

UNCLASSIFIED

~~Restoration~~
PD-AAU-191
46042

INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON, D.C. 20523

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)

PHILIPPINES: Budget Support Program (BSP)
(492-0404)

September 16, 1986

UNCLASSIFIED

United States International Development Cooperation Agency
Agency for International Development
Washington, D.C. 20523

PHILIPPINES
PROGRAM ASSISTANCE APPROVAL DOCUMENT
(PAAD)

BUDGET SUPPORT PROGRAM
(BSP)

AMENDMENT NO. 1

(492-0404)

September 1986

Table of Contents

	<u>Page</u>
PAAD Facesheet	i
I. SUMMARY AND RECOMMENDATION	1
II. OVERVIEW	3
III. UPDATES	3
A. Economic Developments	3
B. Budgetary Problems	6
C. Policy Reforms	8
IV. PROGRAM	10
V. IMPLEMENTATION PROCEDURES	11
VI. CONDITIONS PRECEDENT	11
 <u>ANNEXES</u>	
A. GOP Request for Additional Budget Support Assistance	
B. Congressional Notification Cable	
C. Redelelegation of Authority	

List of Tables

<u>Table No.</u>	<u>Description</u>	<u>Page</u>
1	National Income Indicators	4
2	Balance of Payments, 1985-1986	5
3	National Government Cash Budget Operations, 1986	7
4	GOP Gross Financing Requirements	8
5	Expected 1986 Disbursements Under External Assistance Loans	9

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)

5. To		1. PAAD Number 492-0404, Amendment No. 1 492-K-603B	
Charles W. Greenleaf, Jr., AA/ANE		2. Country Philippines	
7. From		3. Category Cash Transfer	
Peter Bloom, Director, ANE/PD		4. Date September, 1986	
9. Approval Requested for Commitment of \$100,000,000.00		6. OYB Change Number N/A	
11. Type Funding <input type="checkbox"/> Loan <input checked="" type="checkbox"/> Grant		8. OYB Increase None	
12. Local Currency Arrangement <input type="checkbox"/> Informal <input checked="" type="checkbox"/> Formal <input type="checkbox"/> None		To be taken from: Economic Support Funds (ESF)	
15. Commodities Financed N/A		10. Appropriation Budget Plan Code 72-116/71037 QES 6-86-37492-KG-31 (67D-63-492-00-50-61)	
		13. Estimated Delivery Period September 1986	14. Transaction Eligibility Date N/A

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	
Limited F.W.		Industrialized Countries	
Free World		Local \$100,000,000.00	
Cash \$100,000,000.00		Other	

18. Summary Description
This approval document amends the original PAAD to provide an additional \$100 million in ESF funding for the Budget Support Program (BSP), increasing the total authorization for BSP to \$300 million.

The immediate budget crisis facing the new GOP administration has worsened over the last several months. Additional assistance is needed to help ameliorate this crisis. Unless ameliorated, it could serve to undermine the policy reform objectives and ultimately the viability of the new government.

The objective of the BSP remains the same, to provide budget support to the GOP so that it can continue financing basic services in priority sectors of education, health and agriculture, as well as in other priority budget areas mutually agreed upon by A.I.D. and the GOP. This PAAD amendment revises the program description to reflect the new total of \$300 million for BSP and to note that the additional \$100 million is not related to US government's best efforts commitments regarding the use of military bases in the Philippines under the US.-Philippines Military Bases Agreement. The implementation process and implementing entities remain the same as under the original BSP.

Except as amended in this document, the analyses, definitions, terms and conditions of the original PAAD remain unchanged.

19. Clearances		20. Action	
GC/ANE:JSilverstone	Date 7/15/86	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED	
ANE/PD/EA:JTennant	7/15/86	Charles W. Greenleaf Jr.	
ANE/DP:BSidman	7/15/86	Authorized Signature	
ANE/TR:BTurner	7/15/86	Date 9/16/86	
ANE/EA:WNance	7/15/86	Title	
DAA/ANE:JNorris	7/16/86	Assistant Administrator	
M/FM:CChristensen	7/15/86		
PPC:JMudra			

11

I. SUMMARY AND RECOMMENDATION

1. Program Title : Budget Support Program (BSP), Amendment No. 1
2. Grantee : The Republic of the Philippines
3. Grant Amount : \$100 Million (peso equivalent at the rates obtained by the U.S. Disbursing Office in Manila, through its agents, from the Central Bank of the Philippines)
4. Funding Source : Economic Support Fund (ESF)
5. Initial Obligation : FY 1986
6. Program Objectives : The primary objective of this BSP Amendment is to provide non-military bases related ESF funds as budget support to the GOP. This funding will support the BSP objective of assisting the GOP in ameliorating its current budget crisis. This BSP Amendment will contribute to GOP financial and, hence, political stability by providing budget support to the GOP so that it can continue financing basic services in the priority sectors of education, health and agriculture, as well as in other priority budget areas mutually agreed upon by A.I.D. and the GOP.
7. Program Description: A.I.D. will provide, in addition to the \$200 million pesos equivalent initially provided under BSP, pesos equivalent to \$100 million for budget support. The GOP will deposit the provided pesos in the Special Account established for this purpose under the Original BSP Agreement. Transfer of pesos from this Special Account to the GOP's General Fund will be mutually agreed to between A.I.D. and the GOP based upon the satisfaction of initial and subsequent conditions to the Transfers. BSP resources released from the Special Account will be reported against expenditures by the GOP in specific budget categories agreed upon by A.I.D. and the GOP.
8. Estimated Completion Date : Full disbursement by A.I.D. to the GOP for deposit in the Special Account of pesos equivalent to \$100 million in grant ESF is expected to take place by the end of the last quarter of FY 1986.

9. Statutory Requirements : All statutory requirements have been met. See Annex D of the original BSP PAAD.
10. Recommendation : That a \$100 million peso equivalent ESF grant be authorized to the GOP based on terms and conditions described in the attached authorization.

II. OVERVIEW

The enormous public pressures on the new government of President Corazon Aquino to produce tangible results continue. Unfortunately, the economic situation has not greatly improved. The budget situation, despite earlier U.S. assistance, has deteriorated further. The present deficit estimate, even with counting the \$200 million equivalent pesos provided under the original Budget Support Program (BSP), is pesos 29.9 billion or \$1.46 billion, around 4.7 percent of GNP.

The new government is continuing its policy reform efforts. It has moved from declarations of principles into the difficult realm of implementation. It is completing negotiations with the IMF on a stand-by arrangement and with World Bank on an Economic Recovery Loan. The resulting agreements will contain many detailed implementation commitments.

The objective of this amendment is to provide an additional \$100 million in ESF funds for the BSP. This assistance will further the amelioration of the present budget crisis, and, hence, contribute to the financial stability of the new government and help its efforts to institute longer term structural adjustments and reforms. The additional funds, along with the original funds, will provide budget support for basic services in such priority sectors as education, health and agriculture.

This document contains updates on recent economic developments, the budgetary situation and GOP policy reform efforts. It revises the program and implementation sections of the original PAAD to allow for the additional funds and to note that the addition is not related to U.S. commitments concerning the use of military bases in the Philippines.

III. UPDATES

A. Recent Economic Developments

1. Domestic Production, Income and Prices

The country's overall economic activity, as measured by the gross national product (GNP), continued to decline in the first half of 1986 in comparison with the first half of 1985. Real GNP recorded a 2.2 percent decline from the first semester's output in 1985, while real gross domestic product (GDP) was 2.6 percent below last year's level. These recorded declines, however, were slightly less than earlier projections of a 3 percent decline.

Table 1. National Income Indicators
1st Semester, 1984-1986
(Million Pesos, 1972 Prices)

<u>Indicator</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>% Change 1985-86</u>
1) Gross Domestic Product	49,831	46,531	45,319	(2.6)
2) Gross National Product	48,527	45,502	44,489	(2.2)

Source: National Economic and Development Authority (NEDA)

Gross domestic capital formation, which measures investment activity, in the first half of 1986 was 14.6 percent below the level of the first half of 1985. The most notable decline in investment was a 33 percent contraction in construction activity. However, faint encouraging signs of a coming recovery are found in slight increases in investments in durable equipment and in inventories.

At the sectoral level, only agriculture had a positive growth rate. Agricultural crop production led the sector's performance, while forestry output was most sluggish, owing much to more strict GOP enforcement of forestry laws and licensing procedures as well as possibly the effects of the impending log export ban. Despite some growth in the utilities industries, the industrial sector posted a negative growth of 7.4 percent. The mining and quarrying industries, which had managed a positive 1.4 percent growth in the first half of 1985 over the first half of 1984, declined by 2.5 percent. Except for transportation which had minor growth, all subsectors of the service sector declined. The overall sector decline was 1.6 percent.

The inflation rate between June 1986 and June 1985 was 0.03 percent, as compared to 27.6 percent between June 1984 and June 1985. Between December 1985 and June 1986, the change in the general price level was a negative 1.5 percent.

2. Balance of Payments

Based on recent balance of payments estimates presented in Table 2, the projected deficit for 1986, before "new money", i.e. additional borrowings, and the effects of rescheduling, is \$789 million. This is less than the comparable figure of \$1,782 million for 1985 and the earlier 1986 estimate of \$820 million. The deficit is due to a net outflow of capital of \$1,072 million, which is only partially offset by the projected current account surplus of \$283 million. The projected outflow on the capital account for 1986, however, is 40 percent lower than the level in 1985. Principal

Table 2. Balance of Payments, 1985-1986*
(In Million US Dollars)

	1985	1986 (projections)	
		As of April 1986	As of Sept 1986
merchandise trade	(482)	(350)	(550)
Exports	4,629	4,800	4,600
Imports	5,111	5,150	5,150
Non-Merchandise Trade	111	(189)	427
Inflow	3,288	3,224	3,517
Outflow	3,177	3,413	3,090
Transfers, Net	379	406	406
Current Account	8	(133)	283
Long-Term Loans	(1,026)	(953)	(1,041)
Inflow	428	896	854
Outflow	1,454	1,849	1,895
Direct Investments, Net	(9)	90	80
Short-Term Capital, Net	(1,526)	0	(283)
Errors and Omissions, Net	638	0	0
Gold Monetization	221	212	212
Revaluation Adjustment	(88)	(36)	(40)
Capital Account	(1,790)	(687)	(1,072)
Unremittable Arrears/Adjustments	-	-	-
Overall Balance	(1,782)	(820)	(789)
Change in Net Int'l Reserves	991	1,408	
Change in Nonmonetary Arrears			
Increases ()/Decrease	1,798	-	
Exceptional Financing	(3,873)	(2,228)	
Unremittable Arrears/ Adjustments	(698)		

* Before exceptional financing

Source: Central Bank of the Philippines

repayments on medium and long-term loans without rescheduling account for the bulk of the capital outflow. Likewise, net outflow of short-term capital is expected to be significantly below its 1985 level. The BOP deficit is to be financed mainly by new money amounting to \$764 million, representing disbursements from official loans committed during the year and the balance from the commercial credit line (\$525 million) extended in 1985.

The surplus in the current account is expected to come from the net inflows in the non-merchandise trade and transfer accounts. Net services inflow is projected to reach \$427 million, while transfers are estimated to yield a \$406 million inflow. However, the trade deficit is projected at \$550 million, with exports slightly below their 1985 level as the expected decline in traditional exports will not be entirely offset by gains in non-traditional exports. The drop in export receipts from traditional products is primarily attributed to depressed prices for coconut products and lower volume of exports of sugar and forest products. Imports are expected to remain at around the 1985 level in spite of the significant reduction in petroleum prices since other imports are expected to increase due to the import liberalization program and economic recovery efforts.

After reschedulings, the estimated balance of payments will be a surplus of \$1,167 million. Present international reserves are around \$1.7 billion. By the end of the year international reserves holdings are expected to be \$2.4 billion. This level will be able to cover as much as five months of imports at current import levels, or about three and a half months of imports assuming recovery in the next few months.

B. Budgetary Problems

The budget situation has worsened since the preparation of the original BSP PAAD in June. As shown in Table 3, estimates of revenue are now P2.8 billion less and expenditures, P5.0 billion more. The projected deficit (without counting ESF assistance) has increased from P26.2 billion (\$1.3 billion) to P34.0 (\$1.7 billion). Even with the \$200 million already provided, the estimated deficit is running P29.9 billion, which is around 4.7 percent of GNP.

The decrease in estimated revenues is due to the impact of some tax reforms which reduced revenues and less optimistic expectations of increased revenues from other tax reforms and from increased collection efforts. Specifically, the revised budget includes in the non-tax category a provision for a shortfall of P2.0 billion from the target of a P5.5 billion increase in tax revenues.

Table 3. National Cash Budget Operations, 1986

<u>Item</u>	<u>As of BSP PAAD</u>	<u>Adjustments</u>	<u>Latest Estimates</u>
Revenues (Without ESF Funds)	83.2	-2.8	80.4
Tax	76.1	-0.3	75.8
Non-Tax	7.1	-2.5	4.0
Expenditures	109.4	5.0	14.4
Current Operating	65.8	4.0	69.8
Personnel Services	24.0	1.1	25.1
Maintenance and Other Operating Expenses	21.0	0.5	21.5
Interest Payment	16.9	-	16.9
Subsidy	1.0	1.8	2.8
Allotment to Local Government Units	2.9	0.6	3.5
Capital Outlays	17.0	-2.3	14.7
Equity and Net Lending	26.6	3.3	29.9
Deficit (Without ESF Funds)	26.2	7.8	34.0
Deficit (With \$200 M ESF)	22.1	7.8	29.9
Deficit (With \$300 M ESF)			27.9

Despite the lowering of capital outlay plans by P2.3 billion, projected expenditures have increased by P5.0 billion. The major causes of the expected higher expenditures are: salary increases for teachers and other government personnel; greater subsidies to government corporations to offset the removal of tax exemptions as well as provide greater support to the Philippine Ports Authority and the National Irrigation Administration; more net lending to the government corporations to help with their cash flow problems; and, the lifting of a reserve requirement against allotment to local government units.

To finance its deficit, the GOP is depending heavily on domestic borrowings. Even with the additional \$100 million to be provided under this amendment, the GOP's gross financing requirements for 1986 will be

₱40.0 billion. (See Table 4) This includes ₱27.9 billion for the budget, ₱10.3 billion for debt amortization (₱6.5 billion for foreign and ₱3.8 billion for domestic) and ₱1.7 billion for an increase in cash balances. Current GOP plans are to finance this with ₱14.5 billion in foreign borrowings and ₱25.5 billion in domestic borrowings from the Central Bank and the public. The GOP expects 1986 disbursements from official external assistance loans to provide the needed foreign borrowings. See Table 5.

The planned domestic borrowings are quite heavy. Especially if the economy picks up, they carry risk of causing inflation, if borrowed from the Central Bank, or crowding out private investment, if borrowed from the general public. The funds under this amendment will help minimize the risk.

C. Policy Reforms

The new GOP administration continues to make progress on structural adjustments and policy reforms. It is moving from pronouncements or declarations of reform principles into the realm of implementation. For example, an executive order has established a five member subgroup of the cabinet to manage the divestiture of acquired assets. The President approved 29 wide ranging tax reforms in July and most have already been implemented, including selective tax amnesties. The GOP has lowered the support price for rice to a more realistic, defensible level. Restructuring plans for the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP) which substantially reduces them in size and restricts their functions have been prepared.

Table 4. GOP Gross Financing Requirements

I. Budget Deficit (including \$300 M ESF)		₱27.9 B
II. Debt Amortization		10.3 B
a. Foreign	₱6.5 B	
b. Domestic	3.8 B	
III. Change in Cash Balance		<u>1.8 B</u>
IV. Gross Financing Requirements		₱40.0 B
V. Domestic Borrowing		25.5 B
VI. Balance for External Assistance		₱14.5 B
Dollar Equivalent (₱20/\$1)		\$725 M

Source: Ministry of Finance

Table 5. Expected 1986 Disbursements Under External Assistance Loans
(US\$ Million)

	<u>Undisbursed Commitments</u>	<u>Expected 1986 Disbursements</u>
I. Multilateral Institutions	<u>1238</u>	<u>292</u>
A. Asian Development Bank	<u>433</u>	<u>87</u>
1. On-going Projects	316	30
2. Special Project Implementation Assistance (SPIA)	100	52
3. Agricultural Inputs Program	17	5
B. World Bank	<u>805</u>	<u>205</u>
1. On-going Projects	613	120
2. Agricultural Sector/Inputs Loan	110	80
3. Rural Roads	82	5
II. Bilateral Sources	<u>821</u>	<u>433</u>
A. United States	<u>172</u>	<u>49</u>
1. On-going Projects*	137	18
2. PL 480 Title I	35	31
B. Japan	<u>596</u>	<u>362</u>
1. On-going Projects	189	51
2. OECF 13th Yen Project Loan	97	1
3. OECF 8th Commodity Loan	114	114
4. OECF 9th Commodity Loan	98	98
5. OECF Special Commodity Loan	98	98
C. Germany	<u>53</u>	<u>22</u>
1. On-going Projects	14	3
2. Sector Loan	29	9
3. KFW Commodity Loan	10	10
Total	2,059	725

Source: Ministry of Finance

*Note: This table has not been adjusted to take into consideration the recent conversion of undisbursed portions of U.S. loans to grants

Negotiations with the IMF for a stand-by arrangement are almost completed. Differences over the pace of import liberalization apparently have been resolved with GOP assurances that any delays arising from public hearings would not go beyond May 1, 1988. Likewise, GOP has, or is close to, and will shortly meet the preconditions of the World Bank for an Economic Recovery Loan.

USAID has been busy in the policy reform arena through informal advice, technical assistance and interactions over the FY 1986 PL 480 Title I Agreement, the \$100 million additional funds for BSP and various projects. For example, the self-help measures of FY 1986 PL 480 Title I Agreement are quite strict, pushing further National Food Authority (NFA) to concentrate on an effective grain stabilization program for rice and corn and to divest itself of other activities, ensuring wheat importation is truly open and working toward lower fertilizer prices. An AID financed team from Arthur Young and Company, at GOP's request, is preparing a divestiture plan for many NFA activities.

IV. PROGRAM

A. Program Rationale, Objectives, and Funding.

The U.S. Congress has appropriated \$100 million in ESF funds for economic assistance to the Philippines under the Urgent Supplemental Appropriations Act of 1986. These resources are not, however, related to U.S. government's best efforts commitments associated with the use of military bases under the U.S.-Philippines Military Bases Agreement. In August, 1986, the GOP, through the National Economic and Development Authority (NEDA), formally requested A.I.D.'s concurrence in the use of this supplemental appropriation for budget support purposes (see Annex A). In consideration of the worsening budget situation of the GOP, as presented in Section III above, and the U.S. government's continuing desire to be responsive to the critical financial and economic needs of the new government, USAID has agreed to the use of the \$100 million supplemental appropriation for program assistance in addition to the \$200 million Budget Support Program obligated in June 1986, rather than project assistance. Specifically, USAID has agreed that the supplemental appropriation will be used for the same purposes and in accordance with the same procedures as the Budget Support Program. Congress has raised no objections to this decision (please see Annex C).

Accordingly, A.I.D. proposes to amend the \$200 million BSP with an ESF program assistance grant of \$100 million for peso budget support to the GOP.

B. Program Description, Restrictions, and Relationship to other Mission Programs.

Please refer to Section VIII, THE PROGRAM, paragraphs C. Program Description, D. Program Restrictions, and E. Relationship to Other Mission Programs of the BSP PAAD for a full discussion of these project elements. These elements are the same for this Amendment.

V. IMPLEMENTATION PROCEDURES

Please refer to Section IX. Implementation Procedures, pages 32-34 of the BSP PAAD, for a detailed discussion of the implementation procedures to be utilized for this Amendment. The implementation entities and process for this Amendment will be the same as for BSP, with one exception. Please refer to the BSP PAAD, page 32, Section IX.A. Implementation Process, 1. Peso Disbursement. For this Amendment, the amount of peso to be disbursed will be determined on the basis of the rate or rates of exchange obtained by the U.S. Disbursing Office, Manila, Philippines, through its agents from the Central Bank of the Philippines in acquiring the pesos to be transferred.

VI. CONDITIONS AND COVENANTS

No conditions or additional covenants are contemplated.



REPUBLIC OF THE PHILIPPINES
NATIONAL ECONOMIC AND DEVELOPMENT AUTHORITY

Annex A

NEDA sa Pasig, Amber Avenue
Pasig, Metro Manila

Cable Address: NEDAPHIL
P.O. Box 419, Greenhills
Tels. 673-50-31 to 50

8-500
RECEIVED

AUG 25 8 42 AM '86

US

22 August 1986

Mr. Frederick W. Schieck
Director
United States Agency for
International Development
Ramon Magsaysay Center
1680 Roxas Blvd., Manila

DIV	ACB/INT
OD	<input checked="" type="checkbox"/>
E	<input type="checkbox"/>
PE	<input type="checkbox"/>
RLA	<input type="checkbox"/>
PO	<input checked="" type="checkbox"/>
TD	<input type="checkbox"/>
EO	<input type="checkbox"/>
PER	<input type="checkbox"/>
CSD	<input type="checkbox"/>
LOG	<input type="checkbox"/>
GSO	<input type="checkbox"/>
TRV	<input type="checkbox"/>
CO	<input type="checkbox"/>
DMD	<input checked="" type="checkbox"/>
OCD	<input checked="" type="checkbox"/>
ORAD	<input type="checkbox"/>
OPIN	<input type="checkbox"/>
OFFICE	<input type="checkbox"/>
RIC/A	<input type="checkbox"/>
REG/ST	<input type="checkbox"/>
AR	<input type="checkbox"/>
FILE DATE	<input type="checkbox"/>
9-9-86	

Dear Mr. Schieck:

This has reference to the additional \$100 million allocation under the Economic Support Fund outside the Military Bases Agreement (MBA). We would like to propose that the amount be used for general budgetary support to the government. We further suggest that an agreement be drawn to this effect as soon as possible for our signature.

May we expect your favorable consideration.

Very truly yours,

SOLITA COLLAS-MONSOD
Minister for Economic Planning
Director-General

ACTION TAKEN	
NAN	Other
Type <i>DN</i>	No.
Dated <i>9/05/86</i>	Initials <i>K. Collins</i>
<i>by 307</i>	