/projects, together with any other special limitations or special provisions governing the use of such funds.

(3 and 4) Budget Execution and Accountability

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

Prior to the beginning of the budget year, notices of obligation ceilings are released by OBM Budget Operations. These notices indicate the total amount available for obligation during the budget year broken down between current operating expenses and capital outlays. Based on the obligation ceilings, each ministry/agency prepares WFPs which indicates the quarterly allocation of obligation and cash needs. Based on the WFPs OBM after considering budget execution guidelines issues the advices of allotment (A/As). As a general practice, cash disbursement ceilings (CDCs) are issued simultaneously with the A/As in the amounts of their cash needs. A/As are the first fundamental budget execution document since they represent the initial obligation authority to operating entities. CDCs are the second fundamental budget document whose purpose is to control disbursement authorizations.

For purposes of recording loans in kind, each agency/ministry is expected to advise the OBM of their loan utilization so that a corresponding non-cash availment authority (NCAA) could be issued to record the loan.

Advice of Allotment

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

For ESF Projects, however, unobligated portions of Advices of Allotment at the end of the calendar year are submitted to OBM for reprogramming purposes in the form of a Work and Financial Plan. The Work and Financial Plan is usually submitted to OBM at the onset of the new calendar year. Based on the Work and Financial Plan, a Special Budget is issued to the infrastructure agency. A/A's issued against a Special Budget is valid up to the end of the calendar year when issued.

Cash Disbursement Ceiling

The CDC on the other hand, is the control tool for cash outflows from designated sources (including foreign donors) prior to disbursement. Normally, CDCs expire at the end of the quarter when issued except for foreign assisted projects wherein CDCs issued during the calendar year are valid through the end of the 1st quarter of the following year. New CDCs may be issued after the 1st quarter of the following year to pay unliquidated accounts payable emanating from valid obligations.

For ESF funds, however, validity of CDCs issued during the year extend only to December 31 of each calendar year. Immediately after the close of each calendar year, the Office of the President - Economic Support Fund Secretariat submits schedules of all prior year payables to OBM. OBM then issues CDCs covering prior year payables.

Reports and Reviews

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

Furthermore, all agencies are required to submit a trial balance as of the end of the year indicating the outstanding obligations or accounts payables. This report is due not later than March 1 of the following year and is used to confirm the magnitude of payable accounts, determine any savings and to determine CDCs to be issued for payables in the ensuing year.

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

Accountability

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

Exceptions

While the above pertains to all government activities as mandated by PD 1177, other Presidential Decrees, Letter of Instructions (LOIs) and Joint Circulars (specially Joint Circular 5-82 and 5-82A), the system has not been fully operationalized for government-controlled corporations. This exception is true because once the money is made available to the corporation it becomes fungible with the corporation's other funding sources. It maybe noted that counterpart funds of government corporations for foreign assisted projects use a different KBI and are described in the GAA as equity contributions to the corporation.

NONPROJECT ASSISTANCE CHECKLIST

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

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

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

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

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

A Congressional Notification was submitted to Congress on 9-12-85 which fully described the nature and scope of DSP. Neither has changed since that time.

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

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

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

Yes

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?
- Further legislative action is required within the Philippines. The national budget, the basic document upon which DSP relies, has already been submitted to the Batasan (the Philippine Legislature) for approval. Based on previous experience, it is expected to be approved by November 1985.
4. FAA Sec. 209, 619. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance with multilateral plans to the maximum extent appropriate?
- No. The primary purpose of DSP is to provide balance of payment support. Local currency which will be generated as a result of the dollar transfer will be used to fund selected foreign-assisted projects which are experiencing a shortage in counterpart funding. The Philippines is not a "newly independent country".
5. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.
- DSP is designed to provide balance of payments support and additional local counterpart funding to a select group of U.S. and multilateral organization-assisted projects. The majority of these projects relate to rural productivity in some manner, e.g. market roads, irrigation systems, farming systems, small and medium scale industry. Therefore, DSP may be most closely identified with improving the technical efficiency of industry, agriculture and commerce.

4/14

6. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

DSP is a balance of payment (BOP) support program. U.S. private trade and investment will be encouraged by the reduction in the BOP deficit since an improvement in trade opportunities should ensue as the deficit is reduced.

7. FAA Sec. 612(b); Sec. 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.

The GOP must commit itself to providing the original funding as appropriated in the national budget for each of the projects within the program.

8. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

No.

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

N/A

- | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 10. <u>FY 1985 Continuing Resolution Sec. 536.</u> Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? | No |
| 11. FAA 118(c) and (d). Does the project or program comply with the environmental procedures set forth in AID Regulation 16. Does the project or program take into consideration the problem of the destruction of tropical forests? | Yes

N/A |

FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

- | | |
|---------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. <u>Nonproject Criteria for Security Supporting Assistance</u> | |
| a. <u>FAA Sec. 531.</u> How will this assistance support promote economic or political stability? | The proposed DSP will promote economic and political stability by bringing a group of donor-assisted projects in economically disadvantaged rural areas closer to fruition, by increasing the resources made available to these projects. |
| 2. <u>Nonproject Criteria for Development Assistance</u> | N/A |
| 3. <u>Nonproject Criteria for Development Assistance (Loans only)</u> | N/A |
| 4. <u>Additional Criteria for Alliance for Progress</u> | N/A |

STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

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

A. Procurement

- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. <u>FAA Sec. 602.</u> Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? | N/A. DSP is a BOP support program whereby our ESF dollars are transferred to the GOP in exchange for its making additional counterpart available to a select group of projects. |
| 2. <u>FAA Sec. 604(a).</u> Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him? | N/A |
| 3. <u>FAA Sec. 604(d).</u> If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? | N/A |

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) N/A

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one or these areas? N/A

6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates? N/A

7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? N/A

8. International Air Transport. N/A
Fair Competitive Practices Act, 1974.
If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?
9. FY 1985 Continuing Resolution N/A
Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?
- B. Construction
1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? N/A
2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? N/A
3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP)? N/A
- C. Other Restrictions
1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? N/A
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? N/A

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? Yes
4. Will arrangements preclude use of financing:
- a. FAA Sec. 104(f); FY 1985 Continuing Resolution Sec. 527: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion? Yes
- b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property? Yes
- c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? Yes
- d. FAA Sec. 662. For CIA activities? Yes
- e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? N/A

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- f. FY 1985 Continuing Resolution, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel? Yes
- g. FY 1985 Continuing Resolution, Sec. 505. To pay U.S. assessments, arrearages or dues? Yes
- h. FY 1985 Continuing Resolution, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? Yes
- i. FY 1985 Continuing Resolution, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? Yes
- j. FY 1985 Continuing Resolution, Sec. 511. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? No
- k. FY 1985 Continuing Resolution, Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes