

**ASIAN DEVELOPMENT BANK  
Operations Evaluation Department**

**COUNTRY ASSISTANCE PROGRAM EVALUATION**

**FOR THE**

**PHILIPPINES**

In this electronic file, the report is followed by Management's response and the Board of Directors' Development Effectiveness Committee (DEC) Chair's summary of a discussion of the report by DEC.

The logo of the Asian Development Bank (ADB) is a black square with the letters 'ADB' in white, serif font.

## Evaluation Study

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Reference Number: CAP: PHI 2008-20  
Country Assistance Program Evaluation  
June 2008

# Philippines Country Assistance Program Evaluation: Increasing Strategic Focus for Better Results

Operations Evaluation Department

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of April 2008)

Currency Unit	–	Peso (₱)
₱1.00	=	\$0.024
\$1.00	=	₱41.80

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADTA	–	advisory technical assistance
AFC	–	Asian financial crisis
ARMM	–	Autonomous Region of Muslim Mindanao
ASEAN	–	Association of Southeast Asian Nations
BESRA	–	Basic Education Sector Reform Agenda
BFS	–	Bahay Financial Services
BHF	–	Balikatan Housing Finance
BIMP-EAGA	–	Brunei, Indonesia, Malaysia, Philippines-East ASEAN (Association of Southeast Asian Nations) Growth Area
BIR	–	Bureau of Internal Revenue
CAPE	–	country assistance program evaluation
CCAO	–	central court administration office
CFMO	–	central financial management office
COSS	–	country operational strategy study
DILG	–	Department of Interior and Local Government
DMC	–	developing member country
DOH	–	Department of Health
DPSP	–	Development Policy Support Program
EA	–	executing agency
EPIRA	–	Electric Power Industry Reform Act
ERC	–	Energy Regulatory Commission
EVAT	–	expanded value-added tax
GDP	–	gross domestic product
GFI	–	government financial institution
GOCC	–	government-owned and -controlled corporation
HSDP	–	Health Sector Development Program
HSRA	–	Health Sector Reform Agenda
IA	–	implementing agency
IMF	–	International Monetary Fund
LAR	–	land acquisition and resettlement
LEMP	–	law, economic management, and public policy
LGC	–	Local Government Code
LGU	–	local government unit
LGUGC	–	LGU Guarantee Corporation
LWUA	–	Local Water Utilities Administration
MBUSS	–	Mindanao Basic Urban Services Sector
MDG	–	Millennium Development Goal
MEDC	–	Mindanao Economic Development Council
MTPDP	–	Medium-Term Philippine Development Plan
MWSS	–	Metropolitan Waterworks and Sewerage System

NBFI	–	nonbank financial institution
NFA	–	National Food Authority
NGO	–	nongovernment organization
NHMFC	–	National Home Mortgage Finance Corporation
NPC	–	National Power Corporation
NPL	–	nonperforming loan
NRW	–	nonrevenue water
O&M	–	operation and maintenance
OCA	–	Office of the Court Administrator
OED	–	Operations Evaluation Department
PDF	–	Philippine Development Forum
PSRP	–	Power Sector Restructuring Program
RCAO	–	regional court administration office
SBGFC	–	Small Business Guarantee and Finance Corporation
SEC	–	Securities and Exchange Commission
SEDIP	–	Secondary Education Development Improvement Project
SME	–	small- and medium-sized enterprise
TA	–	technical assistance
TVET	–	Technical and Vocational Education and Training
WSS	–	water supply and sanitation

**NOTE**

In this report, "\$" refers to US dollars.

**Key Words**

philippines, adb, asian development bank, country strategy and programs, partnership, sector assessment, operations evaluation, operations evaluation department, agriculture, infrastructure, transport, energy, urban sector, health, education, water supply, finance, environment, private sector development, decentralization, local government, governance, policy dialogue, technical assistance, capacity building

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The guidelines formally adopted by the Operations Evaluation Department (OED) on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. Romeo Bernardo (Senior Strategy Advisor), Teresa Ho (Health Sector Specialist), Steven Tabor (Country Program and Strategy Evaluation Specialist), and Sarath Thalakada (Finance Sector Specialist) were the international consultants. Bing Villarante (Rural Development and Portfolio Specialist), Rowena Bernardine Vicente (Macroeconomic and Public Policy Specialist), Isabel Paula Patron (Fiscal and Public Expenditure Management Specialist), Paulo Rodelio Halili (Energy Specialist), Jose Antonio League (Urban Development Specialist), and Noel Gamo (Finance Sector Specialist) were the national consultants. To the knowledge of the management of OED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

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## EXECUTIVE SUMMARY

### Background

By the end of 2007, the Asian Development Bank (ADB) had approved \$9.8 billion in public loans and \$148.8 million in technical assistance to the Philippines. Through its private sector operations for the same period, ADB had approved \$275 million in loans and \$37 million in equity investments.

### Evaluation Purpose and Approach

The first Philippines country assistance program evaluation (CAPE) was completed in early 2003 for ADB support to the Philippines. It covered ADB's assistance since 1966, but focused on the 1980s and 1990s. The 2008 CAPE assesses the performance of the ADB assistance program since 2003 as an input for preparation of the new country partnership and strategy. The evaluation method is based on the Operations Evaluation Department's CAPE guidelines. The approach involved surveys, interviews, and discussions with Government oversight and line agencies and ADB staff responsible for the lending and nonlending operations under implementation during the CAPE period. Project site visits were made by the CAPE team to eastern Mindanao, north Luzon, and Iloilo to obtain regional and local government and beneficiary views on ADB assistance, and the team attended Philippines Development Forum events as an observer.

### Country Context and Challenges

**Key Challenges.** At the beginning of the CAPE period, the ADB–Philippines partnership was faced with three key challenges: (i) an excessively broad country strategy and program with weak implementation performance; (ii) a large fiscal deficit resulting in low government spending on essential public goods; and (iii) a weak investment climate, and wide regional disparities resulting in persistent unemployment, inequality and poverty, particularly in the southern and eastern areas of the Philippines.

**Government Plans and ADB's Program at the Beginning of the CAPE Period.** Since 1999, the Government's plans covered an extensive set of development needs and programs. But there was a weak link between plans and the budget despite the prevailing fiscal problems. Similarly, ADB country strategies and plans at the beginning of the CAPE period were overly broad-based with wide sector and geographic coverage. Furthermore, ADB's ongoing investment operations experienced implementation delays; problems with land acquisition and resettlement; procurement delays; shifting political support for urban, agriculture, and education reforms; and a dearth of counterpart finance by 2002–2003 when fiscal constraints were most severe.

**Improved Growth Rates.** During 2002–2007, the Philippines achieved 6 consecutive years of annual gross domestic product (GDP) growth averaging 5.6% over the period. Driven largely by an expanded service sector, growth was accompanied by low to moderate inflation, low real interest rates since 2001, and unprecedented current account surpluses that boosted the country's balance of payment position. In early 2008, risks began to emerge to the sustainability of this growth rate arising from a slowdown in the United States economy and other external factors such as high commodity prices.

**Persistent Unemployment and Poverty.** Poverty incidence declined from 33.0% of the population in 2000 to 30.0% in 2003, but then increased again to 32.9% in 2006 despite robust growth performance. Unsatisfactory job creation is reflected in a labor underutilization rate of



25% over the past 10 years and this has encouraged migration. In 2006, an estimated 8.2 million Filipinos, or nearly a fourth of the labor force, were working overseas and migrant worker remittances helped stabilize the domestic economy. However, based on official family household and income surveys, average family incomes in 2006 declined by 4% in real terms between 2003 and 2006. Income inequality continues to be high relative to the country's Asian neighbors, with wide geographic disparities in poverty. Poverty rates are particularly high in the conflict-affected area of the Autonomous Region of Muslim Mindanao (ARMM).

**Low Spending in Essential Public Goods and Services.** Poor fiscal performance in the first half of the decade continued to have broad implications for the economy. Apart from macroeconomic instability and its implications for investor confidence, a weak revenue effort also resulted in lower spending on the public goods and services needed to attract investments and make growth more inclusive. While budgets for education increased significantly in 2008, total spending was still only 2.5% of GDP, well below previous levels for the country, the international benchmark of 6% and neighbors. As a result, a large number of poor had limited access to the basic services needed to augment human resources and create wealth including economic infrastructure, education, and health. The budget deficit widened to over 5% of GDP in 2002 as revenues fell, with deficit financing contributing to a high debt ratio that peaked at 78% of GDP in 2004.

**Weak Investment Climate.** Low spending on infrastructure and human resources undermined the Government's efforts to attract private sector investment and increase competitiveness. Added to this was the deterioration in governance and competitiveness indicators, particularly macroeconomic stability, the control of corruption and infrastructure, which lowered investor confidence. The slow process of asset cleanup and recapitalization of banking after the Asian financial crisis, in part due to fiscal constraints, made banks more reluctant to lend for investment purposes. This combination of factors resulted in low rates of public and private capital formation.

## **Strategic Assessment**

**The Program became Strategically Focused.** To address the fiscal policy problem, ADB, in cooperation with other development partners and stakeholders, engaged the Government in policy dialogue on fundamental reforms in public finance management. To enhance the private sector enabling environment, support was programmed to develop capital markets and ensure energy supplies. To address regional disparities, ADB continued to program a focus on the development of the southern Philippines. Support was programmed for regional cooperation initiatives. Lending to activities of a few government-owned corporations was programmed to enable off-budget lending for initiatives related to the Millennium Development Goals. To address the broad program and poor implementation performance, ADB undertook a major portfolio cleanup exercise from 2002 that helped improve portfolio performance. The 2005 country strategy and program called for greater strategic positioning and selectivity for operational activities through a set of quality-at-entry criteria including executing agency absorptive capacity, availability of budgeted counterpart funds, results-focused outcomes and government readiness filters. In view of the need for furthering priority reforms, policy-based lending was widely used.

**Portfolio Performance Improved.** A combination of portfolio cleanup and timely use of program lending resulted in a restoration of positive net transfers and a reduced number of problem projects. This has made a small but positive contribution to reducing the fiscal drag of slow-disbursing aid on the budget. However, some development partners perceive that ADB gives less attention to support for project implementation than agencies such as the World Bank. Some Government agencies identified a need for clarity on the role and responsibility of

ADB's Philippines Country Office located at ADB headquarters. The Philippines Country Office's role in leading policy dialogue, portfolio cleanup and monitoring was acknowledged by the Government.

**Program Selectivity was Guided by Country-Specific Constraints.** ADB assistance focused on critical constraints to public sector governance, including energy sector restructuring as a key fiscal drain; key issues in fiscal management, including increases in tax revenue; strengthened expenditure management; budget realignment toward priority public goods and services; and local government planning, expenditure management and financing improvements. Alignment of the strategy with fiscal realities was maintained. In addition, support for an enabling environment for the private sector included addressing procurement transparency, deepening nonbank financial market development, lending for small and medium-sized enterprises (SMEs), and microfinance reforms. A significant shift was made by initiating private sector operations support for energy generation. A feature of the support for fiscal, energy and financial reforms was the degree to which political economy factors were aligned in the program, such as timing in relation to political support and more effective sequencing of reform measures. For the CAPE period, improved ADB strategic positioning, institutional performance and contributions to results on priority issues is rated "successful" with scope for further improvement.

### **Sector Assistance Performance**

**Support for Macroeconomic Stability and Fiscal Consolidation.** ADB's support for fiscal and energy reforms contributed to fiscal adjustment by leveraging energy (electricity) tariff adjustments, public energy asset privatization, and increased taxes. This contribution led to reduced credit spreads, improved credit outlooks from international rating agencies, lower hurdle rates on investments, a modest sentiment improvement in some quarters of business, and reduced public sector financing requirements. National Government tax revenues climbed from 12.4% of GDP in 2002 to 14.3% in 2006, but fell in 2007 to 14.1% in 2007, below the target of 14.8%.

**Support for Improved Budget Allocations and Efficiency.** As fiscal space emerged, budget allocations were increased to infrastructure, health, education and agriculture, even though outlays are below needs. Steps were taken to address expenditure efficiency improvements by promoting the use of medium-term expenditure planning and Government performance reviews. The full effects of using medium-term expenditure frameworks and performance budgeting will take a longer time to have widespread and sustained effectiveness, and ultimately impact on welfare improvements. Accordingly, program lending was increasingly designed and sequenced to support reforms that are medium-term in nature, and have avoided the past problems of prior conditionality that undermined government ownership.

**Progress on Energy Sector Restructuring and Capital Market Development to Support the Private Sector Enabling Environment.** Support for fiscal, energy, and nonbank financial reforms contributed to improving the private sector enabling environment. Private sector participation has increased in power generation. With ADB assistance, a wholesale electricity spot market is operational and independent regulation is being strengthened. Sequenced and combined use of public project finance and program lending to effect reforms followed by private sector financing, have improved the relevance and effectiveness of ADB's support for energy sector reforms and development. ADB support has resulted in an improved securities regulatory framework and a stronger securities regulator; an improved governance structure of the stock exchange; establishment of a framework for anti-money laundering; adoption of international accounting and auditing standards; adoption of a capital market development blueprint; and an increase in the number of microfinance institutions and users. Overall, the stock market performance was strong during the CAPE period, but there were few new listings.

**Programmatic Assistance to Health and a Project in Education that Provide Models and Lessons for Advancing Decentralization.** Assistance for health sector supported the Government's health sector reforms and provided lessons for further and more effective decentralization in the sector. Innovative implementation of the Health Sector Development Program facilitated the Government's application of a programmatic approach using multiple development partners. Continuing support for a secondary education project provided a demonstration model for implementing some components of the ongoing education reform and decentralization process.

**Varied Performance in Infrastructure, Urban, Rural, and Water Sectors.** Operations in the urban, rural, and water sectors continued to have mixed results. Some of these projects exited the program as part of the portfolio cleanup exercise, while others continue. Investments in these sectors are usually relevant. Field evidence from individual local subprojects indicates that ADB support has contributed to local income improvements and poverty reduction through support for agriculture, rural development, and service improvement. Projects supporting coastal fisheries and resource management, agrarian reform, and rural infrastructure are having a positive local effect. However, the slow pace of the decentralization process, which began in 1991; overlapping roles and responsibilities of many agencies; lack of access by local government units to development finance; wide geographic dispersion and insufficient follow-through in any one location; use of parallel project management systems; and short local government political tenures and commitment variably affect project effectiveness, efficiency, and sustainability. ADB support for the grains sector reform could have comprehensively impacted on rural development but did not eventuate.

ADB supported the rural water supply subsector where poor quality and limited availability of water supply systems contribute to poor health outcomes, although results vary by location. ADB support to medium-sized cities and towns such as improved water supply to Cebu was successful. ADB has supported Metro Manila water supply for over 30 years with mixed success. ADB's support to the Government for a public-private partnership for Manila water supply did not initially succeed, but the model was relevant and continues to be applied. ADB support for urban environmental improvement through the Manila Air Quality Project was relevant but has not had the desired impact on pollution control, given lack of enforcement of the Clean Air Act. Support for local urban services development in Mindanao show promising early results. ADB support for provincial road development during the CAPE period was delayed due to protracted procurement and land acquisition and resettlement but met its objectives. However, a loan supporting regional airport development was canceled due to right-of-way issues. ADB's role in the North Luzon Expressway Project provides an example of a successful public-private partnership investment in roads.

**Sector Assistance Rated Successful Overall, with Need for Improvement.** ADB's assistance was relevant to the needs of most sectors, and the effectiveness, efficiency, impact, and likely sustainability of program benefits were substantial in some sectors and operations, but considerably less in others. Sector performance was strongest in economic management, nonbank finance, and energy sectors. Delivery of assistance to urban and rural areas was hampered by weaknesses in some project designs and delivery; the absence of uniformly strong, well-coordinated national and decentralized institutions supporting agriculture and rural development; recurrent funding constraints; and an inability to meet land acquisition and resettlement commitments for infrastructure projects. Consequently, program results in transport, urban, agriculture, and rural development were below expectations. Economic management, energy, and finance played a key role in ADB's overall support program; these were weighted more heavily in providing an overall bottom-up rating. The overall rating for ADB sector assistance during the CAPE period is assessed borderline "successful," with need for

improvement in several areas and sectors of the partnership and program. The overall rating for ADB assistance for the CAPE period of 2003–2007, derived by combining the bottom–up and the top–down ratings and weighting these equally, is successful, however, with needs for further improvement in several areas of the country partnership and program.

## Key Findings and Lessons

**Selectivity Based on Country Specific Constraints, Government Commitment, Stakeholder Involvement, and a Medium Term Policy Reform Engagement was a more Effective Approach.** At the beginning of the CAPE period, ADB’s lending operations experienced a range of problems including implementation delays, shifting political support for reforms, and a dearth of counterpart finance. ADB changed strategy from a broad-based approach to a focus on addressing critical constraints to tackle fiscal policy weaknesses, public sector governance, energy sector restructuring, and local government financing through a combination of program lending and technical assistance support. Commitment by the Government improved the design and implementation of critical macroeconomic reforms. Independent analysis and advocacy by the private sector, academe and civil society stakeholders, together with coordinated consultation with the Government, helped to improve the understanding and management of the political economy of fiscal and energy sector reforms.

**Regional Focus on the Southern Philippines Presents some Positive Results but Improvements are Needed.** The focus on the southern Philippines, and particularly Mindanao, presented an opportunity to build positive synergies between agricultural development, SME development, and regional cooperation through the Brunei, Indonesia, Malaysia, Philippines-East ASEAN (Association of Southeast Asian Nations) Growth Area (BIMP-EAGA). An unplanned, but relevant, opportunity for developing rural value chains has emerged as a result of what were previously distinct sets of ADB-supported interventions. This is having a positive effect of increasing the income and employment impacts of agriculture projects. Project lending in the ARMM has, however, faced a number of implementation problems leading to delays in delivery of assistance suggesting the need for alternative approaches.

**Contributions to Improving the Private Sector Enabling Environment were Limited to Specific Sectors.** Support for fiscal, energy, and nonbank financial reforms contributed to improving the private sector enabling environment. Private participation has increased in energy generation, helping to ensure adequate power supply for the country—an important aspect of having a favorable investment climate that is privately driven and not subject to government resource constraints. ADB’s finance sector reform programs have contributed to improved governance in the local stock market; and strengthened regulatory quality, which was important after the Asian financial crisis when most lapses were in underregulated activities. However, new support for transport and water infrastructure has not been forthcoming as planned, even though ADB has demonstrated readiness to be involved in public–private partnerships. Concerns over handling of right-of-way issues requiring resettlement, lack of competitiveness with other bilateral development partners, and perceived high transaction costs of ADB-administered projects have limited ADB’s contribution to large-scale transport and water infrastructure.

**Addressing Good Governance and Corruption has Moved beyond Project Boundaries to a Sector Focus.** ADB has helped the Government with investment climate assessments and advocacy, helping to spotlight the need to reform competitiveness more broadly if the country is to sustain growth and generate the employment and incomes necessary to address exclusion and income poverty. Projects can address corruption issues within their boundaries, but their impact on wider governance problems is inherently limited. Support for fiscal management and budget realignment has opened an avenue for ADB’s contribution to addressing

corruption more systematically than before. Initiatives include promoting more transparent procurement in public projects and supporting judicial reform. The thrust of ADB's capital market reforms was premised on creating a regulatory environment that is fair and transparent, segregating regulation from operations, and having functioning governance structures. This sector exemplifies that avoidance of corruption requires a sector focus with well-defined rules and a good regulatory framework and warrants replication.

**Support for Local Service Delivery is Relevant and would Benefit from Systematic Support through Decentralization.** Support for local service delivery through rural and urban development projects provided positive local livelihood impacts and useful project cycle capacity building for participating local government units. But results have been mixed due to varying project management arrangements, particularly to sector agencies and capacity of local governments. To sustain development of local service delivery, decentralization needs to be progressed more systematically. Lessons from support to health sector reforms in provincial public expenditure reviews and management, together with initiatives to strengthen provincial planning and expenditure management systems offer opportunities for application to other sectors. Reform support for local government finance is a key step to systematically reengaging the Government in decentralization and links to the overall fiscal management agenda. Consideration is needed for approaches to more systematic human resource development and improved incentive structures at the local government level.

## **Conclusions and Recommendations**

ADB assistance program over the past 5 years (2003–2007) has been successful in meeting its more selective objectives, despite a need for improvements. However, the larger context for the next country strategy continues to be daunting. Poverty is high. Progress toward Millennium Development Goals is slow and lagging in key areas, and government expenditures for related social and economic services are still low compared to needs. Private capital formation is low compared to neighbors. The export base is narrow and its value added low. The private sector perceives control of corruption, infrastructure, and education as needs to improving competitiveness. Further infrastructure and social expenditure increases are needed, financed by a strengthened revenue effort. Expenditures need to be more efficient and have greater impact. The reforming energy sector has yet to achieve wider competition and lower electricity rates. Investment rates are low and governance concerns continue to influence investor confidence. Adding to these constraints are global factors such as slowing growth, a credit squeeze, high oil and food prices, and rising inflation. Hence, in the coming years, the Philippines will face significant development challenges. To address the constraints to growth and poverty reduction, the Philippines will need to (i) continue to exercise fiscal discipline and further expand its fiscal space; (ii) more widely institute good governance; (iii) accelerate infrastructure, education, and other social service development; (iv) support expansion and diversification of the economic base; and (v) make access to development opportunities more equitable.

**Future Needs and Recommendations.** Bearing in mind the lessons from the past, and the evolving challenges, the CAPE recommends that the next country strategy (i) deepen the strategic focus on improving national public finance governance and management; (ii) deepen support for local governance and decentralized service delivery to improve public expenditure efficiency and governance; (iii) continue support for private sector enabling environment improvements; (iv) focus on poor provinces to address poverty reduction and build on synergies between local development efforts and regional cooperation initiatives, in particular BIMP-EAGA; and (v) enhance services to the client. The following are key strategic recommendations for consideration by ADB Management in the preparation and implementation of the new country strategy and related assistance programs.

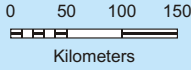
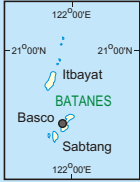
<b>Key Recommendations for Management's Consideration</b>	
1.	Maintain the strategic focus on improving national public finance governance and management: <ol style="list-style-type: none"> <li>(i) Continue to support the Government's fiscal reforms including the revenue effort from income tax and customs collection and related institutional reforms; and</li> <li>(ii) Continue to support improved budget allocations for priority sectors including infrastructure, education, agriculture, and health.</li> </ol>
2.	Deepen support for local governance and decentralized service delivery to improve public expenditure efficiency and governance: <ol style="list-style-type: none"> <li>(i) Continue to support strengthening of local government finances;</li> <li>(ii) Continue support for systematic capacity development to improve public expenditure management and upscale support to local level capacity development in country systems-based planning, management, and internal audit systems to support performance budgeting and governance and anticorruption efforts; and</li> <li>(iii) Focus on national agencies and local government units that support local level goods and services delivery.</li> </ol>
3.	Continue to support private sector enabling environment improvements: <ol style="list-style-type: none"> <li>(i) Build on microfinance reforms with a focus on constraints to increasing access by the poor;</li> <li>(ii) Identify and introduce alternative approaches over and above the current facility to improving SME access to bank finance;</li> <li>(iii) Systematically assess and identify where and how ADB can best contribute to infrastructure development; and</li> <li>(iv) Advance strengthening of the judiciary to improve enforcement of the rule of law.</li> </ol>
4.	Focus on poor provinces to address poverty reduction and build on synergies between local development and regional cooperation initiatives, in particular BIMP-EAGA: <ol style="list-style-type: none"> <li>(i) Support linkages between rural development, SME development, and regional trade opportunities;</li> <li>(ii) Replicate support for local urban services and utilities;</li> <li>(iii) Develop programmatic approaches to supporting local-level rural and urban development; and</li> <li>(iv) Use a regional development approach and pooled financing for supporting peace and development initiatives in ARMM.</li> </ol>
5.	Enhance services to the client through expanded policy dialogue, further harmonization with development partners, greater use of programmatic approaches, balance staff resource allocation, and clarify the country office role: <ol style="list-style-type: none"> <li>(i) Expand economic and sector work and continue policy dialogue with Government to overcoming key constraints and improving the development effectiveness of the ADB–Philippines partnership;</li> <li>(ii) Continue to support country-based development partner harmonization in operations;</li> <li>(iii) Adapt existing assistance modalities to expand systematic institutional strengthening including phasing projects to allow upfront capacity development, TA, loans, and partnerships approaches that pool assistance;</li> <li>(iv) Further develop and expand the use of sector-wide and programmatic approaches;</li> <li>(v) Provide adequate resources and incentives for project and program implementation; and</li> <li>(vi) Clarify the role and responsibilities of the Philippines Country Office.</li> </ol>

ADB = Asian Development Bank; ARMM = Autonomous Region of Muslim Mindanao; BIMP-EAGA = Brunei, Indonesia, Malaysia, Philippines-East ASEAN (Association of Southeast Asian Nations) Growth Area; SME = small- and medium-sized enterprise; TA = technical assistance.

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# PHILIPPINES COUNTRY ASSISTANCE PROGRAM EVALUATION



- National Capital
  - City/Town
  - Main Road
  - Provincial Road
  - Provincial Boundary
  - Regional Boundary
- Boundaries are not necessarily authoritative.

- NCR - National Capital Region
- ARMM - Autonomous Region in Muslim Mindanao
- CALABARZON - Cavite, Laguna, Batangas, Rizal, Quezon
- CAR - Cordillera Administrative Region
- CARAGA - Agusan del Norte, Agusan del Sur, Surigao del Norte, Surigao del Sur
- MIMAROPA - Mindoro, Marinduque, Romblon, Palawan
- SOCCSKSARGEN - South Cotabato, North Cotabato, Sultan Kudarat, Sarangani, General Santos







## I. INTRODUCTION

### A. Objectives

1. The first Philippines country assistance program evaluation (CAPE) was prepared by the Operations Evaluation Department (OED) of the Asian Development Bank (ADB) in early 2003. It covers ADB support to the Philippines since 1966, with a focus on the 1980s and 1990s.<sup>1</sup> The 2008 CAPE builds on the 2003 study and independently examines the performance of ADB's assistance program since 2003. The CAPE assesses overall performance of ADB's assistance program by examining the strategic positioning of ADB's assistance strategy and program, ADB's institutional performance, and its contributions to development results. ADB's sector assistance is assessed in terms of the relevance, effectiveness, efficiency, sustainability, and impact of the assistance. Assistance was assessed through document reviews, interviews, surveys, and selected site visits for loan and technical assistance (TA) projects (Appendix 1). The CAPE is intended to provide inputs to the next country partnership strategy,<sup>2</sup> its assistance program and implementation, and concludes with recommendations for consideration in future programming. The method and approach used for the evaluation is based on OED's CAPE guidelines and is described in Appendix 2.<sup>3</sup>

### B. 2003 Country Assistance Program Evaluation

2. The 2003 CAPE assessed the development effectiveness of ADB's assistance program since 1966 to 2002, rating it "partly successful." Causes of the mixed performance were the turbulent context in which the program was designed and delivered, including the frequent internal and external shocks that the economy experienced. At a strategic level, ADB country programs encompassed a wide range of activities intended to allow ADB flexibility to respond to the country's needs, especially in times of crisis. While this broad-based and flexible program approach was well intentioned, the 2003 CAPE questioned the coherence of ADB country assistance and its alignment with Government plans. Operational problems identified included (i) poor design and implementation shortcomings; (ii) excessive time needed for actions that require legislation; (iii) institutional capacity constraints; (iv) complicated policies and procedures for land acquisition and procurement; (v) lack of counterpart funds that slow the disbursement of ADB funds; and (vi) lack of institutional and financial capacity, particularly of local government units (LGU) to implement projects. Recommendations made in the 2003 CAPE were largely incorporated in subsequent country programs and updates, and related actions taken are summarized in Appendix 3.

## II. DEVELOPMENT CHALLENGES AND THE GOVERNMENT'S PLANS

### A. Economic Performance

3. Since the country's independence in 1948, the Philippines' growth record has been erratic. Early state policies went from import substitution in the 1950s to a weak export promotion strategy in the 1960s to growth in the 1970s that relied on foreign-sourced funds. The costs of these policies were the periodic balance of payments crises and sharp exchange rate devaluations that repeatedly set back economic progress. During 2002–2007, the Philippines

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<sup>1</sup> ADB. 2003. *Country Assistance Program Evaluation in the Philippines*. Manila. Available: [http://www.adb.org/Documents/CAPEs/PHI/cap\\_phi\\_200304.pdf](http://www.adb.org/Documents/CAPEs/PHI/cap_phi_200304.pdf)

<sup>2</sup> In 2007, ADB adopted a country partnership strategy to replace the country strategy and program. For all references to the document, the CAPE uses "country strategy."

<sup>3</sup> ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila. Available: <http://www.adb.org/Documents/Guidelines/Country-Assistance-Program/guide-preparation-0206.pdf>

achieved 6 consecutive years of annual gross domestic product (GDP) averaging 5.6% over the period. While slower than other Asian countries, this growth is notable considering the country's poor record at sustaining growth since the 1980s.<sup>4</sup> Economic growth was fueled by recent global growth and rapid expansion of the more labor-intensive services sector and remittances from migrant workers, which reached \$14.4 billion (recorded through the banking system) in 2007. In contrast to earlier growth episodes, growth accelerated to 7.3% in 2007. This was accompanied by (i) low to moderate inflation, averaging 2.8% in 2007, arising from the benefits of earlier trade liberalization and improved monetary management; (ii) real interest rates below 3% since 2001; and (iii) current account surpluses since 2003, which are an unprecedented development in the country's economic history. This boosted the country's balance of payments position, allowing reserve accumulation to reach \$34 billion by the end of 2007.

4. Several significant concerns prevailed. Unsatisfactory job creation is reflected in labor underutilization, which remained at about 25% over the past 10 years.<sup>5</sup> The lack of domestic jobs and rising overseas labor demand offering higher salaries continued to encourage overseas migration. In 2006, the number of Filipino migrant workers was estimated to be 8.2 million, nearly a fourth of the current labor force. Exports were concentrated in electronic products (almost 70% of merchandise exports since 1997) and competitiveness was lost in other manufacturers such as garments (its share of total exports declined from over 20% of exports in the early 1990s to less than 6% by 2006). Rising imports increased the trade gap to \$8.2 billion in 2007. The slow process of asset cleanup and recapitalization of banking has contributed to banks' risk avoidance which, combined with weak loan demand, resulted in a prolonged period of slow lending growth. The average bad asset ratio fell to single digits by 2005, but lending activity has yet to pick up. Consequently, capital formation, including public and private investment, has been declining in relation to GDP and relative to neighboring countries.

5. By 2002, the fiscal situation had worsened as expenditures grew faster than revenues and a policy of keeping utility tariffs below operating costs caused the fiscal deficit to rise to more than 5% of GDP. The fiscal problems contributed to the buildup of public debt, which peaked at 78% of GDP in 2004, up from 56% of GDP in 1998.<sup>6</sup> Furthermore, concerns over macroeconomic instability were heightened as the Government repeatedly missed announced deficit targets by wide margins and had to postpone its original 2006 balanced budget target by 3 years. Subsequent public expenditure compression resulted in declining government spending on critical public goods and services with, for example, the share of basic social sector spending in total expenditures dipping from 27% in 1998 to 18% in 2005.<sup>7</sup> Poor fiscal performance reduced public spending on goods and services needed to attract investments, declining governance indicators particularly control of corruption and political stability which contribute to reduced investor confidence.<sup>8</sup> With limited contributions from government spending, low private investment, and exports that were largely dependent on the global electronics cycle, the economy increasingly relied on private consumption spending, financed by remittances, to fuel growth.

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<sup>4</sup> From 1994 to 1997, GDP per capita grew annually, averaging 2.9%, slightly lower than the 3.1% average growth rate from 2002 to 2007.

<sup>5</sup> Refers to the sum of unemployment and underemployment rates. Based on the October series of National Statistics Office's Labor Force Survey, the National Statistics Office adopted a new definition of unemployment starting in April 2005. Hence, data before and after the change in definition are not directly comparable.

<sup>6</sup> Credit Suisse research on the Philippines shows the Government's net debt as a percentage of GDP is about 20 percentage points higher than the S&P BB–median (Karacadag, Cem. 2007. *Philippines: Fiscal and Interest Rate Outlook, Emerging Markets and Economics Research*. Manila).

<sup>7</sup> Manasan, Rosario. 2007. *Risks and Opportunities in Securing Increased Resources for MDGs at the National Level*. PIDS Policy Notes 2007–2008. Makati.

<sup>8</sup> Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2008. Governance Matters VII: Aggregate and Individual Governance Indicators, 1996–2007. 24 June. Available at SSRN: <http://ssrn.com/abstract=1148386>

6. Furthermore, some Millennium Development Goals (MDG) are lagging.<sup>9</sup> Trends show national progress for measures relating to child mortality, combating disease, and environmental sustainability; while advances in attaining universal primary education, improving maternal health, and increasing access to reproductive health services have been lackluster.<sup>10</sup> Subnational progress has also been uneven, and in cases deteriorated, with Mindanao having the most lagging regions. Other social sector trends limit progress in poverty reduction. Annual population growth is 2.1%, higher than in many other countries in the region; a coherent population control policy is not yet in place. High population growth undermines social service delivery improvements, and contributes to declining MDG performance in, for example, education. Government statistics show that poverty incidence declined from 33% of the population in 2000 to 30% in 2003, but increased to 33% in 2006.<sup>11</sup> Worryingly, household income surveys show a 4.0% decline in average family income between 2003 and 2006 adjusted for inflation using 2003 prices, despite real per capita increases in GDP.<sup>12</sup> Income inequality, as measured by the Gini coefficient, changed little from 0.4605 in 2003 to 0.4580 in 2006—high relative to Asian neighbors. Poverty in the Philippines is largely found in rural areas and is linked to low productivity, agriculture-based livelihoods. Poverty rates are high in the conflict-affected area of the Autonomous Region of Muslim Mindanao (ARMM) as discussed further in Section IV.

7. Key challenges for the Philippines at the start of the CAPE period were insufficient employment-generating growth, a weak investment climate, and failure to bring the benefits of growth and public goods to wider segments of society. The key underlying cause was the Government's fiscal problem, which, in turn, exacerbated the already unsatisfactory delivery of public goods and services to the regions, leaving a greater number of poor with limited access to wealth-generating basic services such as infrastructure, education, and health. The main missing ingredient to the country's recent growth experience was public and private investment, held back by macroeconomic instability, particularly fiscal weakness and poor governance.

## **B. Government Development Strategy and Plans**

8. Each new government sets out policies and plans at the start of its 6-year term and details these in a 6-year medium-term Philippine development plan (MTPDP). The National Economic and Development Authority leads preparation of the MTPDP in coordination with other government departments and branches and in consultation with stakeholders, including civil society and the business sector. The MTPDP is accompanied by a medium-term public investment program, a 3-year rolling list of projects and regional development plans that share the same time frame as the MTPDP. Successive MTPDPs share broadly common goals: (i) poverty reduction and economic growth through macroeconomic stability, (ii) private sector competitiveness, (iii) employment creation, (iv) access to social services and protection, and (v) rural and agricultural development and environmental sustainability. Line agency sector plans serve as inputs to the MTPDP.<sup>13</sup>

9. The broad policy thrusts in successive MTPDPs are apparent, but each plan covers an extensive set of development needs. A public expenditure, procurement, and financial management review carried out in 2003 highlighted a weak link between planning and

<sup>9</sup> Available: <http://info.worldbank.org/governance/wgi2007>. Based on \$1 (purchasing power parity) a day criteria.

<sup>10</sup> Canlas, Dante. 2007. *Philippines Midterm Progress Report on the Millennium Development Goals*. Available: [http://www.neda.gov.ph/econreports\\_dbs/MDGs/midterm/Midterm%20MDG%20Progress%20Report.pdf](http://www.neda.gov.ph/econreports_dbs/MDGs/midterm/Midterm%20MDG%20Progress%20Report.pdf)

<sup>11</sup> National Statistical Coordination Board. 2008. *2006 Official Poverty Statistics*. Manila.

<sup>12</sup> The source of discrepancy between the Family Income and Expenditure Survey and the national income accounts is not clear implying a need to study the statistics more closely and strengthen sources accordingly.

<sup>13</sup> National Economic Development Authority. 2004. *Medium Term Philippine Development Plan 2004–2010*. Manila; World Bank. 2002. *Philippines: Country Assistance Strategy 1999–2002*. Washington, DC; and ADB. 2002. *Philippines: Country Economic Review*. Manila.

budgeting due to the lack of cost estimates for implementing the proposed strategies, insufficient prioritization, and inadequate discussion of resource allocation between sectors. This weak planning–budget link was compounded by policy and political differences that periodically occur between the legislative branch and Congress.<sup>14</sup> The 2006 Commission on Audit report noted that the proposed budgets under the 2001–2004 General Appropriations Act were not aligned with MTPDP sector allocations, and programs and projects not included in the MTPDP were funded at the expense of identified priority projects.<sup>15</sup> Furthermore, in 3 of the past 7 years, Congress did not pass the appropriations bill, forcing the Government to operate on reenacted budgets that do not reflect the particular years' spending priorities. Policy thrusts of the MTPDP are supportive of the MDGs, but the estimated cumulative resource gap for 2007–2010 is in the range of 1.1% to 1.4% of GDP (₱351 billion to ₱448 billion).<sup>16</sup>

### III. ASIAN DEVELOPMENT BANK'S ASSISTANCE PROGRAM AND PERFORMANCE

#### A. Program Overview

10. By the end of 2007, ADB had approved \$9.8 billion in public sector loans and \$148.8 million in TA to the Philippines. Total lending levels since 2000 were similar to previous periods (Table 1). Fifty-two advisory technical assistance (ADTA) grants with total value of \$36.3 million were approved from 2001 to 2007. The strategy and nature of, particularly, lending assistance changed significantly to address portfolio performance issues and the Government's development and reform agenda during the CAPE period. ADB's private sector operations are discussed in paras. 80–82.

**Table 1: Loan Approvals from 1986 to 2007**

Year	Number of Loans		Amount Approved	
	No.	%	\$ Million	%
1986–1992	47	43.5	2,571.7	34.5
1993–1999	39	36.1	2,454.2	30.0
2000–2007	22	20.4	2,420.7	32.5
<b>Total</b>	<b>108</b>	<b>100.0</b>	<b>7,446.5</b>	<b>100.0</b>

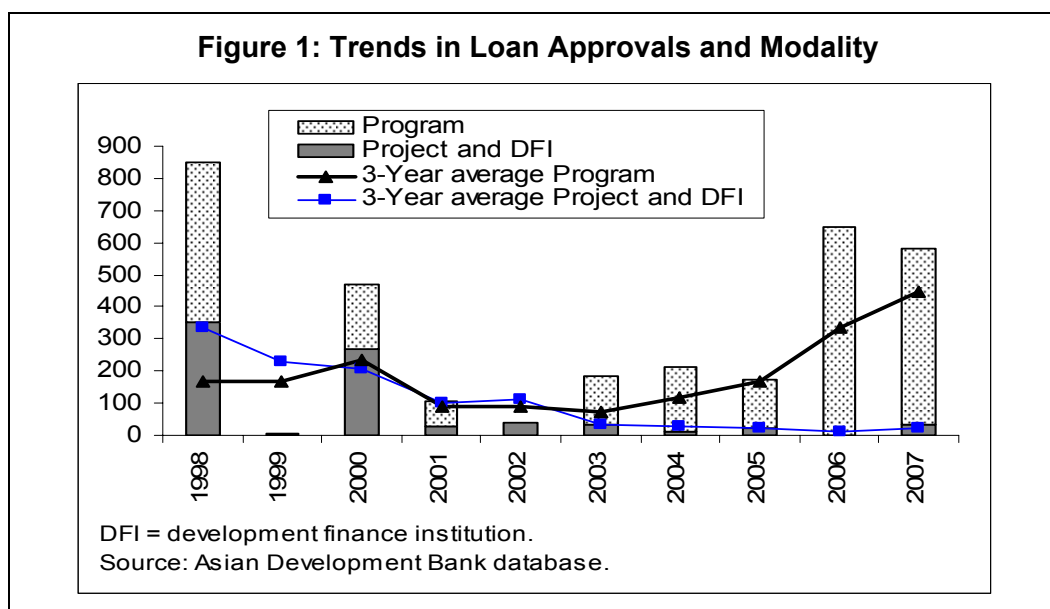
Source: Asian Development Bank database.

11. Between 2000 and 2007, the program had the following key features: (i) portfolio cleanup, which reduced the number of at-risk projects; (ii) greater focus on quality-at-entry; and (iii) a focus on needed macroeconomic and sector reforms. Given the fiscally stressed economy, the 2005–2007 country strategy required setting flexible lending targets, including the possibility of no new lending. Thus, new lending commitments were set up to \$1.7 billion for the 3-year country strategy period depending on the Government's fiscal absorptive capacity. ADB support shifted away from investment projects and increased assistance to support the Government's priority reform agendas, leading to expanded program lending (Figure 1). Few investment projects were approved during the period and efforts continued to close underperforming lending operations resulting in an overall improvement in portfolio performance. Thus, there was a heavy emphasis on policy-based lending, no annual lending target, and emphasized a results-based approach. In total, 22 loans were approved for \$2.4 billion for the period 2000–2007.

<sup>14</sup> ADB, Government of the Philippines, and World Bank. 2003. *Improving Government Performance: Discipline, Efficiency, and Equity in Managing Public Resources*. Manila.

<sup>15</sup> Commission on Audit. 2006. *Effectiveness of the Budget Allocation System of the Government*. Quezon City. Available: <http://www.coa.gov.ph>

<sup>16</sup> Manasan, Rosario. 2007. *Financing the Millennium Development Goals: The Philippines*. Manila. Philippine Institute for Development Studies.



12. ADB TA declined in number and monetary value relative to previous periods as shown in Table 2. According to a survey of TA carried out as part of the CAPE (discussed further below), ADTA projects had a role in leading to, and informing, lending support for reforms, and assessing and supporting institutional capacity development.

**Table 2: Technical Assistance to the Philippines**

Year	Number	Total Value (\$ million)	Average Annual TA Amount (\$ million)	Average TA Amount (\$'000)	Share in ADB-Wide TA (% of total value)
1986–1992	102	44.2	6.3	433.3	10.3
1993–2000	97	51.2	7.3	527.4	5.5
2001–2007	52	36.3	5.2	697.3	3.9

ADB = Asian Development Bank, TA = technical assistance.  
Source: Asian Development Bank database.

13. The slowdown in TA approvals started in 2005 with only eight TA approvals for the year and dropping further to four TA approvals each for 2006 and 2007, 75% of the TA projects going to the law, economic management, and public policy (LEMP). Except for two TA projects still being processed at the end of 2007, the list of approved nonlending products is consistent with the country strategy. Close to 82% of the total TA provided to the Philippines during 2001–2007 was in the form of ADTA, significantly higher than the 65% in 1993–2000.

## B. Country Strategy Positioning

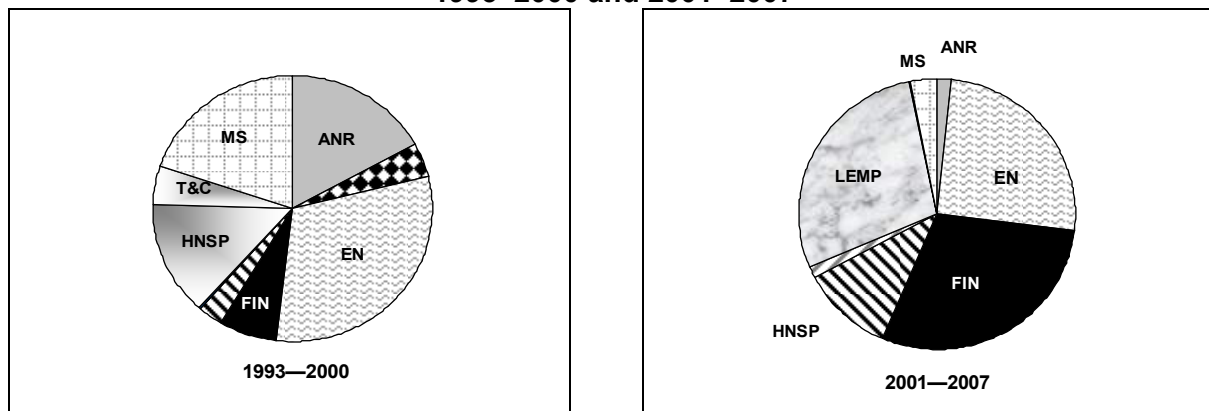
14. As indicated in the 2003 CAPE, ADB strategies and assistance programs became more aligned with the MTPDPs in the latter part of the 1990s; but in doing so, the country strategy at the beginning of the CAPE period was overly broad-based and lacked clear priorities, presenting a key challenge for the program. Thus, a further challenge during the CAPE period was the need for ADB's program positioning and response to become selective. Key features of

country programs since 1998 are provided in Appendix 4.<sup>17</sup> The 1998 Philippines Country Operational Strategy Study (COSS) laid out a development approach that was largely aligned with the prevailing MTPDP but covered a wide range of sectors.<sup>18</sup> Subsequent country assistance plans built on the 1998 COSS. In 2002, the country strategy update continued to address similar goals. However, the 2005 country strategy introduced a fundamental shift in aligning strategy with priority constraints, aiming to achieve greater selectivity and improved sequencing and meeting priority Government needs.

## 1. Selectivity

15. **Aligning Broad-Based Development with Fiscal Realities.** In the past, ADB-financed investment projects were approved with little guarantee that sector agencies would receive sufficient funding to meet counterpart finance requirements, which was an underlying reason for a large number of poorly performing investment projects. The portfolio cleanup began in 2002 to address the immediate problem, and thereafter, the 2005 country strategy focused on identifying measures that could improve the linkage between planning and budget implementation. The strategy was a break with past practice by increasing strategic focus and selectivity for operational activities in line with Government priorities, such as fiscal management and the introduction of a set of quality-at-entry criteria that included a closer assessment of availability of budgeted counterpart funds.<sup>19</sup> As shown in Figure 2, during 1993–2000, ADB’s Philippines portfolio was spread over eight sectors. This was reduced, by value of loan approval, to four sectors during 2001–2007: economic management and policy, energy, nonbank finance, and health. Implementation of adequately performing projects in rural and urban development continued. The sectoral allocation of TA projects was aligned with lending, with LEMP receiving more than 30% of the value of TA projects during the 7-year period. Almost 40% of the ADTA projects went to LEMP, while 68% of the project preparatory TA projects were shared by agriculture and natural resources, LEMP, transport and communications, and multisector.

**Figure 2: Sectoral Allocation of Lending to the Philippines  
1993–2000 and 2001–2007**



ANR = agriculture and natural resources; EN = energy; FIN = finance; HNSP = health, nutrition, and social protection; LEMP = law, economic management, and public policy; MS = multisector; T&C = transport and communications.  
Source: Asian Development Bank database.

<sup>17</sup> Country programs reviewed include the 1998 country operational strategy, 1999–2001, 2000–2002, and 2001–2003 country assistance plans, country strategy updates 2002–2004 and 2004–2006, and country strategy 2005–2007.

<sup>18</sup> ADB. 1998. *Philippines Country Operational Strategy Study*. Manila.

<sup>19</sup> Other quality-at-entry criteria included executing agency absorptive capacity, identification of results-focused outcomes, compliance with government readiness filters, and completion of land acquisition requirements.

**16. Selective Support for Investment Climate Improvement through Sector Reforms.**

Certain sectors proved to be important for simultaneously addressing fiscal problems and the investment climate. The energy sector had long been a drain on public resources because of inefficiencies and high subsidies. To address energy sector reforms, the Government enacted the Electric Power Industry Reform Act (EPIRA) in June 2001 with the objective of reversing the sector's fiscal drain, providing competitively-priced electricity and improving sector competitiveness. Implementation was initially slow. ADB support helped to advance reforms with a focus on lowering the sector's fiscal burden and better assuring long-term availability of power supply through private sector participation. Similarly, continued deepening of nonbank finance sector reforms and development was needed to improve industries' access to capital. ADB's role in the nonbank sector continued to support alternative ways of raising capital. Transport infrastructure development was identified as a priority constraint, but implementation issues in projects hindered expansion of ADB support. Governance indicators for the country show recent improvements in government effectiveness and regulatory quality but a decline in the control of corruption in 2007 (footnote 8). Despite selected governance indicator improvements, the Philippines is falling behind the top performing regional economies, which stands to further challenge the investment climate and competitiveness.

**17. Support for MDGs.** The 2005–2007 country strategy also aimed to accelerate attainment of the MDGs by enhancing public sector efficiency in addition to MDG-related issues addressed through rural and urban operations such as rural incomes, access to water and sanitation, and environment improvements. Support for the Health Sector Reform Agenda (HSRA) was consistent with the country strategy's shift to a results-based management approach at a time of fiscal consolidation. Support for higher education sector reforms in the early part of the CAPE period was cancelled, but assistance for secondary and vocational education improvement has continued through investment projects. Continuing support for local urban and rural development and environmental management issues also contributed to MDGs. In line with the 1991 Local Government Code (LGC), the country strategies endeavored to enhance decentralized service delivery in the regions, provinces, municipalities, *barangays*,<sup>20</sup> and communities, especially for urban and rural development. The intentions of the 1991 LGC were clear, but national and local government roles have yet to be fully rationalized. This compounds the lack of clarity in resource control, accountability and responsibility for administration arrangements, budget allocation, and functional assignments. Urban and rural development was seen as having the potential to address poverty reduction, social inclusion and service access, and environmental problems. While support was relevant, multiple institutional layers; bureaucratic inefficiencies; operational design issues, including land acquisition; and failure to implement policy provisions relating to environmental management limited expansion of the program. Nevertheless, there were good practice examples in support for local level service delivery (Section IV).

**18. Geographic Focus on the Southern Philippines Facilitated Synergy between Rural Development and Regional Cooperation.**

The Government's peace and development process in Mindanao called for intensified development partner assistance to southern Philippines. The country strategies since 1998 have had a geographic focus on southern Philippines with several rural, urban, and small- and medium-sized enterprise (SME) development investment operations being focused on Visayas and Mindanao. Despite problems with rural and urban project designs, they had a useful area development role, supporting local needs, decentralization, and regional cooperation. The latter is seen in rural development projects that have promoted trade and export opportunities for small farmers and SMEs, contributing to the goals of the Brunei Darussalam-Indonesia-Malaysia-Philippines–East ASEAN (Association of Southeast Asian Nations) Growth Area (BIMP-EAGA). ADB support to the Mindanao Economic Development Council (MEDC)

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<sup>20</sup> Barangay is the smallest local government unit in the Philippines.



complements the Government's Mindanao-wide coordination initiative and MEDC's role in BIMP-EAGA. However, needed investments in transport infrastructure, such as regional airports, did not eventuate. Investment projects in ARMM as part of nationwide sector projects faced implementation constraints.

## 2. Sequencing and Continuity

19. **Fiscal Consolidation.** As ADB's country strategy took on greater selectivity during the CAPE period, for continuity it built on earlier assistance in key sectors. Country strategies since 1998 recognized macroeconomic imbalances, but they were not brought to the forefront of programming until 2005 when the focus on fiscal consolidation was established to address a root cause of low public investment and the mixed track record on meeting counterpart funding commitments for ADB operations. Ultimately, the threat of a fiscal crisis resulted in fiscal reforms being made a priority. Assistance was provided to address tax revenues and improved budgeting and performance allocations, which will require a future medium-term engagement. At the height of the fiscal problem in 2005, and with little space in the national government's budget to accommodate new investments, ADB's strategy programmed lending to government-owned and -controlled corporations (GOCC) that were positioned to develop and deliver MDG-related services such as water and health services, and to government financial institutions (GFI) that supported SME financing and development.

20. **Decentralization.** Until 2005, much of the effort to support decentralization was through national line agency projects involving LGUs and communities. Many rural, urban, and social services and small-scale physical infrastructure projects are delivered by local providers and are consistent with the LGC. In the absence of uniformly strong, well-coordinated national and decentralized institutions that can provide TA, institutional development and investment efforts had mixed results. The 1998 COSS recognized the need to progress the 1991 LGC and to build the capacity of LGUs to access commercial finance and public funds in line with decentralization policy, although the needed reforms were not substantially backed until a decade later. After 2005, support for decentralization gathered pace with a series of planning, budget, and expenditure management TA projects being provided. In early 2008, a program loan was provided to address local government finance constraints and reforms (not included in the evaluation). Options for subsovereign lending to local government borrowing was assessed but found to have legal obstacles and low demand at ordinary capital resources rates.

21. **Private Sector Enabling Environment.** The Philippines' lagging performance in attracting foreign investment, capital outflows, and low domestic investment ratios continues to draw ADB attention to the investment climate. The focus on capital market development and related reforms in the nonbank sector has been a consistently supported area since 1998 in areas such as the stock exchange and bond market. The shift from ADB financing public investment in energy generation, to financing reforms, to recently financing private investment in generation also shows sequenced support and long-term commitment to the sector's development. The use of ADB systems in investment projects offers the opportunity of controlling corruption in projects, but addressing the issue more systemically through broader advisory assistance and program lending was increasingly used. For example, the independence of regulators against political pressure is an issue that impedes private sector development and continues to be addressed in the energy sector and capital markets. However, with the exception of energy and housing finance guarantees, overall fewer private sector operations were financed during the CAPE period (para. 80).

22. **Political Economy of Reforms.** A key feature of the program was better alignment with the Government's reform agenda and recognition of political economy factors that have affected reform processes. Few reform processes are "technical exercises in optimal policy design," and

reforms over the past two decades in the Philippines are no exception given the distributional implications, frequent resistance by the status quo, and time required to affect reforms—often influenced by political changes.<sup>21</sup> The reforms addressed in the CAPE period were initiated as far back as the Aquino administration in 1986 and continued in subsequent administrations. They included trade economic liberalization and freeing up foreign investment regulations (Appendix 8, Box A8). In other cases, crippling power shortages of the 1990s helped advance reforms, but in time have needed different solutions such as the shift from public to private power generation.

23. Within the political economy backdrop of ongoing reforms, ADB support for the Government during the CAPE period was better aligned and sequenced across sectors and time. As such, ADB support was delivered when reforms were likely to advance. This has helped reformers to build constituencies and manage vested interests in key areas, such as fiscal management and energy reforms. The relevance of reform support has improved, as evidenced in the approach to reform design involving a medium engagement and dialogue to discuss progress of Government-agreed triggers—a positive departure from the past practice of one-off and loosely connected reforms, and lack of attention to the political economy processes of reforms noted in the 2003 CAPE. Table 3 summarizes progress with major reforms in fiscal consolidation, energy, finance, health, agriculture, and decentralization from a political economy viewpoint, including (i) key issues that led to the reform becoming part of the Government’s reform agenda; (ii) reform complexities that had to be managed such as stakeholders, policy trade-offs, and institutional capacity; (iii) indication of reform acceptance and endorsement; (iv) needed institutional strengthening to implement reforms; and (v) issues affecting reform sustainability.

24. The analysis of the political economy of reforms reveals several points across and within sector reforms. The fiscal reforms were central to progressing reforms in other sectors. However, progress on fiscal consolidation was contingent on prior progress in energy sector reforms, especially progress in privatizing assets of the National Power Corporation (NPC). The political constituency for energy and tax reforms was a turning point for overall fiscal consolidation. This provided a foundation for increasing overall public resources needed to progress reforms to raise spending on basic social services such as health and education. The analysis also shows that strengthened institutions are critical to deepening and sustaining reforms.

25. **Assessment of ADB’s Strategic Positioning.** Positioning of ADB’s country strategies is rated satisfactory. ADB country strategies and plans at the beginning of the CAPE period had wide sector and geographic coverage but were aligned with the Government’s MTPDP. During the course of the CAPE period, macroeconomic stability, including fiscal management and energy reforms, took on greater urgency in the Government’s agenda, and ADB responded by including these issues in country programs through dialogue with the Government, which resulted in stronger country ownership of the program. The 2005 country strategy areas are also consistent with ADB’s Economics and Research Department’s study on critical constraints to growth for the Philippines, which highlighted governance, infrastructure, and access to finance as critical constraints to growth.<sup>22</sup> By focusing on priority issues, greater program selectivity was achieved. Support for reforms, particularly in the energy and finance sectors but also in other sectors, displays ADB’s long-term commitment and appropriate and effective sequencing of reform measures.

<sup>21</sup> ADB. 2003. *Economic Analysis of Policy Based Lending: Key Dimensions*. Manila. Available: [http://www.adb.org/Documents/Books/Eco\\_Analysis\\_PBO/default.asp#contents](http://www.adb.org/Documents/Books/Eco_Analysis_PBO/default.asp#contents); and Abonyi, G. 2004. *Political Economy of Reform: Case Studies of Asian Development Bank Supported Policy-Based Operations*. Manila: ADB Economics and Research Department. Available: <http://www.adb.org/Economics/pdfPBL-S3-Political1-04.pdf>

<sup>22</sup> ADB. 2007. *Philippines: Critical Development Constraints*. Manila. Available: <http://www.adb.org/Documents/Books/Philippines-Critical-Dev-Constraints/default.asp>

**Table 3: The Government's Reform Agenda Supported by ADB: A Political Economy Perspective**

Reform Step	Fiscal Management	Finance Sector	Energy Sector	Agriculture	Health	Local Government
<b>Getting reform issues on the agenda</b>	<ul style="list-style-type: none"> <li>In 2002, government, academe, and private sector highlight urgent need for action to reverse consolidated public sector financial deficit of 5.6% of GDP to create fiscal space for needed development spending</li> </ul>	<ul style="list-style-type: none"> <li>High NPLs lowered with special purpose vehicle, resulted in high bank liquidity</li> <li>Need recognized to strengthen nonbank subsector as source of investment finance</li> <li>Savings mobilization</li> </ul>	<ul style="list-style-type: none"> <li>1990s power shortages open industry to private investment; inefficiencies cause high power costs economy-wide</li> <li>NPC assets worth less than liabilities in 2003 and become a major fiscal drain</li> </ul>	<ul style="list-style-type: none"> <li>Rationalization of three national agencies discussed but limited progress</li> <li>NFA and grain subsector reforms seen as a priority for the Government</li> </ul>	<ul style="list-style-type: none"> <li>Need for defined national and LGU roles in service delivery led to development of convergence strategy in health</li> </ul>	<ul style="list-style-type: none"> <li>Local Government Code (LGC) passed in 1991</li> <li>IRA enacted and automatically released</li> </ul>
<b>Managing reform complexity stakeholders, trade-offs, institutions</b>	<ul style="list-style-type: none"> <li>Achieve government, private sector consensus</li> <li>Weak BIR and BOC institutional capacity</li> <li>Bureaucratic incentives for tax collection agencies</li> <li>Political will for tax evader prosecution</li> </ul>	<ul style="list-style-type: none"> <li>Weak governance in the PSE</li> <li>Weak SEC regulatory powers</li> <li>Little new interest by companies to list on PSE</li> <li>Formalizing the status of microfinance</li> </ul>	<ul style="list-style-type: none"> <li>Achieving public consensus on need to unbundle and restructure power industry, pursue regulatory reform to gain efficiencies</li> <li>Incentives sufficiency for private sector investment in energy</li> </ul>	<ul style="list-style-type: none"> <li>DA, DENR, DAR rationalization requires agencies to relinquish resource control</li> <li>Reconciling food security versus production efficiency policy trade-offs</li> </ul>	<ul style="list-style-type: none"> <li>Agreement on national and local government roles</li> <li>LGU capacity development</li> <li>Improving resource sufficiency for LGUs</li> </ul>	<ul style="list-style-type: none"> <li>Consultations on national LGU responsibilities, accountability</li> <li>Consultations on amending IRA formula to better ensure LGU needs</li> <li>LGU capacity</li> <li>3-year election cycle</li> </ul>
<b>Key reform steps achieved</b>	<ul style="list-style-type: none"> <li>Excise taxes adjustment, EVAT Law passed in 2002 to increase revenue</li> <li>Power rate adjustments to reduce NPC deficits, privatization</li> <li>Debt management</li> <li>Infrastructure and social sector spending increases in 2005, 2008</li> </ul>	<ul style="list-style-type: none"> <li>Securities Regulation Code enacted</li> <li>SEC regulation strengthened</li> <li>International accounting standards adopted</li> <li>Capital market blueprint adopted</li> <li>Support for Philippines Deposit Insurance Corp.</li> <li>Microfinance rise</li> </ul>	<ul style="list-style-type: none"> <li>EPIRA enacted in June 2001 to reverse fiscal drain</li> <li>PSALM established to manage assets sales to private sector</li> <li>Electricity spot market established</li> <li>Regulation reformed for transmission, distribution utilities</li> </ul>	<ul style="list-style-type: none"> <li>NFA and grain subsector reforms agreed in 2001 and canceled by Government in 2002</li> <li>DA, DENR, DAR rationalization not yet advanced</li> </ul>	<ul style="list-style-type: none"> <li>Health Sector Reform Agenda adopted in 1991</li> <li>Fiscal autonomy for hospitals</li> <li>Local health system reform</li> <li>National Health Care Finance Program expanded</li> <li>Regulation</li> </ul>	<ul style="list-style-type: none"> <li>IRA automatically released supported by Supreme Court decision as approved by legislation</li> <li>Provisions for LGU revenue raising and increasing LGU borrowing in 2007 to reduce dependence on national budget</li> </ul>
<b>Institutional capacity issues</b>	<ul style="list-style-type: none"> <li>BIR administrative lapses</li> <li>Weak BOC enforcement</li> </ul>	<ul style="list-style-type: none"> <li>Time needed for institutional development</li> <li>BSP involved in microfinance</li> </ul>	<ul style="list-style-type: none"> <li>WESM role in market needs strengthening</li> <li>ERC seen as less effective, needs strengthening</li> </ul>	<ul style="list-style-type: none"> <li>Differing levels of decentralization between DA, DENR, and DAR</li> </ul>	<ul style="list-style-type: none"> <li>Strengthen national technical roles</li> <li>LGU capacity to manage service, budget</li> </ul>	<ul style="list-style-type: none"> <li>National and local government roles remain unclear in some sectors</li> <li>LGU capacity varies</li> </ul>
<b>Reform sustainability issues</b>	<ul style="list-style-type: none"> <li>Missed targets as institutional reform lacking</li> <li>To avoid tax effort erosion need indexation of excise taxes, rationalization of fiscal incentives</li> </ul>	<ul style="list-style-type: none"> <li>Investor confidence</li> <li>Contractual savings reforms, e.g., pensions</li> <li>Capital market reform blueprint follow-up</li> <li>Avoid crowding out private sector in microfinance</li> </ul>	<ul style="list-style-type: none"> <li>Fiscal drain of energy sector stemmed but wide efficiency gains and lower consumer prices not yet realized</li> <li>Spot market and regulator effectiveness crucial</li> </ul>	<ul style="list-style-type: none"> <li>Reconciling production increase with low producer prices, high consumer prices</li> <li>Insufficient reform to sustain sector development</li> </ul>	<ul style="list-style-type: none"> <li>Rationalization of hospitals</li> <li>Need for performance-based funding</li> <li>PhilHealth access by the poor</li> </ul>	<ul style="list-style-type: none"> <li>Further role clarification</li> <li>Further LGU capacity development needed, takes time</li> <li>Deepen budget sufficiency for development</li> </ul>

ADB = Asian Development Bank, BIR = Bureau of Internal Revenue, BOC = Bureau of Customs, BSP = Bangko Sentral ng Pilipinas, DA = Department of Agriculture, DAR = Department of Agrarian Reform, DENR = Department of Environment and Natural Resources, EPIRA = Electric Power Industry Reform Act, ERC = Energy Regulatory Commission, EVAT = expanded value-added tax, GDP = gross domestic product, IRA = internal revenue allotment, LGU = local government unit, NFA = National Food Authority, NPC = National Power Corporation, NPL = nonperforming loan, PhilHealth = Philippine Health Insurance Corporation, PSALM = Power Sector Assets and Liabilities Management Corporation, PSE = Philippine Stock Exchange, SEC = Securities and Exchange Commission, WESM = Wholesale Electricity Spot Market.

Source: Operations Evaluation Mission.

## C. Institutional Performance

26. This section assesses ADB performance in delivering assistance to the Philippines since 2003.

### 1. Application of ADB Strategies and Policies

27. **Alignment with ADB Strategies and Crosscutting Issues.** The country strategies over the CAPE period were aligned with ADB's 2001 Long-Term Strategic Framework and its core strategic areas of sustainable economic growth, inclusive social development, and governance for effective policies and institutions; and crosscutting themes of private sector development, regional cooperation, and environmental sustainability.<sup>23</sup> The 2005 country strategy achieved greater selectivity by focusing on (i) fiscal consolidation as a key constraint; (ii) addressing decentralization to improve local service delivery; and (iii) pursuing portfolio cleanup and introducing quality-at-entry filters. Country leadership of the program was maintained, while shifting from a broad-based sector approach to a program hierarchy that was increasingly focused on key country constraints. This approach is also consistent with the recently introduced ADB's middle-income country strategy.<sup>24</sup> The program also showed that ADB is not simply a "projects bank" and can be an agent of change through engagement with various stakeholders to support needed policy reforms.

28. **Good Governance and Anticorruption.** Governance in the CAPE is viewed as (i) support for policy reforms, (ii) improvement in the legal and regulatory environment, (iii) improvement in government planning and expenditure frameworks, (iv) organizational development and restructuring, (v) systems development, and (vi) and human resource development through training. Anticorruption was addressed systemically through strengthening institutions and systems and through ADB-financed project level administrative requirements.<sup>25</sup> Anti-money laundering was addressed through the provision of TA to prepare a legal framework. The 2005 country strategy focus on fiscal management and decentralization and the private sector enabling environment facilitated a more systemic approach to addressing governance and corruption problems at the country and sector level (Section IV). Over the CAPE period, the 40 ADTA projects carried out addressed one or more aspect of governance as defined above. Specifically, 33% of TA projects addressed policy reforms; 25% improvement to laws and regulations; 45% improvements to planning; 63% systems development; 25% organizational development and restructuring; and 90% provided training. In many instances, capacity building was not limited to executing agency (EA) and implementing agencies (IAs); but extended to other stakeholders such as LGUs, market participants, private institutions, professional organizations, nongovernment organizations, and other civil society groups.

29. **Environment and Gender.** Given the concerns over urban environmental issues such as air quality and solid waste management, environmental issues were assessed and advocated by the Philippines Country Office from a crosscutting perspective.<sup>26</sup> Most often, solutions to problems were mainstreamed as a part of projects including those addressing urban, rural, and water supply development. Clean energy has become an increasing focus of

<sup>23</sup> ADB. 2001. *Moving the Poverty Agenda Forward in Asia and the Pacific. The Long-Term Strategic Framework of the Asian Development Bank (2001–2015)*. Manila. The strategy was replaced with Strategy 2020 in May 2008 (ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila).

<sup>24</sup> ADB. 2006. *Enhancing Asian Development Bank Support to Middle-Income Countries and Borrowers from Ordinary Capital Resources*. Manila.

<sup>25</sup> Allegations of corruption in ADB-financed projects in the Philippines are filed with ADB's Integrity Division, Office of the Auditor General.

<sup>26</sup> ADB. 2004. *Country Environmental Analysis for the Republic of the Philippines*. Manila.

attention through dialogue and conferences, and TA was provided to address renewable energy. Urban environmental improvement was addressed with mixed success through a range of projects and programs. Natural resource management was addressed through a range of agriculture, rural development, and coastal resource management-related projects. Gender equality was mainstreamed in health, education, agriculture and rural development projects, and was particularly effective through support for microfinance development.<sup>27</sup>

30. **Regional Cooperation.** Lack of economic competitiveness in the Philippines was the single greatest obstacle to deeper regional cooperation and economic integration. In addition to trade and financial reforms, the country needed to address key domestic structural constraints such as infrastructure, human resources, and governance to compete successfully in regional and global markets and to restore investor confidence. The movement toward a more integrated East Asian economy and the possibility of pan-Asian integration through the Association of Southeast Asian Nations (ASEAN) presents opportunities for the Philippines. ADB contributed to the Philippines' regional cooperation and integration efforts through support for BIMP-EAGA, ASEAN and ASEAN+3 initiatives, as well as other regional programs in which the Philippines participates. ADB efforts to foster regional cooperation through BIMP-EAGA highlighted an opportunity to address a range of constraints in the Mindanao economy. In addition to supporting regional financial integration through ASEAN, ADB supported TA to assess the banking and capital markets in East Asia, promote more sustainable development of Islamic finance, and strengthened financial market regulation (TA projects for Strengthening Asian Financial Markets, Development of International Prudential Standards for Islamic Financial Services, and Supporting Enhanced Cooperation Among Southeast Asian Equity Markets [Appendix 1]). The latter resulted in an agreement to harmonize regulation and link equity markets across the region by 2010. ADB supported the Philippines' efforts to enter into free trade agreements with Japan, and more recently the United States and Pakistan. It has provided support to strengthen capacity for the control of severe acute respiratory syndrome and other communicable diseases (Emergency Regional Support to Address the Outbreak of SARS).

31. **Land Acquisition and Resettlement.** An ADB policy that drew particular attention during the CAPE period was the policy on land acquisition and resettlement (LAR).<sup>28</sup> Compliance requirements for the ADB resettlement policy, especially following the change in ADB operating procedures in 2003, were reasons for the closure of one infrastructure project and caused delays in others. Revisions to operating procedures were introduced in 2003, requiring additional steps such as preparation of the LAR plan for ongoing lending projects for all subprojects that were not budgeted for; and (in cases where counterpart financing for resettlement could not be realized) within the planned life of projects. Nevertheless, the Government acknowledged that wider right-of-way and land acquisition issues are a constraint to infrastructure development, and policy and institutional improvements are needed to ensure that priority public goods are delivered and people affected are justly compensated.

32. Findings from an ADB Southeast Asia Department commissioned study of resettlement operations in the Philippines and OED's evaluation of resettlement have some common conclusions.<sup>29</sup> Cases were cited of (i) lack of adequate project preparation and monitoring;

<sup>27</sup> ADB. 2008. *Special Evaluation Study on the Effect of Microfinance Operations on Poor Rural Households and the Status of Women*. Manila. Available <http://www.adb.org/Documents/SES/REG/SST-REG-2007-19/SST-REG-2007-19.asp>

<sup>28</sup> ADB's policy on involuntary resettlement was introduced in 1995 (ADB. 1995. *Involuntary Resettlement*. Manila (R179-95. 12 September). The operations manual was updated on 2003 (ADB. 2003. *Operations Manual*. Section F2/BP: Involuntary Resettlement. Manila [29 October]) and again in 2006.

<sup>29</sup> ADB. 2006. *Special Evaluation Study on Involuntary Resettlement Safeguards*. Manila; and ADB. 2007. *Resettlement Operations in the Philippines*. Manila.

(ii) lack of EA experience; (iii) difficult relationships between EAs and ADB on managing resettlement; (iv) inflexibility by ADB; and (v) high costs of meeting ADB requirements. Needs were identified for (i) adequate initial social assessment on the scope of likely resettlement; (ii) effective upfront planning for mitigation measures to minimize the effects of displacement; (iii) adequate consultation with people affected; (iv) consistent compensation standards in line with national laws and regulations and ADB's minimum standards; (v) prior institutional capacity assessment and development; (vi) adequate monitoring and evaluation by the EA and external monitors; and (v) sufficient and qualified safeguard staff within the regional department to support and supervise resettlement activities.

## 2. Development Partner Coordination and Harmonization

33. To facilitate more substantive and continuous policy dialogue on the country's development agenda, the Government and its international development partners converted the annual consultative group meetings into the Philippines Development Forum (PDF) in 2005.<sup>30</sup> PDF working groups are chaired by an undersecretary (or comparable staff) of relevant government oversight and sector agencies and co-chaired by development partners.<sup>31</sup> ADB has been an active PDF supporter, co-chairing the Working Group on Governance and Anticorruption. The PDF was instrumental in addressing a number of core policy issues, in particular fiscal management and harmonization. Nevertheless, a perception by some development partners is that ADB needs to provide greater attention to implementation and could have greater "voice." The Government acknowledges the valuable role played by the Philippines Country Office in policy dialogue, coordination, and portfolio reviews. However, there is a need to clarify the relative roles of Philippines Country Office staff and ADB headquarters staff, and in supporting implementation. Development partner views, including the Government's perception of ADB are provided in Box 1.

34. An increasingly important aid coordination issue is the Government's commitment to harmonization. ADB provided TA to support the Government in addressing harmonization and the requirements of the Paris Declaration on Aid Effectiveness (Harmonization and Managing for Results TA). The assistance supported (i) a harmonization action plan and tracking mechanism; (ii) harmonizing government and development partner procedures for procurement, financial management, and audit; (iii) performance-based budgeting; and (iv) streamlining project processing procedures. The TA was strongly supported by the Government, although views were that it required greater focus given the number of agencies involved, scope of activity, and available resources. Follow-on TA is planned. The Health Sector Development Program (HSDP) is currently the only lending operation to use a programmatic approach whereby the EA coordinates participating development partners. Factors that supported progress include partnering with a single national line agency; the agency's commitment to a reform agenda; and the agency's commitment to systematic, prior provincial public expenditure reviews to assess readiness for participation, and use of agency management systems. The approach offers not only strong potential for greater harmonization between ADB, development partners and the Government, but also a high degree of supervision from ADB support staff during planning and implementation. Overall, the Government and development partner perceptions of ADB performance are positive (Box 1).

<sup>30</sup> The PDF is the primary mechanism of the Government for facilitating substantive policy dialogue among stakeholders on the country's development agenda. Available: <http://pdf.ph/>

<sup>31</sup> Currently, the PDF has seven working groups, each focused on one of the following themes: (i) MDGs and social progress, (ii) growth and investment climate, (iii) economic and fiscal reforms, (iv) governance and anticorruption, (v) decentralization and local government, (vi) sustainable rural development, and (vii) Mindanao.

### **Box 1: Development Partner Perceptions of ADB**

#### **Government Views**

- ADB is regarded as a key member of the PDF, having contributed to discussions and subsequent reforms in fiscal management, development partner harmonization, and measures on governance and controlling corruption.
- ADB was the lead financier in promoting the first use in the Philippines of a sectorwide, programmatic approach to support government health sector reforms. According to the Ministry of Health, this has unified support to the sector between participating bilateral development partners and ADB.
- ADB is seen as an active supporter of aid harmonization centered on country systems, although improvements in providing technical assistance to support key oversight agencies is needed.
- ADB is regarded as actively supporting regional cooperation and capacity development initiatives through MEDC, but this would benefit from more on-the-ground support and follow-through; and ADB could play a more prominent role in advising MEDC given the value and potential seen in initiatives such as BIMP-EAGA. The cancellation of the Third Airports Project is seen as hindering the development of regional air services as a priority BIMP-EAGA activity.
- ADB is acknowledged as an active participant in discussions on peace and development in Mindanao through the PDF working group, although ADB support to the ARMM is seen as slow moving and needs improvement.
- The Philippines Country Office has provided valuable support and advice, although the distinct roles of the country office and ADB's Southeast Asia Department's sector divisions need clarification.
- ADB's regular contact and informal meetings with key oversight agencies during the process of preparing key reform programs such as the DPSP are seen as effective means of carrying out policy dialogue.

#### **Other Development Partner Views**

- ADB and IFAD have cofinanced projects supporting agriculture and rural development assessed as successful. A high-level meeting between IFAD and ADB identified the following needs to expand cofinancing: (i) streamlining of cofinanced operations, (ii) regular partnership consultations and greater harmonization of joint ADB-IFAD operations within country context and in line with country initiatives to strengthen development partner harmonization to lower transaction costs, (iii) joint policy analysis and advocacy on agriculture and rural development, and (iv) updating of the ADB-IFAD partnership arrangement.
- ADB needs a greater "voice" in forums such as the PDF in terms of making its policy support position clear to other development partners.
- When multilateral development banks jointly support major reforms also supported by bilateral agencies unified policy matrixes are needed.
- ADB is seen as giving less attention to implementation support than the World Bank.

ADB = Asian Development Bank; ARMM = Autonomous Region of Muslim Mindanao; BIMP-EAGA = Brunei, Indonesia, Malaysia, Philippines-East ASEAN Growth Area; DPSP = Development Policy Support Program; IFAD = International Fund for Agricultural Development; MEDC = Mindanao Economic Development Council; PDF = Philippines Development Forum.

Source: Operations Evaluation Mission.

### **3. ADB Knowledge and Advisory Assistance**

35. The CAPE team carried out a survey of EAs and project officers to assess the effectiveness of ADB TA projects implemented over the CAPE period (Appendix 1). TA projects generally met EA needs and demand. Eighty-two percent of EAs reported that TA projects were high in their priorities, and 86% felt that their staff were adequately consulted. However, less than half (45%) of TA projects built on previous TA projects or loans with insufficient follow-through reported. The EAs regarded more than 90% of TA projects as having satisfactory designs, but considered that about 25% were underresourced. Lack of counterpart staff to work on TA projects reduced their potential impact. The EAs rated 81% of consultants as good at communicating best practice, although one-quarter of EAs reported problems with consultants. Project officers interviewed on the same TA projects estimated that an average of 12.2 months was required from initial fact-finding to mobilization of consultants. This long gestation period meant that advice for loan planning and implementation was delivered late. For 61% of the ADTA projects, two or more staff acted as project officers for the TA and this contributed to delays in some cases.

36. Recommendations from 73% of the TA projects involve policy reform, reflecting the focus on supporting reform during the CAPE period and the TA project's role in doing so. Eighty-two percent of EAs describe such recommendations as at least satisfactory, although half reported that policy proposals had to be adapted before they were acceptable to government. Two thirds of EAs acted on recommendations made to improve EA functioning. Three quarters of TA projects included training, and 87% of EAs reported at least some improvement in staff performance following training. However, few ADTA projects trained trainers or supported components, which could have improved the implementation of new skills and the sustainability of capacity development efforts. Ninety-one percent of EAs rated ADB's flexibility and responsiveness as at least satisfactory. Half of the project officers rated the impact of the TA as high, 33% as medium, and 17% as low; a lower performance assessment than reported by the EAs. Forty-four percent of officers rated the sustainability of the TA impacts as high, 33% as medium, and 22% as low. The Economics and Research Department study that assessed critical constraints to growth (footnote 22) was reported to have wide usage among business groups and other development partners such as the Millennium Challenge Corporation.

#### **4. ADB Lending Products**

37. Program lending dominated the new lending portfolio during the CAPE period. A key change was made in the design of program loans from multiple tranche loans with ex-post conditions to a series of single tranche loans with prior conditions or triggers. This is acknowledged by the Government as a means to avoid the previous problems of program loan cancellation arising from difficult to meet second tranche conditions involving controversial legislation or requiring cumbersome legislative processes, and improves government ownership and leadership. However, while single tranche program loans that support development policy are quick-disbursing, they require intensive upfront policy dialogue and continuous monitoring of the triggers for subsequent loans. While fewer loans were made during the CAPE period compared to previous periods, average loan size increased from \$63 million per loan during the first 7 years to \$110 million per loan in 2000–2007, in part reflecting the nature of program loans. The HSDP was the first loan to take a government-led programmatic approach (Section IV). Furthermore, in line with the 2005 country strategy, more lending was planned through off-budget channels such as GOCCs and GFIs (past or ongoing examples include those to NPC, the Small Business Guarantee Fund, Metropolitan Waterworks and Sewerage System (MWSS), and the Local Water Utilities Administration [LWUA]). However, no new loans were made to GOCCs during the CAPE period. There are also concerns that off-budget lending carries risks from government liability (in the event of default from underperforming and inefficient GOCCs), lower transparency, and could undermine budget discipline.

#### **5. Portfolio Performance**

38. While the portfolio shifted in composition to address priority policy problems, the cleanup initiated in 2000 inevitably led to a decline in portfolio size. The disbursements in 2003, 2005, and 2007 were mostly from program loans approved in the same or previous year. Program loans also brought in positive net resource transfers in 2006 and 2007 for the first time since 1998 (Appendix 6, Figure A6.1), with program loan disbursements making up 45% of total disbursements in 2003, 73% in 2005, 90% in 2006, and 78% in 2007. With the reduction in investment projects and shift to program lending, the active portfolio increased and disbursement rose in 2006 to \$833 million (Appendix 6, Figure A6.2).



39. Program loans, in view of their quick-disbursing nature, have a short average life. For projects closed after 2000, transportation and communication projects took the longest to implement at 110 months. Furthermore, while the ADB portfolio in the Philippines decreased in size, the quality of resource management improved with a decline in projects at risk from 17 loans in 2001 to 9 in 2003 and 3 in 2007 (Appendix 6, Figure A6.6), and this was accompanied by an improvement in start-up performance (Appendix 6, Figure A6.7). As the economic management, finance, and energy sectors had a large program loan content that was effectively implemented, the average life of lending operations closed after 2000 was 28.8 months for economic management, 33.6 months for finance, and 69.9 months for energy (Appendix 6, Figure A6.8). Overall, the portfolio cleanup focus on key policy constraints through program lending and the strategy of linking new lending commitments to the Government's fiscal absorptive capacity have resulted in a smaller portfolio but with improved performance.

40. Despite the overall improvement in implementation and a lower number of projects at risk, problems persist in some sectors and projects (Box 2). Implementation delays arising from EAs and IAs include multiple institutional layers and weak coordination among agencies that support local services development; protracted bidding of civil works and contractual disputes between IAs and a contractor; weak project implementation capacity and the need for longer capacity strengthening lead time; and protracted procedures for right-of-way and LAR. Problems and solutions specific to each sector are discussed in Section IV. As the portfolio shifts from its present reform focus supported by program lending back to an investment portfolio, it is crucial that such problems are resolved and quality-at-entry filters continue to be applied to avoid a reemergence of past poor portfolio performance.

**Box 2: Common Implementation Issues in Sector Lending Operations**

- (i) Complex implementation arrangements, overlapping agency roles, multiple institutional layers (urban, rural development, water supply and sanitation);
- (ii) Weak coordination among agencies and local government units (LGUs) (urban, health);
- (iii) Weak project implementation capacities including managerial, technical, financial management, procurement (education, health, water supply and sanitation, urban);
- (iv) Weak regulatory enforcement and institutional framework (urban, water supply and sanitation);
- (v) Limited assessment of local institutions and associated risks during project preparation stages (urban);
- (vi) Capacity-building during pre-implementation phase took longer than expected (rural development, health);
- (vii) Devolved functions not clearly defined between national agencies and LGUs which result in confusion (rural development, urban);
- (viii) Protracted bidding of civil works and contractual disputes between an implementing agency and a contractor (transport, urban);
- (ix) Right-of-way problems and protracted land acquisition and resettlement procedures (transport, urban); and
- (x) Lengthy project level approval process (urban, rural development).

Sources: Asian Development Bank. 2007. *Philippines Country Program Annual Portfolio Review*. Manila; and Operations Evaluation Mission.

41. Considering the application of ADB policies, development partner coordination, use of lending and nonlending products, and overall portfolio performance, the CAPE rating for institutional performance is "satisfactory."

#### **D. ADB's Results Contribution**

42. The 2005–2007 country strategy was the first country strategy for the Philippines to include a results framework. This framework was used as the basis for setting and assessing progress toward agreed country strategy targets. Table 4 summarizes the ADB–Philippines partnership targets set and program delivered. Outputs for past and ongoing programs are

discussed in Section IV, which includes consideration of the results of operations started prior to 2002. The results framework provides a logical hierarchy and basis for monitoring how operations results contribute to targets and development goals. The CAPE rating on ADB contributions to long-term development results is “modest to substantial.” The reasons for this rating are summarized below.

**43. Improved Macroeconomic Stability and Fiscal Outlook.** The fiscal crisis at the beginning of the CAPE period led to a substantial response by ADB and a significant contribution to fiscal adjustment through support for specific measures, including power rate adjustments and increased taxes. This contribution led to reduced credit spreads; improved credit outlooks of international rating agencies; lower hurdle rates on investments; a modest sentiment improvement in some quarters of business; and reduced public sector financing requirements. ADB’s statements on the expanded value-added tax (EVAT) were strategic and critical and ADB was among the first development partners to openly acknowledge the importance of EVAT. ADB support for fiscal consolidation contributed to the Philippines’ recent macroeconomic stability and to the broader enabling environment for economic growth. The consolidated public sector budget balance improved from a deficit of 5.6% of GDP in 2003 to being virtually balanced in 2007. Despite the overall improved tax effort between 2002 and 2007 by almost 2% of GDP, this did not meet the partnership target of 14.8% for 2007. As fiscal space emerged, ADB support has helped to effect improved budget allocations to infrastructure, social services, and agriculture. Overall public infrastructure spending grew by 29.5% in 2007, but slowed year-on-year in the first quarter of 2008. Steps have been taken to address expenditure efficiency improvements by promoting the use of medium-term expenditure planning and Government performance reviews through ADTA and the Development Policy Support Program (DPSP), although the full effects of the latter initiatives will take a longer time.

**44. Investment Climate and Competitiveness.** ADB’s contribution to energy sector reform has helped underline the importance of full cost recovery in setting tariffs for moving privatization efforts forward. The adjustment in power rates in late 2004 contributed dramatically to the turnaround in the public sector financial position. Progress in power privatization helped to ensure adequate power supply for the country, a fundamental component of a favorable investment climate. The industry is increasingly run by the private sector and not subject to government resource constraints. However, these structural improvements have yet to translate into lower electricity prices, which remain among the highest in the region and undermine competitiveness. In recent years, the domestic financial industry has become more efficient and competitive as capital market reforms have progressed. ADB-supported finance sector reform programs have contributed an alternative source (to banks) of long-term financing and increased transparency in the domestic stock market, including strengthened regulatory quality, which was important in the aftermath of the Asian financial crisis (AFC). ADB supported SME financing and played a role in rationalizing the microcredit delivery system away from government-led provision into wholesale microfoundations. ADB also gave critical support to the Government’s reform initiative of maintaining market-oriented credit policies. ADB’s nonsovereign support to the North Luzon Expressway (the first tolled expressway) was a good practice example of a public–private partnership. The model has been replicated elsewhere in the country. Overall, private sector construction grew by 15.9% in 2007 reflecting improved private sector investment sentiment. The adequacy of public infrastructure and education outcomes remain a key competitiveness concern for the private sector, as well as the control of corruption.

**45. Good Governance, Corruption, and Peace and Order.** ADB assessed and publicized the state of the investment climate and advocated action on governance and corruption issues which constrain investors. The program helped the Government formulate and implement policy

and address aspects of the bureaucracy, regulatory processes, and corruption in government. In addition to policy-based lending for public resource management, tax collection, and procurement, TA addressed public expenditure management including the improvement of national and local accounting, budgeting, and reporting systems on the overall quality, efficiency, and impact of government spending, thus addressing transparency, accountability, and corruption concerns. Early results, such as less duplication of reporting forms and the tracking of progress in decentralization through a common national and local classification of budgeting, spending, reporting, and auditing system are important steps. With uptake and dissemination, they have the potential to provide meaningful and timely information. Such initiatives, if followed through, will be instrumental in renewing efforts to further decentralized service delivery. Support for greater transparency in public procurement showed results such as lower procurement prices for school textbooks. Improved regulatory processes were largely within the power subsector and have paid dividends. Beyond these system and sector contributions, governance and corruption issues remain deep-rooted. Support to Mindanao is seen to support the peace process through development, although support to ARMM has not been effective.

46. **Contributions to Poverty Reduction and MDG Attainment.** Poverty levels were on a downward trend and then were reported to rise in the latter part of the CAPE period (footnote 12). Performance prospects for realizing other MDGs remain mixed. In support of the need to increase spending on MDG-related goods and services, ADB assistance has helped to catalyze budget shifts which increased resources for addressing MDGs, and through local-level investment projects demonstrated useful approaches to reducing income and non-income poverty at the local level. Improved fiscal performance has created scope for higher public investment and increases in social service outlays. National government infrastructure outlays have risen from 1.5% of GDP in 2005 to 2% in 2007 and are programmed to rise further to 2.2% in 2008. Likewise, the budget for social services, half of which is for education, is programmed to rise from 4.7% of GDP in 2005 to 5% in 2008. However, improved benefit incidence from budget allocations will depend on improved local service delivery and widespread strengthening of local institutions to deliver services, which ADB is supporting. The growth strategy also needs to be further optimized to more deliberately ensure that it filters to household levels, especially the poorer segments. ADB's support for health sector reforms is also acknowledged to have supported a reform that addresses health improvements and decentralization of service delivery. Support for secondary education is providing a model that is being used in ongoing education reforms. ADB-supported water projects, while having mixed results depending on locations, have connected hundreds of thousands people to clean and accessible water sources. Other contributions include support for raw water supply to Metro Manila and capacity development for regulating water concessions.

## **E. Overall Top–Down Assessment**

47. The top–down assessment followed the criteria: (i) ADB's positioning (including relevance and alignment, selectivity, sequencing, and continuity); (ii) ADB's performance (responsiveness, suitability of ADB policies, lending instruments, portfolio performance, coordination with development partners); and (iii) ADB's contributions to long-term development results (results and their likely sustainability, impact, and value addition). ADB assistance as a whole, from a top–down perspective, was assessed to be "successful" (Appendix 2, Table A2.4). The main reasons for this rating are the substantially improved positioning of ADB's program to address relevant and priority development constraints; improved performance of ADB's partnership, dialogues, and lending and nonlending portfolio; positive client feedback; and ADB's contribution to improving the Philippines' fiscal outlook and governance reform, but so far modest impact on improving the investment climate and contributions to MDGs.

**Table 4: Summary of ADB–Philippines Partnership Targets and Progress for 2005–2007**

Philippines Development Goals	2005 ADB–Philippines Partnership Targets		Program Delivery	
	Planned	Progress	Planned	Progress
<p><b>Improved macroeconomic stability and fiscal outlook</b></p> <p><b>Improved competitiveness and investment climate</b></p> <p><b>Job creation</b></p>	<p><b>Improved fiscal outlook</b></p> <ul style="list-style-type: none"> <li>• 2004 NGFD-GDP ratio of -3.8% reduced by 2.5% percentage points</li> <li>• 2004 CPSB-GDP ratio of -4.8% reduced by 10% per year</li> <li>• 2004 revenue-expenditure ratio of 79.1% increased</li> </ul> <p><b>Better investment climate</b></p> <ul style="list-style-type: none"> <li>• Improved investor perception</li> <li>• Improved global competitiveness rankings</li> <li>• 2003 net FDI of \$57 million increased (\$188 million in BOP)</li> <li>• Increased SME share of job creation</li> </ul>	<ul style="list-style-type: none"> <li>• 2007 NGFD-GDP reduced to 0.1%</li> <li>• 2007 CPSB surplus at 0.5% of GDP</li> <li>• 2007 revenue-expenditure ratio of 99% (includes large privatization receipts)</li> <li>• TI corruption perception index of 2.5 and country ranking of 131</li> <li>• WEF global competitiveness ranking of 71 in 2007</li> <li>• 2007 net FDI reflected in BOP data shows a rise to \$2.8 billion in 2006 but reversed to negative \$514 million in 2007</li> <li>• Economy-wide estimates show modest job creation and rise in unemployment among 15 to 24-year-olds</li> </ul>	<p>Policy support and recommendations to reform key sectors including power, governance, local government, and financial markets</p>	<ul style="list-style-type: none"> <li>• Development Policy Support Program supported fiscal consolidation measures, transparent procurement</li> <li>• Power Sector Development Program supported privatization of generation and distribution, regulation, energy markets</li> <li>• Financial Markets Regulation and Reform Program supported institutional strengthening of the nonbank subsector</li> <li>• Local Government Financing and Budget Support supported access of LG to finance and budget management</li> <li>• Advisory TA projects delivered</li> <li>• Country Investment climate assessment completed</li> </ul>
<p><b>Good governance, anticorruption, and peace and order</b></p>	<p><b>Results-based development partnership</b></p> <ul style="list-style-type: none"> <li>• Strategy adopted, implemented</li> <li>• Enhanced development partner coordination</li> </ul> <p><b>Efficient, effective delivery of resources</b></p> <ul style="list-style-type: none"> <li>• Improved portfolio performance</li> <li>• Attained expected results and deliverables</li> <li>• More stable peace and order situation</li> </ul>	<ul style="list-style-type: none"> <li>• Harmonization achieved in procurement</li> <li>• Country has committed to principles of harmonization effected through PDF, ADB active member</li> <li>• Fall in at-risk projects, return to net positive transfers, improvements in PPRs</li> <li>• See sector performance evaluations</li> <li>• Apparent decline in insurgency, but peace agreement not yet signed</li> </ul>	<p>Flexible, results-based strategy with greater focus, selectivity, and quality-at-entry</p> <p>Restructured portfolio</p> <p>Aligned development goals and strategies</p> <p>Progress on peace and development</p>	<ul style="list-style-type: none"> <li>• Country strategy lending volumes linked to fiscal and portfolio performance targets</li> <li>• Results-based framework adopted</li> <li>• Portfolio cleanup resulted in closure of 40 projects consisting of 47 loans; aided by program lending, net positive resource transfer resumed in 2006</li> <li>• Country Governance assessment completed</li> <li>• Investment Climate assessment completed</li> <li>• ADB co-chair of PDF Working Group on Governance and Anti-corruption</li> </ul>
<p><b>Poverty reduction</b></p> <p><b>Social and human development</b></p>	<p><b>Progress in the attainment of MDGs and MTPDP targets</b></p> <ul style="list-style-type: none"> <li>• Improved rural incomes</li> <li>• Increased access to shelter</li> <li>• Increased access to electricity</li> <li>• Increased access to better roads</li> <li>• Improved water supply in Metro Manila and water supply access in other areas</li> <li>• Improved education and health services</li> <li>• Improved access to better agricultural services, irrigation</li> <li>• Improved fisheries resources</li> </ul>	<ul style="list-style-type: none"> <li>• Poverty incidence rose from 30% of population in 2003 to 33% in 2006, largely in rural regions</li> <li>• 80% electrification in 2005, connections rising</li> <li>• Roads at 2.5 km/1,000 people, with RP lowest on connectivity infrastructure for SEA</li> <li>• 80% access to improved water in 2004, increasing but below target</li> <li>• 86% sanitation, high and increasing in urban area, on target</li> <li>• Primary, secondary education enrollment, completion deteriorating, but recent national, local government budgets increased</li> <li>• Recent increases in budget allocations to ARD, but below needs</li> </ul>	<p>Goods, services, infrastructure, and policies that support a wide range of activities on SME, microfinance, water supply, environment, transportation, energy, health, education, and urban development</p>	<ul style="list-style-type: none"> <li>• SME Development Support Project</li> <li>• Metro Manila Urban Services for the Poor Project approved</li> <li>• Angat Water Utilization and Aqueduct Project under reconsideration</li> <li>• Integrated Coastal Resources Management Sector Project approved</li> <li>• 27 other active loans agriculture, natural resources, energy, health, education, urban development, transport</li> </ul>

ADB = Asian Development Bank, ARD = agriculture and rural development, BOP = balance of payments, CPSB = consolidated public sector balance, FDI = foreign direct investment, GDP = gross domestic product, km = kilometer, LG = local government, MDG = Millennium Development Goal, MTPDP = Medium-Term Philippine Development Plan, NGFD = national government fiscal deficit, PDF = Philippine Development Forum, PPR = project performance rating, PRC = People's Republic of China, RP = Republic of the Philippines, SEA = Southeast Asia, SME = small- and medium-sized enterprise, TA = technical assistance, TI = Transparency International, WEF = World Economic Forum.

Sources: Operations Evaluation Mission and 2005–2007 country strategy.

#### IV. EVALUATION OF THE SECTOR ASSISTANCE PROGRAM

48. This section presents the summary of sector results and assessment. The overall country setting is discussed in Appendix 7. The associated government policy and plans for each sector are outlined in Appendixes 8–12 together with an elaborated description of ADB's assistance program and criteria-specific assessment of assistance performance.

##### A. Economic Management, Public Policy, and Social Services

49. **Key Challenges.** The Philippines political economy backdrop stems back to problems and solutions prevailing and promoted in previous government administrations. In the aftermath of the AFC, economic management continued to face severe challenges from political turbulence and leadership changes, a deteriorating fiscal situation, a heavy public debt overhang, a low domestic resource mobilization effort, incomplete and inconsistent decentralization, and a judiciary perceived (from ratings) to have insufficient checks-and-balances to curb corruption and widespread erosion in public trust. Faced with a high deficit and decreasing fiscal space, spending on public investment and social services were scaled back. The need to resolve the fiscal problem as a necessary condition for reducing macroeconomic risk and reviving investments was evident in all political quarters, especially in view of the successive downgrading of sovereign credit by international rating agencies (Appendixes 8–9).<sup>32</sup>

50. Following the 2004 elections, a succession of reform measures implemented within a year turned the situation around and the debt ratio began to fall. The fiscal reforms included increases in power tariffs; adjustment of excises on alcohol and tobacco products; and legislation that expanded the sector application of the value-added tax, increased the value-added tax rate, and increased income tax collection efforts. One-off privatization receipts were used to make up for lost tax revenue. As fiscal space began to be realized, the Government placed spending priority in a number of critical areas with the greatest growth impact, principally infrastructure, health, and education. To strengthen the linkage between planning and budgeting, efforts were focused on the medium-term expenditure framework and supported by sector effectiveness and efficiency reviews and the organizational performance indicator framework to promote greater flexibility, transparency, and accountability. They also promoted a shift in the budget process from inputs and rules-based compliance to outputs, outcomes, and results orientation. Continued attention was given to debt and risk management, especially to off-budget risks, to reduce the interest burden and minimize unexpected demands on the budget.

51. A parallel need to improve the efficiency and effectiveness of local public spending was also evident. The LGC was introduced in 1991, but the expected benefits of decentralization have yet to be realized in many LGUs. Elements included efforts to clarify national versus local government roles in various activities to match these against financial transfers and to improve resources provided to poorer LGUs. The latter is important with respect to meeting the MDGs, as the distribution formula of the internal revenue allotment needs to consider an equalization objective relative to LGUs' capacity to provide minimum service standards. Needs were identified to improve local revenue mobilization, budgeting, and resource management; and explore options for subsovereign lending, including nontraditional options such as guarantees.<sup>33</sup> In many areas, good governance and capacity development of local governments continues to

<sup>32</sup> S&P ratings from BB+ in 2002 to BB in 2003 and BB- in 2005. S&P's credit rating improved from "negative outlook" in 2006, "stable outlook" in 2007, and "positive outlook" in 2008. Moody's ratings from Ba1 in 2003 to Ba2 in 2004 and B1 in November 2007. Moody's November 2007 outlook for the Philippines' credit was stable.

<sup>33</sup> World Bank. 2005. *Philippines: From Short-Term Growth to Sustained Development*. Washington, DC (Report 32055-PH).

be seen as a fundamental institutional need. However, efforts in these areas are complicated by the 3-year electoral cycle that has profound effects on policy continuity, reform commitments, and willingness to borrow at the local level.

52. In the social sectors, education was beset by a range of performance problems. The country is lagging on some education MDG indicators (Appendix 7, Table A7.4). Education outcomes show lagging indicators in the mathematics and science subjects.<sup>34</sup> The higher education system is considered to be highly inefficient, producing large numbers of poorly qualified graduates. This is largely attributed to the proliferation of state universities and colleges. Per capita government education spending has been on a decline which is aggravated by inefficient and inequitable allocation of resources.<sup>35</sup> At present, there are wide variations in the quality of technical and vocational schools, with many of them being substandard. In addition, there is a growing mismatch between the needs of the business sector and labor supply and capabilities. The problem is exacerbated by the rapidly changing patterns of demand in the labor market. For example, the expanding service sector, and especially the growth of the outsourcing and offshoring industry, requires strong English language and technology-related skills to improve competitiveness and market share. Public health systems have also deteriorated in recent years. Support for preventive health care for the rural and poor segments of the population has not kept up with the population increase. Access to quality care is severely limited, especially for the rural poor. The development of the health sector was slow due to inadequate health financing, inefficient sector priorities, poor quality and cost-effectiveness of service delivery, financial and physical constraints to access for the poor, and inadequate sector governance.

## 1. Law, Economic Management, and Public Policy

53. **Program Results and Assessment.** ADB support was “relevant” as it was consistent with the Government’s fiscal reform agenda and ADB’s country strategy, with TA providing a means for supporting policy analysis and dialogue and as an instrument to provide urgently needed fiscal support while helping to leverage reforms. Contributions to the analytical process in economic policy making helped reinforce the Government’s commitment to follow-through on contentious yet critical reforms despite pressures from segments of government concerned with maintaining political popularity. Fiscal reforms have led to a reversal of the public sector financial position from a deficit of 5.6% of GDP in 2002 to a deficit of 0.1% of GDP in 2007, and a concomitant improvement in the national government budget balance, creating additional space for development spending and social outlays. The tax effort has increased from 12.4% of GDP in 2002 to 14.3% of GDP in 2006 due to introduced tax measures, in particular the excise tax adjustment and the EVAT law. Power rate adjustments reduced NPC’s deficit from 1.5% of GDP in 2004 to 0.3% of GDP in 2005. However, government revenues did not meet expectations and fell to 14.1% of GDP in 2007.<sup>36</sup> Shortfalls were met by the privatization of state-owned assets, and largely from the sale of energy sector assets as part of the EPIRA. The

<sup>34</sup> In 2003, Trends in International Mathematics and Science Study (TIMSS) ranked the Philippines in the lowest 10% of participating countries in both subjects in grades 4 and 8, well below Asian neighbors. National achievement test scores for Grade 6 students were 60%, 52%, and 61%, respectively, for Math, Science, and English in 2006–2007. Corresponding scores for second year high school students were 39%, 42%, and 52% respectively, in the same year. In 2005–2006, the average national achievement test score among public elementary school students was 57% versus the 75% passing score.

<sup>35</sup> The international benchmark for the education budget as a percent of GDP is 6.0%. In 2007, spending on education in Malaysia was 7.4%, Thailand 4.0%, and Philippines 2.5%.

<sup>36</sup> In its Philippines 2007 Article IV Consultation, the International Monetary Fund (IMF) assesses several possible reasons for the decline in tax receipts: tax evasion related to the election and continued noncompliance with following the tax-evader amnesty revenue agency discontent, lifting of the value-added tax input cap, peso appreciation, and higher smuggling (imports may have also been low in 2007 from possible under-recording). Source: IMF. 2008. Philippines: Staff Report for the 2007 Article IV Consultation. *IMF Country Report 08/119*. Washington, DC.

Bureau of Internal Revenue (BIR) issues arising from the DPSP experience revealed capacity and resource constraints within the agency that help to explain its short-term orientation, such as resorting to advanced collections of the next period's tax liabilities from corporations and absence of programs to deal with medium-term challenges such as tax arrears and prosecution of tax offenders. Development partner support to BIR is now focusing on building up its database, revenue forecasting, risk-based audit system, and tax prosecution.<sup>37</sup> On the expenditure side, budgeted social spending was increased from 3.7% in 2006 to 5.8% on 2008, with the Department of Education receiving the largest budget (₱147.2 billion) followed by the Department of Public Works and Highways (₱102.4 billion), although levels are still relatively low compared to neighboring countries.

54. Enactment and implementation of the Government Procurement Reform Act in 2003 was a significant development. It helped streamline rules and regulations, and increase competition and transparency in government procurement; it removed loopholes in various regulations by having an omnibus law. The setting up of an electronic procurement system that posts procurement opportunities in the public sector to help consolidate the purchase of common use items is an important step in this area. Cost savings have resulted from the introduction of the new systems in procurement.<sup>38</sup> On the other hand, recent controversies arising from supply-driven procurement in large infrastructure projects funded by official development assistance reveal the need for greater transparency in project selection, award, and implementation, especially with regard to the one area that is not covered by the procurement law pertaining to government-to-government contracts.<sup>39</sup> Steps have been taken to introduce competitive bidding into these projects and involve the private sector in a procurement transparency group spearheaded by the Department of Budget and Management.<sup>40</sup> TA for Debt and Risk Management addressed the lack of a formal debt management strategy and dispersed organizational responsibilities for key issues, recommending a new debt and risk management office to lead the work.

55. ADB assistance contributed to assessing LGU financing options, building capacity for local planning and project management, and developing an automated system for local government performance assessment. The local government public expenditure and planning guidelines prepared with TA (Strengthening Provincial and Local Planning and Expenditure Management TA) are technically sound, relatively simple, and user-friendly; and training programs have succeeded in building capacity to use the new system. In addition, the signing of the Joint Memorandum Circular 1, Series 2007, is a landmark achievement of ADB assistance in local government reform, and strengthens the collaborative arrangements among concerned national agencies and provincial governments; it helps solidify the link between provincial plans and budgets. Support to local governance in Mindanao resulted in major changes to legislation governing the LGC, Courts Act, Administrative Code, and Code of Muslim Commercial laws; as well as development of handbooks and procedures that are now used for planning and budgeting purposes. Overall, planned outcomes of support were generally achieved and ADB assistance contribution is rated "effective."

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<sup>37</sup> The DPSP includes support for Government programs such as Run After Tax Evaders, the Revenue Integrity Protection System, and Run After Smugglers through ADB TA to the Philippines for Enhancing Revenue Collection and Strengthening the Criminal Prosecution of Tax Evasion Cases. Accumulated cases filed at the Department of Justice by September 2007 included 87 cases filed under the Run After Tax Evaders program and 52 cases filed under Run After Smugglers. Sources: ADB staff and reports to the Fiscal Working Group of the Philippines Development Forum.

<sup>38</sup> The MTPDP (2004–2010) notes a 30% cost savings in government procurement. ADB's DPSP reports ₱400 million overall savings in 2005 and 40% reduction in cost of textbooks since 2000.

<sup>39</sup> Examples include the cancelled Commission on Elections electronic system and the National Broadband Network Project.

<sup>40</sup> The Procurement Transparency Group was created through Executive Order 662A and is comprised of representatives from the Government Procurement Policy Board and six civil society organizations.

56. The lead up to DPSP involved a 3-year policy dialogue culminating in the first time use by ADB of a series of single-tranche program loans (one of which was provided during the CAPE period) in the Philippines. This positions ADB to follow through with reform deepening over the medium term, even though ADTA projects had delays and identified areas for improvement in delivering technical support. Overall, the support for fiscal reforms is assessed “highly efficient.” The support is assessed “likely sustainable” as reforms are reflected in the approved 2008 budget for the country and improved sector allocations. Forward risks include commitments to a balanced budget, slowing of the global economy, political pressures to provide short-term solutions to the current food price rises, and possible effects of rising inflation. The assistance is assessed as having “substantial impact” on the improved fiscal situation and budget alignment, although the full welfare impact on improved expenditure on needed social services is not yet known given the lagged effects of budget alignment improvements.

57. To foster respect for the rule of law, ADB assistance helped build a general consensus that judicial reform is necessary, and the Action Plan for Judicial Reform for establishing fiscal and administrative independence of the judiciary was adopted. A new administrative structure involving the delegation of responsibilities to regional courts was agreed upon, and steps were taken to reform the operations of the Supreme Court to address the backlog in local-level courts and hence in the judiciary as a whole. While increasing remuneration for judges and other court personnel during a period of fiscal consolidation is under discussion, the Government increased the special allowances for judges as a sign of its commitment to boosting incentives in the judiciary. A program loan was under preparation at the end of the CAPE period to address judicial reform.

58. Overall, ADB’s assistance to LEMP during the CAPE period is rated “successful.”

59. **Recommendations.** Progressing fiscal reforms is crucial for maintaining macroeconomic stability and improving public expenditure management to facilitate growth and poverty reduction. In the event of a global and domestic economy slowdown, maintaining fiscal discipline will continue to be needed. Continued operational focus is needed on fiscal reforms including revenue efforts and improving budget allocations for priority sector development (infrastructure, education, health, agriculture, and rural development). To progress expenditure efficiency and improve local service delivery, support is needed for systematic capacity development to improve public expenditure management and service delivery. Increasing support for local capacity development in country systems-based planning, management, and internal audit is needed and requires consideration of alternative modalities to expand systematic institutional capacity development. Wider consideration is needed for human resource development and incentive structures, especially at the local government level. Given the ongoing national agency rationalization process, a focus on national agencies and LGUs that support or are responsible for the provision of local goods and services is needed.

## 2. Health Sector

60. **Program Results and Assessment.** Sector challenges, government policy, and ADB assistance are discussed in Appendix 8. ADB support through the HSDP was consistent with the HSRA, provided a means for supporting human resource development, and was a ready instrument to respond to an urgent need for fiscal support. Other lending assistance completed during the CAPE period included the Women’s Health and Safe Motherhood Project and Early Childhood Development Project. Assistance is rated “relevant.” The Integrated Health Sector Development Project became a vehicle for reestablishing partnerships between the Department of Health and various levels of LGUs in planning, managing, and financing health services in a



devolved setting. An integrated approach to community health service delivery provided useful lessons for the institutional convergence approach to implementation of the HSRA, while developing tools for systems management and planning. The ongoing support for health sector reforms, through the HSDP, systemically addresses sector constraints to improving decentralized health services. Together with development partners, it helped to pioneer the use of provincial expenditure reviews in participating provinces (carried out with European Union assistance) as the basis for improving local expenditure efficiency on services. Nevertheless, the effectiveness of some policies needs improvement. Foremost among these is the expansion of membership under the Philippine Health Insurance Corporation-sponsored program and on more progressive premium contributions. Operations completed during the CAPE period have helped to leverage improvements to the health care service infrastructure and were generally “effective.”

61. All three loans experienced implementation delays, and because of slower than expected realization of benefits from reforms and investment, they are assessed “less efficient.” However, in the future, the introduction of performance-based funding approaches under the HSDP is expected to contribute to improved efficiency in resource allocation, as are measures aimed toward the rationalization of hospitals. In terms of sustainability, the HSDP has contributed to raising awareness on the HSRA and built a national constituency for health sector reform, including among key agencies such as the National Economic and Development Authority, Department of Budget and Management, Department of Finance, and LGUs. The process of preparing HSDP policy actions at a time of fiscal stress facilitated an increase in understanding of the HSRA and its acceptance among Department of Health technical staff. As a result of fiscal reforms, the health sector budget in 2007 and 2008 was increased significantly. Assistance is assessed to be “likely sustainable.” Forward risks to sustainability include population pressures that undermine recent budget allocation improvements, insufficient government investment in health services and facilities, and inconsistent standards across LGUs that may unduly affect service delivery and reverse earlier reform gains. Assessment of the full impact of sector policy reform is too early at this stage as the reforms must be continued. However, the impact is positioned to be “likely substantial” and complements the localized impact of the Women’s Health and Safe Motherhood Project and Early Childhood Development Project. Overall, ADB’s assistance to the health sector over the CAPE period is assessed “successful.”

62. **Recommendations.** Given that the HSRA is several years into the reform process, a review is needed to identify adjustments where appropriate. TA will be critical to deepen improvements in national and local capacity. Further reforms and related policy matrixes should be more selective and substantive, and aligned to leverage efficiency improvements from national government transfers to LGUs (e.g., investment plans must be strictly aligned with HSRA directions; apply performance-based funding; and discriminate judiciously among poor and nonpoor regions with respect to terms of onlending or ongranting). Further development of programmatic modalities need to be explored for leveraging reforms and efficiency improvements through government performance-based transfers rather than relying on policy loans, which would also require more flexible onlending or ongranting arrangements.

### 3. Education Sector

63. **Project Results and Assessment.** Sector challenges, government policy, and ADB assistance are discussed in Appendix 8. Education has consistently featured in ADB country strategies, but there was no new lending during the CAPE period. Ongoing ADB support to the sector focused on the Secondary Education Development Improvement Project (SEDIP) and Technical and Vocational Education and Training (TVET). TVET was not evaluated. Support for secondary education was assessed “relevant.” The SEDIP was consistent with the Government’s

priorities and ADB's strategies and program of supporting human development and poverty reduction. The project implemented ADB's operational strategy for the Philippines, and focused on human development by improving access to quality basic social services by geographically targeting deprived rural and poverty-affected areas. The project is assessed "effective" as most of the outputs achieved met expectations, despite being considered "at risk" during the midterm review due to slow progress. These included enhancing the capacity for school-based management, provision of education materials, and use of new teaching methods that promote students' participation and encourage more proactive responsibility for their own learning as well as community involvement. Although initially the TA report was not accepted by the then education Secretary, the TA outputs were in conformity with the Government Act on Basic Education for decentralization and later formed the foundation for the Implementing Rules and Regulations for this Act. The decentralization process eventually progressed and the TA output continues to be a road map for the policies, strategies, and action for decentralization of the education system. The project is also assessed "less efficient" given the substantial delays in project implementation. The most significant factors impeding progress in the first half of the project were the weak project management unit (later replaced) and fluctuating support for decentralization by the Department of Education. Furthermore, while the constituency for reforms, including decentralization, was strong at the design stage, a change in the Department of Education Secretary resulted in a changed agenda that also affected SEDIP implementation and the initial acceptance of TA recommendations. Nevertheless, a significant advance was the decrease by 40% in textbook costs after international competitive bidding was introduced for their procurement.

64. The loan project and TA projects are assessed "likely sustainable" as outputs and outcomes so far meet expectations, and recent developments in the secondary education systems provide opportunities to replicate the project approach. SEDIP contributed to implementing some components of the education decentralization process advocated in the Implementing Rules and Regulations of the Basic Education Sector Reform Agenda, providing an opportunity to mainstream the project's output nationwide. Nevertheless, risks to sustainability include the pressures from population growth on existing budget provisions, slower than needed growth of the education budget required to upgrade and replicate the SEDIP model, and unclear priorities among a needed long list of reform actions. While still being implemented, the project has facilitated decentralization of the education system and is assessed to have a "likely substantial impact." Overall TA and project assistance performance is assessed "successful."

65. **Recommendations.** SEDIP highlights the need for mutual understanding of the project design at the outset to avoid delays. In cases of frequent changes in heads of department, especially at the Secretary level, close dialogue is needed to identify the risks to the project and to aid ADB decision making on the possible need for changes in scope or cancellation where covenants are fundamentally compromised. Even in cases where TA recommendations are initially rejected, maintaining a policy dialogue can result in the possibility of future acceptance. Where ADB's assistance in a sector is a relatively small contribution to overall Government efforts, the emphasis should be on demonstration effects. Falling MDG performance in education, private sector concerns over education standards, and the still tenuous budget allocations to the sector suggest that ADB's engagement in the sector should be a priority.

## **B. Private Sector Enabling Environment**

66. **Private Sector Development Challenges.** The combination of the AFC and the country's subsequent struggle to restore fiscal discipline adversely affected private sector confidence and growth. This is reflected in a dearth of large projects, including the privatization program that was stalled until recently, and reduced interest in public-private partnership schemes in infrastructure.

From 1986 to the end of the 1990s, the Government privatized about 450 of the 562 GOCCs.<sup>41</sup> The private sector is estimated to generate about 95% of GDP, a situation that has persisted since the early 1990s.<sup>42</sup> Annual foreign direct investment inflows in the 5 years to 2006 averaged \$1.4 billion, significantly below amounts received by the other large crisis-affected economies in the region. Constraints to investments range from macroeconomic instability, to poor infrastructure facilities, to weak governance and institutional capacity; many of which have proved difficult to resolve in the context of the political economy.<sup>43</sup> The Philippines' relatively low performance in attracting more inward investments is a reflection of its relatively low competitiveness vis-à-vis its neighbors, although its ranking in 2007 improved largely due to its improved macroeconomic performance.<sup>44</sup> The World Economic Forum's Global Competitiveness Report and an earlier ADB investment climate survey find that corruption, inadequate infrastructure supply (notably power), policy instability, perceived inefficiencies in government bureaucracy, tax regulations and administration, restrictive labor regulations, and anticompetitive practices were among the top 10 constraints to fostering private sector development. Further details discussed in Appendix 9.

67. **ADB's Support for Private Sector Development.** The emphasis of ADB support for private sector development has changed over time. The 2001–2003 country strategy called for ADB to support private sector development by assisting the Government in its privatization program and developing the private sector enabling environment. This included support for private sector financing of infrastructure projects that address critical constraints, financial intermediation including capital market development and financial infrastructure; and deregulation of industry, trade and investment, privatization of selected GOCCs, and improved regional capacity for build-own-operate/build-operate-transfer financing. As the fiscal deficit persisted and deepened following the AFC, ADB accorded increasing support to the Government's privatization program in energy and other sectors.

### 1. Finance Sector

68. **Program Results and Assessment.** Sector challenges, government policy, and ADB assistance are described in Appendix 9. The main purpose of ADB's finance sector assistance was to develop the nonbank financial subsector to support economic growth. Through consistent and sequenced engagement, ADB has helped to advance reforms and institutions in areas such as the Philippine Stock Exchange, government and corporate bond markets, mutual funds, and microfinance and related regulation and governance issues including the Securities and Exchange Commission and to an extent money laundering. TA and lending operations were consistent with the Government's plans and ADB country strategies supporting nonbank financial subsector development and microfinance, and are assessed "highly relevant." ADB operations in the nonbank financial subsector have contributed to strengthening the regulatory and policy framework, building the capacity of regulatory agencies, improving governance structures and prudential standards among market participants, enhancing investor protection, improving market infrastructure, and is assessed "effective." ADB assistance has also resulted in adoption of international accounting and auditing standards, adoption of a capital market development blueprint, and an increase in the number of viable microfinance institutions. Developing the domestic bond market was viewed as a way to reduce the current debt portfolio's foreign exchange exposure. Assistance is rated "efficient" with the four program loans prepared,

<sup>41</sup> ADB. 2007. *Evaluation on ADB's Private Sector Development and Operations*. Manila.

<sup>42</sup> ADB. 2006. *Assessment of Private Sector Development in the Philippines*. Manila (January, draft).

<sup>43</sup> Fabella, Raul. 2000. The Soft State, the Market, and Governance. *Philippine Review of Economics* 37, no. 1.

<sup>44</sup> The World Competitiveness Yearbook reported the Philippines rise to 40th place out of 55 economies, scoring 50.5 out of 100 (the United States scored 100). This placed the Philippines above European Union economies such as Italy and Greece, but still below large regional economies including the People's Republic of China, Thailand, and Malaysia.

negotiated, and started in a timely manner and three loans completed ahead of schedule. Completion of three ADTA projects took longer than anticipated.

69. Assistance is assessed “likely sustainable” given the increased investor confidence and participation in the financial markets. Trading volume on the Philippine Stock Exchange increased from ₱145 billion in 2003 to ₱1,338 billion in 2007, capital raised increased from ₱1.7 billion in 2003 to ₱90 billion in 2007. Foreign firm investments increased from ₱1,634 billion in 2003 to ₱3,711 billion in 2007. However, this performance declined early in 2008 as trading volume fell to ₱262.7 billion between January and April, and capital raised decreased to ₱139 billion. There were also few new listings on the stock market. Furthermore, banks continue to dominate the finance sector with the ratio of bank resources to nonbank financial institution (NBFIs) resources at year-end 2007 at 4:1—the same ratio as in 1996. Critically, SMEs still do not have the level of access needed to capital from bank and nonbank sources. In terms of enhancing access of the poor to financial services, the impact of ADB assistance was direct and immediate—the number of active microfinance clients almost doubled from 1.4 million in June 2004 to 2.7 million in June 2007; more than 90% of the borrowers were women. Published ADB evaluation work shows that microfinance support keeps recipients economically active, has a consumption-smoothing effect, and lowers dependence on more expansive microfinance alternatives; although income impacts are modest and access by the poor is still limited.<sup>45</sup> While market performance cannot be solely attributed to ADB reforms, ADB support made a significant contribution and impact is assessed “substantial.” Overall sector performance is assessed “successful.”

70. **Recommendations.** The Philippines still lags behind major neighboring countries in finance sector development. Key related issues are reversing the decrease in the rate of capital formation and financial intermediation processes, and high liquidity in the banking system. Further development of the finance sector, including NBFIs, is needed to improve the investment climate and increase access to longer-term capital to better facilitate wider private sector participation, especially by small investors and businesses. ADB’s continuing participation in developing NBFIs, capital market, and microfinance subsector is necessary to further expand the finance sector base, competitiveness, and efficiency. To increase the benefits from the institutional infrastructure now set in place, the following are needed: deepening of the product mix, further measures to reduce transaction costs, promotion of the corporate bond market, and awareness programs to encourage greater use of the capital markets for mobilizing investment capital. In support of improving SME access to finance, ADB has been an active advocate of the credit information bureau, which is an important facility for providing credit information on creditworthy small and medium-sized borrowers; progress would help to unlock bank financing for SMEs. Successful models and good practice used in other regional developing member countries (DMCs) for expanding SME access to finance could be further assessed for application to the Philippines.

## 2. Energy Sector

71. **Program Results and Assessment.** Sector challenges, government policy, and ADB assistance are discussed in Appendix 9. Assistance is assessed “relevant” as the TA projects and loans were generally consistent with the Government and ADB strategies for restructuring the power subsector toward a competitive market in parallel with rural electrification and promotion of renewable energy. ADB’s assistance resulted in (i) a power subsector that has been restructured and exhibits improved financial viability, a stronger sector regulatory framework, greater private sector participation in power generation and transmission, and

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<sup>45</sup> Kondo, T, A. Orbeta, Jr., C. Dingcong, C. Infantado. 2008. *Impact of Microfinance on Rural Households in the Philippines*. Sussex: Institute of Development Studies. Available: <http://www.ids.ac.uk/go/bookshop/ids-bulletin/ids-bulletin-39-2008/ids-bulletin-39-1>.

enhanced consumer welfare and protection; (ii) a working wholesale electricity spot market using the market management system procured under the Electricity Market and Transmission Development Project; (iii) improved awareness among rural communities of the importance of community and cooperative activities in support of rural electrification using new and renewable energy resources; and (iv) accelerated progress in power subsector privatization. The key objectives of ADB support to the power subsector were largely achieved and assistance is assessed “effective.” Except for delays in start-up operations due to ADB’s protracted recruitment process, ADB assistance has been generally “efficient.” The EAs provided sufficient counterpart staff, and ADTA projects were generally implemented within budget, even though extensions were agreed to cover additional activities.

72. Assistance is assessed “likely sustainable.” Reforms supported by ADB have halted the drain on the budget caused by power sector subsidies. Privatization of generation assets reached 48% by the end of 2007, the wholesale electricity spot market has been in operation since June 2006, and the Energy Regulatory Commission is operational. Rules for performance-based regulation for transmission and distribution businesses were promulgated and the Department of Energy reorganized to perform its expanded mandate of supervising the implementation of power reforms including power subsector planning. Private sector participation in rural areas has been pursued, leading to the entry of new players in rural power markets. The Energy Regulatory Commission promulgated a Magna Carta specifying rights for residential consumers, and the Department of Energy initiated other customer awareness and empowerment programs. Moreover, the Government appears to be close to achieving the 70% threshold in sale of power assets for open access, the milestone for effective competition in the power subsector. However, under EPIRA, there will no longer be take-or-pay arrangements guaranteed by the Government implying a forward risk unless reforms are maintained. Furthermore, without new baseload plants, shortages may reemerge.<sup>46</sup> Moreover, there is a risk that the lag between reform and benefits to consumers may result in political temptation to roll back market-oriented reforms to deliver short-term benefits, such as lower tariffs or subsidies, to consumers. Recent reemergence of political debate to amend provisions of the EPIRA would place reform progress at risk.<sup>47</sup> Nevertheless, ADB has contributed to the long-term development of the sector and its impact is assessed “substantial.” Overall sector performance is assessed “successful.”

73. **Recommendations.** Fostering privatization and competition in the power subsector takes time and proceeds in an incremental fashion. Substantial reform efforts have addressed power supply uncertainties, but this has yet to translate into markedly lower tariffs, due to the need to reduce the fiscal burden of tariff subsidies and to repay the long-term maturity debt needed to develop energy assets. To sustain the positive reform progress, it is essential to ensure that private sector entry to the sector leads to deeper competition, operating efficiencies, gains for consumers; and enhanced access to reliable power supplies in rural areas. To minimize the possibility of a repeat of the power shortages of the 1990s, private sector investors need reassurance on government commitment to sector reforms, the independence and transparency of the regulatory regime, effective operation of the spot market, and existence of a competitive market. Reform momentum can be maintained through continued assistance in financing key privatization projects, promotion of competition, and improved regulation, and moreover, to

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<sup>46</sup> Forced outages of power plants in Luzon may be remote following the takeover of Masinloc and soon of Calaca by private businesses. However, supply shortages during peak periods may happen in the Visayas, where rotating blackouts are currently experienced.

<sup>47</sup> SN Power is reported to have given three reasons for investment in generation in the Philippines: (i) progress of the Power Sector Assets and Liabilities Management Corporation in packaging a marketable portfolio of assets that could be financed; (ii) confidence in the wholesale electricity spot market as an alternative market for their capacity; and (iii) the improved macroeconomic growth (*Manila Bulletin Online*. 2008. Investors Want Stability in Power Policies. Manila [May 13]).

address the large unmet demand for rural electrification. To address current high oil prices and global warming, expanded support for energy efficiency and renewable energy is needed.

### 3. Transport Sector

74. **Assistance Results and Assessment.** Sector challenges, government policy, and ADB assistance are discussed in Appendix 9. Assistance is assessed “relevant” as support was consistent with the Government and ADB strategies for developing provincial and regional transport and communication infrastructure, despite operational design problems in the Sixth Road Project and cancellation of the Third Airports Development Project. Quality-at-entry for the Sixth Road Project was affected by the lack of a clear LAR policy and problems with subproject selection. Nevertheless, about 80% of the objectives identified at appraisal were achieved; and despite delays, the economic efficiency exceeded appraised estimates (although delays meant foregone benefits and additional administration costs). The LAR problems led to delays and cancellations of some road improvements and bridgeworks. Compliance was late for a number of project covenants related to land acquisition. An ADTA approved with the loan reviewed the roles of the Bureau of Equipment and Regional Equipment Services, and determined how these institutions could be restructured into commercial ventures in the private sector. Recommendations made by the TA consultants to privatize the Bureau of Equipment were not implemented. Thus, the TA project’s intended outcome was not achieved.<sup>48</sup> However, the road is operating and the project was assessed in the project completion report validation as successful. ADB’s nonsovereign support to North Luzon Expressway—the first tolled expressway—in the road sector, exemplified a public–private partnership.

75. The Third Airports Development Project covered major improvements to two regional airports (Cotabato and Puerto Princesa) and minor improvements to four domestic airports (Butuan, Dipolog, Pagadian, and Sanga–Sanga). The scope consisted of improvements at the existing airports rather than construction of new airports. None of the originally planned outputs were achieved, and the main causes of the project’s failure were the slow progress of the LAR activities, severe delays in recruitment of consultants, and significant civil works and equipment procurement problems. The project was terminated in September 2005 when the many outstanding issues, particularly related to procurement, indicated that the project had little chance of getting back on track.<sup>49</sup> The project completion report assessed the project “unsuccessful.” The combined operations were assessed “less effective,” “less efficient,” “likely to be sustainable,” and have “modest impact.” Overall, ADB assistance is rated “partly successful.”

76. **Recommendations.** Transport infrastructure is a key constraint to private sector development and growth, and transport development is an area of ADB’s core corporate competence deserving significant attention. At the operational level, careful evaluation is needed of LAR issues to ensure an accurate, agreed, and costed LAR plan prepared in advance of appraisal and to ensure that ADB policies are clearly understood and included in the Loan Agreement. To avoid major changes in design, optimistic implementation schedules place additional burdens on EAs and ADB. Clear roles and responsibilities of regional and local project management offices are needed. At the strategic level, development partners including ADB have provided substantial support for transport planning and attention needs to turn obstacles to implementation of plans. This needs ADB to systematically assess where and how it can best contribute to sector’s needs. To foster public–private partnerships in transport, greater coordination is needed among regulatory agencies and support is needed for infrastructure implementation. ADB needs to continue to address areas such as transport policy;

<sup>48</sup> ADB. 2008. *Project Validation Report. Philippines: Sixth Road Project*. Manila.

<sup>49</sup> ADB. 2008. *Project Validation Report. Philippines: Third Airports Development (Southern Philippines) Project*. Manila.

transparent procurement; and improving the prospects for public–private partnerships, including needs for areas such as mass transit in Metro Manila and roll-on-roll-off ferry systems to promote trade through and beyond the archipelago.

#### **4. Direct Support for Private Sector Development**

77. Direct support for the private sector covered advisory support for private sector development, and ongoing support for SME development and private sector operations. Assistance and results are assessed. However, the ongoing SME project and private operations lending were not rated for the CAPE.

##### **a. Support for SME Development**

78. **Assistance and Results.** A priority of the Government under its MTPDP 2004–2010 is to strengthen its support to 3 million entrepreneurs and SMEs by providing credit, technology, and marketing assistance. To assist, ADB approved the SME Development Support Project in 2005 with the following components: (i) a \$25 million credit line to the Small Business Guarantee and Finance Corporation (SBGFC) for onlending to SMEs in local currency; (ii) an \$18.4 million partial credit guarantee facility to selected financial institutions; and (iii) an equity investment of up to \$1.0 million in a credit information bureau. The objective of the loan was to provide SBGFC with additional funds to help the company fulfill its mandate of lending to SMEs, increase the number of SME borrowers by 250% or 3,710 enterprises, increase retail lending by 250% or ₱1.572 billion, and increase wholesale lending by 300% or ₱5.8 billion. SBGFC is reportedly on track to meet these targets. Utilization of the ADB loan is high. For the majority of borrowing SMEs, this was either their first bank loan or their first longer-term loan.

79. In addition, three ADTA projects were approved during the CAPE period to support development of the private sector. These were (i) capacity development of MEDC, (ii) strengthening SME credit management systems, and (iii) developing the Philippine Business Registry. The MEDC ADTA strengthened MEDC and focal business support organizations capacity in their respective roles to assist SME development in Mindanao. Specific outputs included SME development strategies and plans and an information exchange and SME database management system. The institutional mechanisms and models for strengthening public–private partnerships in local SME development have been endorsed as a national strategy, and the Department of Trade and Industry has integrated the “localization” of SME development planning into its agency-wide work program. The ADTA for strengthening of SME credit management systems supported implementation of the \$25 million credit line to the SBGFC. Furthermore, the ADTA helped to effect SBGFC’s shift from collateral-based lending to risk-based lending, which is more suited for SMEs. Moreover, the TA helped in the development and adoption of the borrower risk-rating system—a credit scoring model that incorporates SBGFC’s own underwriting standards and draws on lessons from its own lending experience. The Philippine Business Registry ADTA is ongoing. On completion, it is expected to facilitate transactions for the business registry with government agencies, including the Securities and Exchange Commission, Department of Trade and Industry, and BIR.

##### **b. Private Sector Operations**

80. **ADB Assistance.** Private sector operations in the Philippines started in 1986. Since then, a total of 25 transactions involving \$37 million in equity investments and \$275 million in loans have been approved. Private sector transactions peaked in 1993–2000 with loans to independent power producers during the power crisis and to transportation-related companies focusing 86% of the loans to the private sector. Thereafter, the number and amount of approved private sector

transactions declined significantly with only four projects in 2001–2007. These were (i) an equity investment of up to \$2.0 million in LGU Guarantee Corporation (LGUGC), which is a credit guarantee company that protects investors or lenders against borrower payment default; (ii) a loan of up to \$33 million to Balikatan Housing Finance (BHF), a special purpose entity created to acquire highly delinquent mortgage loans from the National Home Mortgage Finance Corporation (NHMFC); and (iii) an equity investment of up to \$1.0 million in Bahay Financial Services (BFS) established to service, manage, and administer mortgage loans acquired by BHF.

81. **Assistance Results.** Although relatively small in amount and number, these projects played a complementary role in private sector development work and were in line with Government and ADB sector strategies. The LGUGC investment enabled municipal governments to fund their development projects (particularly water supply) through funding sources other than budgetary allocations, such as facilities from commercial banks, bond issuances. The LGUGC Project is likely sustainable as evidenced by LGUGC's strong balance sheet and has potential for replication in other DMCs. Meanwhile, the BHF–BFS Project helped to (i) resolve the nonperforming loan problem of NHMFC and strengthen its financial viability; (ii) establish a secondary mortgage market; (iii) provide needed liquidity to the Philippine pension system through the repayment of NHMFC's debt to the Social Security System and the Home Development Mutual Fund; (iv) create a best-practice mortgage loan servicing entity in the Philippines; and (v) allow delinquent borrowers who are mostly in the low- and middle-income bracket to restructure their loans. The BHF–BFS Project appears sustainable as the loans are secured, cash flows from loan repayments are increasing, and BFS is operating profitably. The SME Development Support Project partial credit guarantee has so far been extended to one participating financial institution (Security Bank Corporation) for SME promotion. The other component of this project—the creation of a credit information bureau—is still on hold pending enactment by Congress of the legal basis for its establishment.

## 5. Recommendations

82. ADB assistance for private sector development faces an array of competitiveness constraints—political, macroeconomic, infrastructure, business environment, law and order, and governance-related. Making substantial progress on all constraints at once is difficult. Continued perception of corruption and inefficiency in government bureaucracy as well as unresolved infrastructure bottlenecks are considered hindrances to private sector investment. To understand the broad context in which support to SMEs is delivered, regular updating of understanding of the financial markets and the business environment is needed to design relevant assistance. Despite the good performance of the SME facility, the current high domestic liquidity and low market rates question future rationale for the instrument. The ADB facility has become less competitive in part due to lower guarantee fees charged by the Department of Finance and the similar Bangko Sentral ng Pilipinas facility for SMEs. Given the importance of developing the SME subsector to maintain and accelerate inclusive economic growth, an assessment is needed of the facility's value addition from the point of view of SME demands, recent trends in private bank lending to SMEs, and the expanding microfinance subsector. In addition, SME access to capital and business development support needs to be facilitated.

### C. Urban Development

83. **Key Sector Challenges.** Approximately 52% of the country's 91 million residents live in urban areas. Metro Manila (Manila) is the most densely populated urban center, with a population of approximately 13 million. From 1960 to 2000, the urban population grew at an average annual rate of more than 5%, and by 2010, 60% of the total population is expected to live in urban areas. About 8 million or just over a fifth of the urban population were classified in 2000 as having incomes below



the poverty line. Nationally, about 2.5 million urban households or some 35% of the urban population live in informal slum settlements in 2000 that occupy high-risk areas along riverbanks; canals; environmentally sensitive coastal areas; and infrastructure easements such as railroad tracks, utility corridors, watersheds, other government land, or private land. These squatter communities and slum areas are characterized by poor quality housing, overcrowding, inadequate access to services, and lack of security of tenure. While three quarters of the squatter settlements have access to piped water or tubewells, more than half of these are reported to convey contaminated water. Urban communities are subject to regular flooding, exacerbated by indiscriminate dumping of solid wastes in waterways and drainage channels, and settlement along the waterways themselves. With the initiation of the revised LGC of 1991, LGUs now have a major role in the administration and management of urban areas. Decentralization of urban management authority has been hampered by managerial and technical capacity constraints, functional overlap between national and local agencies, the 3-year tenure of mayors, a tradition of political patronage and elite capture, complex implementation arrangements for cross-sector projects, and weak regulatory enforcement and project implementation capacities. Government policy and plans for urban development are outlined in Appendix 10.

84. **Program Results and Assessment.** Assistance to the sector is assessed “relevant” as the urban development projects were consistent with Government and ADB sector strategies. Both the Subic Bay Area Municipal Development and the Clark Area Municipal Development projects suffered from inadequate project formulation, which contributed to the weak ownership of the subprojects and limited achievements against planned outcomes. However, ADB assistance has contributed to innovative solutions in providing urban services in some small- and medium-sized cities, and has helped to improve municipal management policies. Better municipal services, for example, have been provided to more than 700,000 beneficiaries as a result of the 17 completed subprojects under the Mindanao Basic Urban Services Sector Project. Water supply subprojects under the project have increased the number of household connections resulting in improved access to better water quality, savings in water expenses, and day-long availability of water supplies. A novel feature of the Development of Poor Urban Communities Sector Project is the provision of shelter financing and microcredit facilities at market-based rates to low-income beneficiaries. Overall, operations undertaken during the CAPE period are assessed generally “effective” despite outcomes in some projects and program loans falling short of expectations.

85. In the case of the Metro Manila Air Quality Sector Development Program, support was provided for sector reforms, improved air quality monitoring, and vehicle and traffic control. Facilities for air quality monitoring were provided as planned; but without enforcement of required lower emission levels, the intended outcomes cannot be achieved. Other projects, particularly the Subic Bay Area Municipal Development and Clark Area Municipal Development projects, and Pasig River Environment Management and Rehabilitation Program, had limited achievements against planned outcomes. However, as Metro Manila urban projects are under implementation, the extent of output and outcome achievement will be determined at completion. While the tranche release conditions for the Pasig River Environment Management and Rehabilitation and Metro Manila Air Quality Improvement programs were met, the investment components suffered substantial implementation delays because of shifting priorities, major changes in scope, slow consultant recruitment, disagreements regarding onlending policies, and insufficient counterpart finance. In contrast, the Mindanao Basic Urban Services Sector and Development of Poor Urban Communities Sector projects have incorporated lessons from previous projects and are being implemented in a relatively timely manner. Overall, ADB operations are assessed “less efficient.”

86. Most of the hardware infrastructure in various ADB-supported urban projects has been maintained, with the exception of the sewerage management plant of the Pasig River Environment Management and Rehabilitation Project, which has not been completed. Tariff generation and inadequate operation and maintenance (O&M) budget are considered widespread problems across projects. Also, many project staff were unable to continue working with the EAs since they were hired as contract workers. Thus, ADB assistance is assessed “less likely sustainable.” In terms of impact, ADB support for urban environmental improvement through the Manila Air Quality Project was relevant but has not had the desired impact on pollution control given the lack of enforcement of the Clean Air Act. The impact of the recently completed Clark Area Municipal Development Project was found to be marginal as compared with appraisal estimates because of a large-scale reduction in scope following the withdrawal of more than half of the original participating LGUs. ADB projects have helped build capacity for environmental hazard mitigation and for ambient air quality control, traffic exhaust monitoring and control, and river water control and riverbank management. But without effective government enforcement of pollution control measures, the impact of improved capacities will not have the intended long-term, positive impact on environmental improvement and human health. Overall, impact is assessed “modest.” Generally, ADB’s assistance to urban development over the CAPE period is rated “partly successful.”

87. **Recommendations.** Urban development was seen as having the potential to address poverty reduction, social inclusion and service access, and environmental problems. However, urban development is hampered by a wide range of contextual factors, which must be considered in project design. ADB’s urban development projects also suffered from multiple institutional layers, fiscal constraints, 3-year mayoral tenure cycles, bureaucratic inefficiencies including complicated multiagency mandates and project management unit arrangements, and a series of difficult land acquisition issues. Hence, a more thorough assessment of local institutions and risks is needed at the design and appraisal stages. In the case of sector projects, a rigorous assessment of institutional capacity is needed prior to committing new subprojects. Moreover, success factors and good practices between project and nonproject municipalities can provide insights on design and implementation issues between municipalities.<sup>50</sup> The mixed results in the urban development sector suggests a need for assistance approaches that foster widespread participation in design and implementation, combined with designs for operations that can more effectively anticipate and address complex cross-sector concerns. There is also a need to spur greater private sector participation in urban infrastructure and services through strengthening of public–private partnerships.

#### **D. Agriculture and Rural Development**

88. **Key Sector Challenges.** More than a third of Filipinos are engaged in agriculture, fisheries, and forestry activities. Taking agriculture and agroprocessing together, nearly 40% of GDP is generated in agriculture and downstream activities such as processing and trading through SMEs and larger private enterprises and GOCCs. The bulk of the rural population depends on subsistence farming and fishing, and have limited access to land and capital. A small segment of the rural population control the bulk of the land. The sector is marked by high underemployment because of the seasonal nature of agriculture, with low productivity and limited crop diversification. Growth has been relatively slow in the sector and barely keeping pace with rural population growth. Low productivity and slow growth can be attributed to several factors, including (i) public policy focus on

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<sup>50</sup> For example, successful management of land acquisition for Marikina City by a committed municipal government with strong leadership was key to riverside environmental cleanup, improved flood management, lowered flood damage costs, and improved common recreational facilities.

rice production at affordable prices for consumers; (ii) inadequate provision of public goods (rural infrastructure, extension and support services, research and development, and marketing support); (iii) limited access of poor farmers to productive resources such as land, capital, and technology; and low incentives to raise productivity; (iv) unsustainable management of natural resources; and (v) multiple and overlapping institutional roles and responsibilities, especially at the national level.

89. **Program Results and Assessment.** ADB assistance to the sector was “relevant” given that it generally reflected Government plans for agriculture and rural development. Several ADB-supported projects aimed to raise agricultural productivity, considered to be the major constraint facing the sector. The policy reforms supported by ADB were relevant at the time but the midcourse change of the Government and perspective on the reforms, which was beyond ADB control, altered the programs alignment with government policy (Box 3). In retrospect, ADB’s grain subsector reforms were controversial but relevant in terms of needed improvements to farmer incentives and removal of costly government intervention in grain marketing. While the assistance program was relevant to the range of development constraints and needs, the solutions have proved difficult in part because of overlapping and unclear roles and responsibilities of the many agencies involved in addressing the rural agenda; varying degrees of decentralization among national agencies; lack of access by LGUs to development finance, wide geographic dispersion, and complex operational designs; and in some instances, insufficient follow-through in any one location. Nevertheless, operations completed during the CAPE period have resulted in substantial outputs and outcomes and were generally “effective.” Irrigation projects have contributed to an increased cropping intensity and higher rice production. Farm-to-market roads, bridges, and domestic water systems have yielded both economic and social benefits. Extension support has contributed to the adoption of new production techniques, new livelihood activities, and more sustainable management of natural resources. Some projects, such as those involving LGUs in the southern Philippines, have had a positive demonstration effort on neighboring LGUs, increasing the spread of project benefits. In general, ADB assistance has contributed to improved transparency and accountability in the LGUs involved in agriculture and rural development projects, while providing skills that will be useful in identifying, preparing, implementing, and monitoring projects.

90. In terms of supporting sector policy change, agriculture assistance has had a mixed record. ADB assistance contributed to support for the 1991 decentralization policy by implementing projects in cooperation with LGUs, but project management systems are not fully in line with LGU systems. Assistance was less successful in its support aimed at liberalizing the rice market, ratifying the forestry code, and modernizing the rural road development policy framework. Agriculture and rural development projects were hampered by implementation delays and suffered from shortfalls in counterpart finance. While beneficiaries, in general, were mostly aware of project purposes, a key efficiency issue was managing their expectations. In some cases, the project benefits realized were in addition to those envisaged at the design stage. For example, further infrastructure development sometimes followed, such as power lines for rural electrification and cellular sites, which took place after ADB-supported rural road projects were completed. Diversification to high-value crops was undertaken and social benefits such as increased number of children attending school and easier access to hospitals were realized. Nevertheless, overall ADB operations are assessed “less efficient.”

### Box 3: Policy Issues in Agriculture

The National Food Authority's (NFA) corporate mandate is to (i) ensure the country's food security in times of emergency or occurrence of calamities; (ii) stabilize grain supply and prices at the farm gate and for consumers; (iii) provide assistance to grain producers; and (iv) ensure affordable food prices. The policy objectives of a high-productivity, high-income sector for producers has inherent inconsistencies with a policy of affordable grain for consumers; to satisfy both policy objectives is costly and ineffective.<sup>a</sup> Despite its strategy of "buying high and selling low," NFA's price regulation led to farm-gate prices being set relatively low and acting as a disincentive to rice producers in particular. The consumer floor price was set relatively high and the ceiling price relatively low.<sup>b</sup>

The Asian Development Bank (ADB)-supported Grains Sector Development Program sought to address these issues by aiming to increase the productivity and competitiveness of the grain subsector through a package of policy and institutional reforms, investments, and advisory technical assistance. Alternatives assessed under the program included four options:

- (i) Option A was to retain the present NFA structure and expand to other nongrain food commodities such as sugar, corn, and fertilizer.
- (ii) Option B sought to retain the regulatory and trading functions of NFA to focus on rice, as markets for other nongrain food items were already liberalized.
- (iii) Option C was a more liberalized, cost-effective grain pricing, and import policy that would decouple NFA's regulatory functions and address food security through a transparent process of buffer stock management. Less government intervention was expected to spur greater competition and lower prices in the rice market to the benefit of both producers and consumers, with government savings being channeled to support services and provision of rural infrastructure.
- (iv) Option D proposed rice price stabilization without buffer stocks; creation of a national rice board; transfer of NFA's duplicated functions to appropriate government units; and full privatization of NFA's proprietary functions, including sale of its assets to the private sector and adoption of other complementary policy and institutional reforms.

Option C was selected. The Government canceled the loan in 2003 stating difficulties with liberalizing grain pricing and import policies, improving the administration of grain buffer stocks, and restructuring NFA to separate its regulatory function from its trading function, among others.<sup>c</sup> Although the tariff reductions for corn products and agricultural trade measures did proceed, the status quo on NFA continues and the sector is uncompetitive compared to neighboring countries.

The cost of producing rice in the Philippines is higher than in neighboring countries. Tolentino and Noveno (2001)<sup>d</sup> estimate that on average, the cost to Filipino farmers to produce a kilogram of paddy is ₱7.45. In comparison, as of the mid-1990s, Filipino farmers spent ₱5.71 to produce a kilogram of paddy, while Vietnamese farmers spent ₱2.33 and Thai farmers ₱4.30. Also, the costs of production per kilogram of rice produced incurred by Thai rice farmers were 61% of those incurred by Filipino rice farmers, 77% for Vietnamese farmers, and 72% for Indonesian. The failure of the farm-gate price to keep pace with costs undermined the financial attractiveness of rice production compared to other crops, especially horticulture and oil-producing crops, discouraging crop conversions to paddy.<sup>e</sup> Balisacan (2008), in his presentation "Responding to the Rice Crisis," stated that since 1970, very little improvement has been made in agricultural productivity in the Philippines. His estimates show that the average growth of agriculture total factor productivity was 1.0 % for 1970–1980, 0.1 % for 1980–2000, or a growth of 0.2 % for all periods. In contrast, Thailand registered an average growth of total factor productivity in agriculture of around 1.3% (1970–1980), 1.0% (1980–2000), and 1.2% for all periods.

<sup>a</sup> Streeton, P. 1987. *What Price Food?* New York: Macmillan Press.

<sup>b</sup> De la Peña, Ching. 2006. *Rural Growth and Development Revisited: Policy Issues*. Manila (paper produced for the World Bank). The authors assess that the impact of the NFA interventions resulted in (i) high rice prices for consumers and upward pressure on wages, (ii) low farm-gate prices for producers, (iii) high subsidies benefiting nonpoor consumers, and (iv) financial problems for NFA because of the high subsidy and operating costs.

<sup>c</sup> The project completion report for the program stated that the reforms were "ambitious and ADB recognized the risks involved." The Government assured its support for the program during project preparation and appraisal.

<sup>d</sup> Tolentino, V.B., and E. Noveno. 2001. Rice is very expensive in the Philippines...and hunger is deepening. *Development Research News*. July–August.

<sup>e</sup> Evidence of this was found by the Operations Evaluation Mission during field visits to eastern Mindanao.

Source: Operation Evaluation Mission.

91. Many projects had real and sustainable outcomes even though sustainability issues were not fully taken into account during the design and implementation stages. However, the issues surrounding financial sustainability, particularly maintenance funds, and post-project

institutional sustainability remain largely unresolved. Hence, ADB assistance is assessed “less likely sustainable.” Generally, ADB support to the sector impacted on the lives of beneficiaries in terms of increased production, income improvements, and opening up of new opportunities for communities, although to varying degrees. Unintended positive impacts included the replication of practices by nonproject LGUs, thus increasing the coverage of project benefits. However, in many ongoing ADB operations covered by this CAPE, it is too early to determine the full impact of these interventions. In other instances, assumed impacts have not occurred and the measurement of impacts is problematic. As such, impact of outcomes is considered “modest” at this stage. Overall, ADB assistance to agriculture and rural development over the CAPE period is rated “partly successful.”

92. **Recommendations.** Agriculture and rural development has long been recognized as having the potential to contribute to growth, poverty reduction, and environmental management; remaining engaged in the sector is recommended. Reengaging in systematic sector analysis and policy dialogue on agriculture is a key need for ADB. While the envisaged grain subsector reforms have so far failed to garner sufficient political support, the reform needs are still prevalent and intentions are still relevant. If support for grain subsector reform is revived, support through a series of single-tranche loans would be appropriate, rather than loans that attempt to schedule difficult reforms that require midcourse legislation. In future designs, careful consideration is needed of which institutions best support decentralized services for agriculture and rural development, given that the Government has yet to complete the rationalization of these institutions. Systematic consideration is needed for appropriate modalities that can effectively contribute to improvements in the policy setting, institutional capacity, and improvements for beneficiaries. Appropriate designs are needed for operations that lower transaction costs, are in line with the principles of harmonization in the Philippines, and are consistent with the principles of the 1991 LGC.

## **E. Water Supply, Sanitation, Waste Management**

93. **Program Results and Assessment.** Sector challenges, government policy, and ADB assistance are discussed in Appendix 12. Overall assistance is rated “relevant.” All water supply and sanitation projects were part of ADB country strategies and aligned with Government strategies. The Metro Manila projects were consistent in terms of their goals, purposes, and outputs with key water supply-related issues in Metro Manila. The other projects for the municipal, small town, and rural water supplies were technically sound. Designs benefited from lessons from previous projects including the importance of consultation, financial viability of the water districts for sustainable O&M, institutional development of water districts, and strengthened tariff collection.

94. Overall support to the municipal and rural water subsector is rated “effective.” Both the Municipal Water Supply and the Small Towns Water Supply Sector projects have substantially achieved the targets set. In the case of the Municipal Water Supply Project, the water production and distribution facilities planned for the eight water districts at appraisal were completed, which helped increase total water production capacity by almost four times and improve access for an additional 501,959 people, which was more than double the appraisal estimate. The Small Towns Water Supply Sector Project brought safe and reliable water supply and sanitation to 80 small towns. The target was to provide 1 million people, 60% of them living below the poverty line, with piped and safe water by 2001. By the end of 2005, 90 subprojects had been completed, covering about 2.1 million people. The Rural Water Supply and Sanitation Project provided nearly 6,000 water supply facilities serving nearly 2 million people, established a network of water quality laboratories, and provided necessary sanitation facilities for schools and nearly 60,000 households in poor rural areas.

95. Overall support to the municipal and rural wastewater subsector is rated “less likely sustainable.” There were successes in supported water districts such as Cebu, and progress was made in developing the institutional framework for decentralized provision of water supply and sanitation services. However, a key concern was that LWUA was unable to achieve capacity to internally generate funds that would allow the creation of second-generation funds or built-up reserves for future water projects. Furthermore, water districts that are relatively creditworthy could not access financing to expand facilities from GFIs or commercial banks given the requirement for LWUA to issue waivers and revise prepayment policies. LWUA had to rely on external financing via counterpart funding from national government equity and subsidies and international grants to achieve its role of providing funds for water district projects. For the water districts, inconsistencies in tariff setting resulted in variable financial viability and ability to cover O&M costs. While only 66% of the targeted number of facilities were constructed in the Rural Water Supply Project, local beneficiaries surveyed indicate that the facilities provide adequate water supplies and convey substantial health benefits. Combined, the non-Manila water projects are rated as having had “substantial impact” to beneficiaries in the areas served.

96. Metro Manila water projects are assessed “relevant” but “less effective.” ADB-financed projects for Manila water supply have contributed to the construction of water supply infrastructure from the Angat reservoir, but the dependence on this single water supply continues. Reducing nonrevenue water (NRW) in Metro Manila could substantially increase water availability. The projects were unable to reduce NRW and in some years NRW even increased. The projects to supply water outside Metro Manila achieved targets and largely met program objectives. Most physical infrastructure was delivered and capacity strengthening was well implemented. Except for the Manila South Water Distribution Project, the financial internal rates of return of the projects were estimated to be above the weighted average cost of capital and economic internal rates of return above 12% largely due to water tariff revisions. The FIRR for the Manila South Water Distribution Project was estimated at 0%. Assistance to the water sector as a whole is rated “less efficient.”

97. The sustainability of Manila water projects is “less likely” as this will depend on a future, consistent tariff policy across all Manila water suppliers. Socioeconomic benefits have accrued in terms of marked improvement in economic and social welfare as a result of water connections to households, but there is much room for improvement and expansion. The Angat Water Optimization and Umiray–Angat Transbasin increased the water supply in Metro Manila, but not as much as expected. The number of households connected fell short of the target, and targets to reduce NRW were not met. The Manila South Water Distribution Project did not achieve its objectives and project outputs were limited. ADB’s role in supporting Manila water supply services to involve the private sector was less effective. The success of efforts to reduce NRW for the concessionaire operating in the west zone of Manila was limited. However, NRW in the east zone was substantially reduced. Also, the west zone has now paid off its remaining debts and has embarked on a new capital expenditure program after it was reawarded to the private sector. ADB support to MWSS for a public–private partnership for Manila water supply did not initially succeed, but the model remains effective and recent results are improving under the new concessionaire for the west zone. ADB’s capacity-building support to MWSS for regulation is considered useful and experience was gained in supporting private sector participation in Metro Manila’s water supply system (Appendix 12, Box A12). While ADB has helped in improving raw water supply and developing public–private partnerships for water supply, Metro Manila projects are assessed to have had overall “modest” impact to date.

98. Considering the municipal and rural water subsector and Metro Manila water supply assistance together, and despite some individual project successes, the overall sector ratings are “relevant,” “effective,” “less efficient,” “less likely sustainable,” yet potential impact was “substantial.”

99. **Recommendations.** ADB support for a second water supply project for Metro Manila remains an urgent priority. Previous experience with support for private sector concessions provides valuable lessons for supporting public–private partnerships in future support for development of Metro Manila water supply. To broaden financing alternatives for local water supply development, lower the cost of borrowing, and expand beneficiary water districts and LGUs, alternative channels for lending to water districts need to be explored. The larger water districts have greater capacity to implement projects efficiently, financed by a combination of their own equity, internally generated funds, and loans. Appropriate phasing of projects would allow local governments, water districts, and community water associations more time to build capacity and prepare, implement, and obtain finance and set tariffs to maintain projects. Mechanisms are needed to provide TA to local governments and water districts to formulate integrated water, sanitation, and sewerage master plans including the identification of appropriate technological and financing options. Potential reform agenda support includes reforming tariffs, establishing LGU credit ratings, implementing credit guarantee mechanisms for LGUs and other water service providers, and rationalizing financial intermediation in the sector. This would provide the basis for the formulation of an integrated sector investment program.

## **F. Overall Bottom-Up Assessment**

100. Sector assistance is assessed to be overall “successful” with need for improvements in several areas and sectors. Assistance was relevant or better to the needs of most sectors, and the effectiveness, efficiency, impact, and likely sustainability of program benefits was substantial in some sectors and projects and less in others. Effectiveness improved in many sectors following the portfolio cleanup, with remaining projects better achieving their outputs and outcomes. However, efficiency was mixed, especially in projects owing to delays in realizing outputs that delay benefits. Sustainability is “likely” in LEMP, finance, energy, health, education and transport sectors, but mixed for urban and rural development. All sectors face forward sustainability risks arising from the need for recurrent expenditure to maintain and operate investments or the need to maintain reform paths. Impacts are “evident” but their extent will depend on managing risks. The economic management, power, and finance sectors played a more important role in ADB’s overall program of support, and these sectors have been weighted more heavily in providing an overall headline (bottom-up) sector rating. The bottom–up rating of ADB assistance to each of its key sectors of support is provided in Appendix 2, Table A2.5. Further discussion of the sector performance assessment and rationale for the ratings is provided in Appendixes 8 to 12.

## **V. FINDINGS, LESSONS, AND RECOMMENDATIONS**

### **A. Findings, Lessons and Conclusion**

101. The overall rating for ADB assistance during the CAPE period, derived by combining the bottom–up and the top–down ratings and weighting these equally, is successful, however, with needs for further improvement in several areas of the country partnership and strategy.

102. **Overall Findings.** At the beginning of the CAPE period, ADB’s investment operations in the Philippines experienced a range of problems including implementation delays; serious problems with LAR; shifting political support for urban, agriculture, and education reforms; and a dearth of counterpart finance by 2002–2003 when the fiscal crisis was at its worst. ADB changed its strategic directions to focus on addressing critical constraints to address fiscal policy weaknesses, public sector governance, energy sector restructuring, and local government financing. These were addressed through a combination of program lending, project lending, and

TA support. In retrospect, while the project lending operations had relevant objectives—they were addressing real needs—their outcomes were mixed even in areas of ADB’s relative strength such as transport infrastructure. Conversely, and with the exception of one agriculture program loan, program lending has exceeded expectations. However, constraints to mobilizing certain categories of investment operations such as LAR remain. The recent program demonstrates the virtues of addressing critical constraints to growth and poverty reduction. These were in the past, and continue to be, largely in the way the public sector is governed. Experience over the past 5 years provides a wide range of lessons for improving performance in strategy development, programming, and operations. Over the past decade, awareness of the factors that influence the performance of ADB assistance to the Philippines has improved and were incorporated into the design of the program. A summary of strengths to build on, weaknesses to address, opportunities to build on and risks to manage is provided in Table 5. A discussion of lessons that can be drawn from program performance during the CAPE period follows.

**Table 5: Strengths, Weaknesses, Opportunities, and Risks**

Item	Factors Contributing to Results	Factors Detracting from Results
<b>Factors internal to ADB operations</b>	<p><b>Strengths to build on</b></p> <ul style="list-style-type: none"> <li>• Portfolio clean-up reduced fiscal drag and improved portfolio performance</li> <li>• Policy lending and technical support has addressed key macro, sector policy constraints</li> <li>• Alternative programmatic approaches to investments promoted harmonization</li> <li>• ADB’s country strategy better aligned with Government MTPDPs, yet implemented flexibly in line with economic, sector realities</li> <li>• Greater selectivity was realized with a focus on key constraints, particularly fiscal consolidation</li> <li>• Political economy of reforms better considered</li> <li>• ADTA to support analysis, policy dialogue, systems and capacity development</li> </ul>	<p><b>Weaknesses to address</b></p> <ul style="list-style-type: none"> <li>• Progress in some reform areas was constrained by changed political interests, institutional capacity and inertia</li> <li>• Investment projects with multiple subprojects bear high transaction costs</li> <li>• Urban and rural development were hampered by overlapping agency roles, lack of LGU finance, and parallel project management systems, protracted procurement</li> <li>• Protracted land acquisition and resettlement procedures and approvals led to delays and higher project costs</li> <li>• Limited assessment of local institutions and risks at the design and appraisal stages of project processing</li> <li>• Needed pre-implementation capacity building took longer than expected</li> </ul>
<b>Factors external to ADB operations</b>	<p><b>Opportunities to capitalize on</b></p> <ul style="list-style-type: none"> <li>• Improving governance indicators and investment climate</li> <li>• Replication of successful approaches to public–private partnerships</li> <li>• Deepening national and sector MTEFs, performance-based approach in working with national agencies and LGUs to improve infrastructure and local service delivery</li> <li>• Government commitment to harmonization and use of SWAP frameworks for development partner coordination</li> <li>• Best practice reform agendas with strong ownership among oversight and technical agencies</li> <li>• Devolution for local services focuses attention at level of clients empowers them for improved local control, accountability and responsibility</li> </ul>	<p><b>Risks to mitigate</b></p> <ul style="list-style-type: none"> <li>• Rising inflation (especially oil, food prices), slower growth threatens macro gains and budget allocation improvements, efforts to effect inclusive growth, reduce poverty</li> <li>• Slow down in global economy</li> <li>• Near-term political pressures for subsidies could undermine fiscal consolidation</li> <li>• Slow policy making and implementation</li> <li>• Realizing expenditure efficiency gains depends on public service commitment and incentives to improve performance</li> </ul>

ADB = Asian Development Bank, ADTA = advisory technical assistance, LGU = local government unit, MTEF = medium-term expenditure framework, MTPDP = Medium-Term Philippine Development Plan, SWAP = sector-wide approach.

Source: Operations Evaluation Mission.



103. **Selectivity Based on Country-Specific Constraints was an Effective Approach.** Building selectivity into the country program by focusing on key constraints, in particular fiscal management, that were mutually understood and agreed between the Government and ADB has paid off in terms of clearer, more substantial, and earlier results and portfolio improvement. The combination of portfolio cleanup and timely use of program lending resulted in a restoration of net transfers, closed ineffective investment projects, and helped address the Government's fiscal burden from underperforming operations. However, bureaucratic inertia in key revenue collection agencies, misaligned institutional incentives, and vested interests have hampered progress on deepening revenue gains and highlighting the need for continued, focused engagement.

104. **Supporting Policy and Institutional Reform Takes Government Commitment, Stakeholder Involvement, and Medium-Term Engagement.** Strong agreement and coordination by Government oversight agencies has improved the design and implementation of critical macroeconomic reforms. Independent analysis and advocacy by the private sector, academe, and civil society stakeholders together with coordinated consultation with the Government helped to improve the understanding and management of the political economy for fiscal and energy sector reforms that complemented fiscal management improvements.

105. The introduction of a medium-term development policy support approach to fiscal reforms has avoided previous problems with prior conditionality and facilitated more continuous policy dialogue and positioning for next stage reforms. Sequenced and combined use of program lending, public project finance, private sector finance, and TA for capacity building in regulation has helped energy sector reforms and development. The development of needed institutional infrastructure in the nonbank financial subsector took time, as well as lending and nonlending support. Here, the lesson is that reforms involving institutional strengthening should take a medium- to long-term perspective. The HSDP provides good practice examples of the use of sectorwide, programmatic approaches using existing ADB modalities, and the DPSP provides a good practice example of engaging in difficult reforms over the medium term. Appendix 5, Box A5 provides examples of comparable programs in the Philippines and other DMCs using programmatic approaches and progressive alignment with country systems.

106. **Contributions to Improving the Private Sector Enabling Environment Were Largely Sector Specific.** Support for fiscal, energy, nonbank finance reforms contributed to improving the private sector enabling environment. The North Luzon expressway PPP is an example of both involving the private sector in infrastructure development and lowering travel costs between economic centers. However, new support for transport and water infrastructure has not been forthcoming as planned. Concerns over handling of right-of-way issues requiring resettlement, lack of competitiveness with other bilateral development partners, and perceived high transaction costs of ADB-administered projects have limited ADB's contribution. ADB has demonstrated readiness to be involved in public-private partnerships such as the Maynilad water consortium, but this did not prosper due to management problems with the original concessionaire.

107. **Addressing Good Governance and Corruption has Moved beyond Project Boundaries.** ADB has supported investment climate assessment and advocacy helping to spotlight the need to reform competitiveness more broadly if the country is to sustain growth and generate the employment and incomes necessary to address exclusion and income poverty. Projects can address corruption issues within their boundaries, but their impact on wider governance problems is inherently limited. Support for fiscal management and budget realignment has opened a promising avenue for ADB's contribution to addressing corruption systemically through initiatives such as more transparent procurement in public projects. Policy-based lending and related technical support is better placed to address systemic governance

issues. Inadequacies in the judicial system and rule of law have been deterrents to investments. The fact that the leadership of the judiciary was prepared to be engaged is a good start. Successes in capital market reforms shows that avoidance of corruption requires a sector focus with well-defined rules and a good regulatory framework.

108. **Support for Local Service Delivery is Relevant.** While relevant, overlapping roles and responsibilities of many agencies, lack of access by LGUs to development finance, wide geographic dispersion and complex operational designs, and in some instances, insufficient follow-through in any one location have hampered support for the rural and urban agenda. However, rural and urban development projects have provided positive local livelihood impacts and useful project cycle capacity building for participating LGUs that complements recent initiatives to strengthen provincial planning and expenditure management systems. Reform support for local government finance is a key step to systematically re-engaging the Government on decentralization, and links to the fiscal management agenda, but requires more intense and systematic support for capacity development.

109. **Linkages between Rural Development, SMEs, and Regional Cooperation Supported Development of Value Chains in Mindanao.** A focus on the southern Philippines, and particularly Mindanao, has presented an opportunity to build a synergy between agricultural development, SME development, and regional cooperation through BIMP-EAGA. This is accompanied by an unplanned but highly relevant opportunity for developing rural value chains, backward linking to areas with high rural poverty, and clarifying public and private sector roles in the process. This is having the unanticipated effect of increasing the income impact of agriculture projects. Planned advisory activity such as quarantine, immigration, customs, and security will strengthen synergies, and has the potential to develop into a structured strategy. The canceled support for regional airport infrastructure development was a missed opportunity to further integrate such linkages.

110. **The Current Approach to Supporting the Autonomous Region of Muslim Mindanao Has Not Been Effective.** Support to the ARMM has had limited effectiveness, and for lending operations became a factor in delaying the implementation of some projects. This suggests that the current lending operational designs and approach are not relevant or effective in meeting the critical needs of the ARMM. Support for Islamic finance through regional technical support to, for example ASEAN, had a potential application in the ARMM, but ADB has not yet explored this link.

111. ADB assistance program over the past 5 years (2003–2007) has been successful in meeting its more selective objectives, despite need for improvements. However, the larger context for the next country strategy continues to be daunting. Poverty is high. Progress toward MDGs is slow and lagging in key areas, and government expenditures for related social and economic services are still low compared to needs. Further infrastructure and social expenditure increases are needed, financed by a strengthened revenue effort. Expenditures need to be more efficient and have greater impact. The industrial base is small and narrow. The reforming energy sector has yet to achieve wider competition and lower electricity rates. Investment rates are low and governance concerns continue to influence investor confidence. Adding to these constraints are global factors such as slowing growth, a credit squeeze, high oil and food prices, and rising inflation. Such forward risks could threaten macroeconomic gains including employment generating growth and revenues, which in turn could affect recent improvements in public spending on infrastructure and social sectors and efforts to reduce poverty. Other risks include continued near-term political pressures to increase subsidies to reduce the effects of high prices of goods and services in some sectors. A near-term slowing of policy making due to the 2010 election would also affect needed reform momentum. Institutional commitment to

improved performance is critical for realizing improved expenditure efficiency gains and higher benefit incidence from services. Hence, in the coming years, the Philippines will continue to face significant development challenges. To address the constraints to growth and poverty reduction, the Philippines will need to (i) continue to exercise fiscal discipline and further expand its fiscal space; (ii) more widely institute good governance; (iii) accelerate infrastructure, education, and other social development; (iv) support expansion and diversification of the economic base; and (v) make access to development opportunities more equitable.

## **B. Strategic Issues for the Future**

**112. Focus the Follow Through on Fiscal Reforms and Further Improvement in Sector Budget Allocations and Institutional Reforms.** Progress was made in positioning for improved budget allocations and distribution. The next steps to ensuring increased public resources needed for social services and transfers are spent efficiently and benefit society at large will depend on improving sector planning and strengthening institutions needed to deliver services. Reform gains should be consolidated and achievable next steps planned, especially those involving the need to deepen institutional reforms in revenue collection, improving public expenditure management and efficiency, and improving decentralized service delivery. Support for medium-term expenditure frameworks is an important initial step to forward planning for deepening and sustaining reforms, but will take time to become fully effective. Progress is needed on effective local service delivery through a clear policy on local service delivery and decentralization, and related clarification between national and local roles and capacity development.

**113. Systematic Support for Institutional Strengthening and Capacity Development.** Institutional strengthening and capacity development are crucial for implementing, deepening, and sustaining reforms initiated in revenue collection, decentralization, health, and the nonbank financial subsector. Advancing sector policy and related institutional reforms can be accomplished by a sequenced and mix of policy dialogue, advisory operations, policy-based lending, and investment in capacity development. Systematic identification of capacity development needs will indicate the scope and resource requirements for institutional capacity development needed to progress reforms in these areas. Consideration is needed for allocating loan funds to support capacity development, especially in sectors involving decentralized service delivery.

**114. Improvements in the Private Sector Enabling Environment Need a Wide Perspective but a Focused ADB Response.** Progress on the private sector enabling environment is contingent on spending on infrastructure and governance reforms, and in turn is crucial for driving growth and revenue generation needed to enhance service access and distribution. Continued attention is needed to build capacity for local service delivery; involving civil society institutions and the private sector in delivering services is a sound strategy. There is no shortcut to developing a public service that operates in a transparent, accountable, and responsive manner. The good governance and anticorruption agenda continues to require a broad view including improvements in national and sector policy, public institution management (including capacity, the incentive framework under which government employees operate, and government systems), regulatory capacity, and the rule of law. At this juncture, there is a clear understanding that governance needs substantial reform, and that the problems are too wide-ranging and deep-seated to address at once. In such a setting, ADB needs to identify focused and feasible governance reforms, to help generate positive momentum, and identify future strategic actions that can keep the governance reform agenda moving forward in areas such as public resource management, decentralization, and utility regulation. However, governance concerns should not be the reason for avoiding investing in key constraints such as physical

infrastructure. Disturbing trends in education related MDG and private sector concerns over the decline in basic human resources warrants ADB's continued support for education.

**115. To Address Infrastructure Development as a Key Constraint to Growth, Explore Alternatives of Supporting its Development.** Future infrastructure development needs to carefully assess alternatives by, first looking for private sector interest, followed by public-private partnerships, and finally public provision where there is genuine market failure. Where market failure is caused by policy failure, then advisory support and dialogue is needed as a first step to initiate corrective measures prior to considering lending operations. In cases where the private sector is not forthcoming and more competitive bilateral financing is available, ADB can collaborate by focusing on sector planning, policy, and issues such as regulatory capacity development and other sector governance issues. The land acquisition problem will require particular attention if ADB is to expand support for major infrastructure projects; this means building Government capacity as well as ensuring that ADB's own safeguard policies are enforced in an even-handed and realistic manner. ADB should continue to address areas such as transport policy, planning, transparent procurement, and improving the prospects for public-private partnerships, including needs for mass transit, that have potential for support through private sector operations.

**116. Support in Agriculture and Rural Development to Address Rural Poverty and Efficient and Sustainable Agricultural Production.** Staying engaged in agriculture, natural resource management, and rural development is needed to address poverty reduction, rural-urban migration, regional disparities, and environmental degradation. The recent high rice prices are exacerbated by distorting policies that do not send the right price signals to producers, while inefficiently subsidizing consumers. As a first step, ADB's reengagement in policy dialogue and advisory support is needed to ensure ongoing and future support for rural infrastructure, such as irrigation, is carried out in a conducive policy environment. But mixed performance and high transaction costs need to be addressed through improved designs for operations. Consideration is needed for the replication of programmatic approaches already used in the health sector. To improve feasibility, assistance needs to address institutional fragmentation and focus on institutions that support consistent and effective decentralization of rural development. Existing project management systems that are set up in parallel to line agency systems add to already fragmented institutions and undermine sustainability. Support for areas such as urban and rural development need to be closely linked to improvements in improved fiscal allocations and sector budgets to avoid previous counterpart funding problems and lack of O&M, such as inefficient deferred maintenance in, for example, rural infrastructure.

**117. Continue the Focus on Southern Philippines and include other Poor Provinces, and Expand the Linkage between Rural Development and Regional Cooperation Initiatives.** High poverty in the southern Philippines, but also other provinces with poverty levels above the national average warrants a focus on their development. The unexpected support for value chains that confer price and productivity incentives to low-income farm households while linking to agribusiness SMEs in, for example, Mindanao can be built into ongoing projects, assessed at project completion, and lessons incorporated into future designs. To promote backward and forward linkages, attention is needed to enhance the enabling environment for microenterprises and rural SMEs, including further improvements in their access to finance and support services. Support for MEDC offers a unique opportunity to facilitate cross provincial boundary coordination in areas such as watershed management. Support to the ARMM is better channeled through area development facilities, including the use of development partner pooled funds or through bilateral assistance channels that can meet the needs of local communities more effectively and efficiently.

118. **Combine Program, Programmatic, and Investment Lending.** After the successful portfolio cleaning exercise, efforts need to continue to ensure that only relevant and feasible projects enter the portfolio and problem projects continue to be dealt with in an expeditious manner. Quality-at-entry triggers are needed, not only before projects are identified and appraised, but for key points in the supervision cycle. They need to consider more than disbursement. Programmatic approaches need to be developed to reduce transaction costs. To accomplish this, close collaboration with bilateral development partners is needed and will require intensive ADB staff effort. Future lending operations should continue to be anchored in the need to maintain fiscal discipline; improve expenditure allocations in line with recent progress on medium-term expenditure frameworks in education, health, public works, and agriculture; as well as critically assessed national, provincial, and local plans through prior public expenditure reviews. To ensure accountability of funds use, greater attention is needed to strengthen national agency and local government audit systems, which are a crucial component of country-system-based and programmatic approaches.

119. **Future Needs and Recommendations.** Bearing in mind the lessons from the past, and the evolving challenges, the CAPE recommends that the next country strategy (i) deepen the strategic focus on improving national public finance governance and management; (ii) deepen support for local governance and decentralized service delivery to improve public expenditure efficiency and governance (iii) continue support for private sector enabling environment improvements; (iv) focus on provinces below the national poverty line to address poverty reduction and build on synergies between local development and regional cooperation initiatives, in particular BIMP-EAGA; and (v) enhance services to the client through expanded policy dialogue, further harmonization with development partners, greater use of programmatic approaches, balance staff resource allocation, and clarify the country office role.

120. The following are key recommendations for consideration by ADB Management in the preparation and implementation of the new country partnership strategy and program.

### Key Recommendations for Management's Consideration

1. Maintain the strategic focus on improving national public finance governance and management:
  - (i) Continue to support the Government's fiscal reforms including the revenue effort from income tax and customs collection and related institutional reforms; and
  - (ii) Continue to support improved budget allocations for priority sectors including infrastructure, education, agriculture, and health.
2. Deepen support for local governance and decentralized service delivery to improve public expenditure efficiency and governance:
  - (i) Continue to support strengthening of local government finances;
  - (ii) Continue support for systematic capacity development to improve public expenditure management and upscale support to local level capacity development in country systems-based planning, management, and internal audit systems to support performance budgeting and governance and anticorruption efforts; and
  - (iii) Focus on national agencies and local government units that support local level goods and services delivery.
3. Continue to support private sector enabling environment improvements:
  - (i) Build on microfinance reforms with a focus on constraints to increasing access by the poor;
  - (ii) Identify and introduce alternative approaches over and above the current facility to improving SME access to bank finance;
  - (iii) Systematically assess and identify where and how ADB can best contribute to infrastructure development; and
  - (iv) Advance strengthening of the judiciary to improve enforcement of the rule of law.
4. Focus on poor provinces to address poverty reduction and build on synergies between local development and regional cooperation initiatives, in particular BIMP-EAGA:
  - (i) Support linkages between rural development, SME development, and regional trade opportunities;
  - (ii) Replicate support for local urban services and utilities;
  - (iii) Develop programmatic approaches to supporting local-level rural and urban development; and
  - (iv) Use a regional development approach and pooled financing for supporting peace and development initiatives in ARMM.
5. Enhance services to the client through expanded policy dialogue, further harmonization with development partners, greater use of programmatic approaches, balance staff resource allocation, and clarify the country office role:
  - (i) Expand economic and sector work and continue policy dialogue with Government to overcoming key constraints and improving the development effectiveness of the ADB–Philippines partnership;
  - (ii) Continue to support country-based development partner harmonization in operations;
  - (iii) Adapt existing assistance modalities to expand systematic institutional strengthening including phasing projects to allow upfront capacity development, TA, loans, and partnerships approaches that pool assistance;
  - (iv) Further develop and expand the use of sector-wide and programmatic approaches;
  - (v) Provide adequate resources and incentives for project and program implementation; and
  - (vi) Clarify the role and responsibilities of the Philippines Country Office.

ADB = Asian Development Bank; ARMM = Autonomous Region of Muslim Mindanao; BIMP-EAGA = Brunei, Indonesia, Malaysia, Philippines-East ASEAN (Association of Southeast Asian Nations) Growth Area; SME = small- and medium-sized enterprise; TA = technical assistance.

## LIST OF LENDING AND NONLENDING OPERATIONS

**Table A1.1: List of Public Sector Project/Programs  
Active as of 31 December 2001**

Loan Number	Project/Program Name	Amount (\$ million)	Date Approved
<b>Agriculture and Natural Resources</b>			
Agriculture Sector Development			
1421	Cordillera Highland Agricultural Resource Management	9.500	11 Jan 1996
1422(SF)	Cordillera Highland Agricultural Resource Management	9.500	11 Jan 1996
Environment and Biodiversity			
1745	Pasig River Environmental Management and Rehabilitation Sector Development Program—Program Loan	100.000	20 Jul 2000
1746	Pasig River Environmental Management and Rehabilitation Sector Development Program—Project Loan	75.000	20 Jul 2000
Fishery			
1562(SF)	Fisheries Resource Management	14.999	16 Oct 1997
1563	Fisheries Resource Management	20.223	16 Oct 1997
Forest			
1191(SF)	Forestry Sector	50.000	19 Nov 1992
1192	Forestry Sector	50.000	19 Nov 1992
Irrigation and Drainage			
1365	Second Irrigation Systems Improvement	15.000	30 Aug 1995
1366(SF)	Second Irrigation Systems Improvement	15.000	29 Aug 1995
1668	Southern Philippines Irrigation Sector	60.000	18 Dec 1998
<b>Education</b>			
Basic Education			
1654	Secondary Education Development and Improvement	53.000	11 Dec 1998
Nonformal Education			
1254(SF)	Nonformal Education	25.200	30 Sep 1993
Technical, Vocational Training and Skills Development			
1750	Technical Education and Skills Development	25.000	24 Aug 2000
1751	Fund for Technical Education and Skills Development	20.000	24 Aug 2000
<b>Energy</b>			
Energy Sector Development			
1662	Power Sector Restructuring	300.000	16 Dec 1998
Transmission and Distribution			
1288	Power Transmission	191.400	16 Dec 1997
1474	Leyte–Mindanao Interconnection Engineering	5.347	30 Sep 1996
1590	Power Transmission Reinforcement	191.400	16 Dec 1997
<b>Finance</b>			
Finance Sector Development			
1858	Nonbank Financial Governance	75.000	15 Nov 2001
Microfinance			
1435	Rural Microenterprise Finance	20.000	23 Apr 1996
<b>Health, Nutrition, and Social Protection</b>			
Early Childhood Development			
1606	Early Childhood Development	15.700	27 Jan 1998
1607(SF)	Early Childhood Development	8.800	27 Jan 1998

<b>Loan Number</b>	<b>Project/Program Name</b>	<b>Amount (\$ million)</b>	<b>Date Approved</b>
<b>Health Programs</b>			
1331(SF)	Women's Health and Safe Motherhood	54.000	10 Nov 1994
<b>Health Systems</b>			
1396(SF)	Integrated Community Health	25.910	17 Oct 1995
<b>Multisector</b>			
<b>Multisector</b>			
1453(SF)	Bukidnon Integrated Area Development	20.000	23 Jul 1996
1599	Subic Bay Area Municipal Development	22.000	19 Dec 1997
1658	Clark Area Municipal Development	24.300	15 Dec 1998
1663	Metro Manila Air Quality Improvement Sector Development	200.000	16 Dec 1998
1664	Metro Manila Air Quality Improvement (Air Pollution Control Facility)	25.000	16 Dec 1998
1665	Metro Manila Air Quality Improvement (Investment Loan)	71.000	16 Dec 1998
1667	Agrarian Reform Communities	93.162	18 Dec 1998
1772	Infrastructure for Rural Productivity Enhancement Sector	75.000	31 Oct 2000
1843	Mindanao Basic Urban Services Sector	30.000	27 Sep 2001
<b>Transport and Communications</b>			
<b>Civil Aviation</b>			
1536	Third Airports Development (Southern Philippines)	93.000	16 Sep 1998
<b>Roads and Highways</b>			
1473	Sixth Roads	167.000	30 Sep 1996
<b>Water Supply, Sanitation, and Waste Management</b>			
<b>Water Supply and Sanitation</b>			
0986	Angat Water Supply Optimization	130.000	14 Nov 1989
1150	Manila South Water Distribution	31.400	19 Dec 1991
1379	Umiray-Angat Transbasin	92.000	21 Sep 1995
1269	Municipal Water Supply	43.200	25 Nov 1993
1440	Rural Water Supply and Sanitation Sector	18.500	4 Jun 1996
1441(SF)	Rural Water Supply and Sanitation Sector	18.500	4 Jun 1996
1472	Small Towns Water Supply Sector	50.000	30 Sep 1996

SF = special fund.

Source: Asian Development Bank database.



**Table A1.2: List of Public Sector Project/Programs  
Approved after 31 December 2001**

<b>Loan Number</b>	<b>Project/Program Name</b>	<b>Amount (\$ million)</b>	<b>Date Approved</b>
<b>Agriculture and Natural Resources</b>			
Environment and Biodiversity			
2311	Integrated Coastal Resources Management	33.800	23 Jan 2007
<b>Energy</b>			
Energy Sector Development			
2282	Power Sector Development	450.000	8 Dec 2006
Transmission and Distribution			
1984	Electricity Market and Transmission Development	40.000	19 Dec 2002
<b>Finance</b>			
Finance Sector Development			
2003	Second Nonbank Financial Governance	150.000	2 Sep 2003
2278	Financial Market Regulation and Intermediation	200.000	6 Dec 2006
Microfinance			
2199	Microfinance Development Program	150.000	15 Dec 2004
<b>Health, Nutrition, and Social Protection</b>			
Health Systems			
2136	Health Sector Development—Program Loan	200.000	15 Dec 2004
2137	Health Sector Development—Project Loan	13.000	15 Dec 2004
<b>Industry and Trade</b>			
Small- and Medium-Sized Enterprises			
2186	Small and Medium Enterprise Development Support	25.000	29 Sep 2005
<b>Law, Economic Management, and Public Policy</b>			
Economic Management			
2315	Development Policy Support Program Subprogram I	250.000	8 Feb 2007
Public Finance and Expenditure Management			
2387	Local Government Financing and Budget Reform Cluster Subprogram I	300.000	13 Dec 2007
<b>Multisector</b>			
Multisector			
2063	Development of Poor Urban Communities Sector	30.500	18 Dec 2003
<b>Water Supply, Sanitation, and Waste Management</b>			
Water Supply and Sanitation			
2012	MWSS New Water Source Development	3.260	14 Oct 2003

MWSS = Metropolitan Waterworks and Sewerage System.

Source: Asian Development Bank database.

**Table A1.3: List of Advisory Technical Assistance Projects by Sector  
Active as of 31 December 2001**

<b>TA Number</b>	<b>Project Name</b>	<b>Amount (\$)</b>	<b>Date Approved</b>
<b>Agriculture and Natural Resources</b>			
Agriculture Production, Agroprocessing, and Agribusiness			
3429	Grains Policy and Institutional Reforms	630,000	24 Apr 2000
Environment and Biodiversity			
3393	Implementation of the Convention on Biological Diversity	120,000	21 Jan 2000
3469	Capacity Building Support for Pasig River Environmental Management and Rehabilitation	1,000,000	20 Jul 2000
<b>Education</b>			
Education Sector Development			
3609	Studies on the Access of the Poor to Education	150,000	21 Dec 2000
Technical, Vocational Training, and Skills Development			
3482	Strengthening Management Capacity and Improving Quality of Technical Education and Skills Development System	775,000	24 Aug 2000
<b>Energy</b>			
Energy Sector Development			
3422	Rural Electrification Institutional Strengthening	750,000	23 Mar 2000
3820	Competition Policy for the Electricity Sector	990,000	19 Dec 2001
<b>Finance</b>			
Finance Sector Development			
3773	Strengthening Regulatory and Market Governance	1,000,000	15 Nov 2001
<b>Law, Economic Management, and Public Policy</b>			
Economic Management			
3411	Joint ADB, UNDP, and World Bank Poverty Consultations	123,200	8 Mar 2000
3421	Establishment of an Official Development Assistance Unit in the Flagship Committee	100,000	23 Mar 2000
3656	Improving Poverty Monitoring Surveys	347,000	24 May 2001
Law and Judiciary			
3693	TA to Strengthen the Independence of the Judiciary	1,200,000	2 Aug 2001
National Government Administration			
3475	Institutional Strengthening of Housing and Urban Development Sector	150,000	2 Aug 2000
<b>Transport and Communications</b>			
Roads and Highways			
3805	Rural Road Development Policy Framework	720,000	18 Dec 2001
<b>Water Supply, Sanitation, and Waste Management</b>			
Water Supply and Sanitation			
3703	Capacity Building for the Regulatory Office of the Metropolitan Waterworks and Sewerage System	800,000	8 Aug 2001

ADB = Asian Development Bank, TA = technical assistance, UNDP = United Nations Development Programme.  
Source: Asian Development Bank database.

**Table A1.4: List of Advisory Technical Assistance Projects by Sector  
Approved after 31 December 2001**

<b>TA Number</b>	<b>Project Name</b>	<b>Amount (\$)</b>	<b>Date Approved</b>
<b>Agriculture and Natural Resources</b>			
Fishery			
4708	Strategy for Sustainable Aquaculture Development for Poverty Reduction	600,000	2 Dec 2005
Water Resource Management			
4552	Master Plan for the Agusan River Basin	970,000	23 Dec 2004
<b>Education</b>			
Basic Education			
4524	Development of Basic Education in the Autonomous Region in Muslim Mindanao	375,000	23 Dec 2004
Tertiary Education			
3954	Organizational Development of the Commission on Higher Education	500,000	31 Oct 2002
<b>Energy</b>			
Energy Sector Development			
4073	Transition to Competitive Electricity Market	800,000	19 Dec 2002
4151	Promoting Good Governance in the Restructured Power Sector	800,000	18 Jul 2003
4557	Institutional Strengthening of Energy Regulatory Commission and Privatization of National Power Corporation	1,200,000	28 Dec 2004
Renewable Energy Generation			
4174	Rehabilitation of Renewable Energy Projects for Rural Electrification and Livelihood Development	450,000	16 Sep 2003
Transmission and Distribution			
7012	Rural Electric Cooperatives Development	550,000	11 Dec 2007
<b>Finance</b>			
Capital Markets and Funds			
4321	Strengthening Governance of Securities Trading Markets	250,000	18 Mar 2004
Finance Sector Development			
3847	Strengthening the Anti-Money-Laundering Regime	1,000,000	19 Mar 2002
4168	Support for the Nonbank Financial Sector	500,000	2 Sep 2003
4884	Strengthening Regulation and Governance	800,000	6 Dec 2006
Microfinance			
4544	Enhancing Access of the Poor to Microfinance Services in Frontier Areas	250,000	23 Dec 2004
4693	Support the Implementation of the Microfinance Development	500,000	22 Nov 2005
<b>Health, Nutrition, and Social Protection</b>			
Health Systems			
4647	Support for Health Sector Reform	1,000,000	15 Sep 2005
<b>Industry and Trade</b>			
Industry			
3921	Promotion of Cleaner Production	775,000	6 Sep 2002
4198	Institutional Strengthening for the Development of the Natural Gas Industry	800,000	16 Oct 2003
9070	Developing the Philippine Business Registry	700,000	8 Aug 2005

<b>TA Number</b>	<b>Project Name</b>	<b>Amount (\$)</b>	<b>Date Approved</b>
<b>Small- and Medium-Sized Enterprises</b>			
4523	Strengthening Small and Medium Enterprise Credit Management Systems	500,000	23 Dec 2004
<b>Law, Economic Management, and Public Policy</b>			
<b>Economic Management</b>			
3932	Improving the Climate for Investment and Productivity in the Philippines: An Approach to Long-Term Poverty Reduction	120,000	25 Sep 2002
3940	Capacity Building of the Mindanao Economic Development Council to Enhance Private Sector Activity in the Philippine EAGA	200,000	16 Oct 2002
4809	Government-Owned and -Controlled Corporations Reform	750,000	29 Jun 2006
4920	Strengthening Investment Climate and Competitiveness	800,000	8 Feb 2007
<b>Law and Judiciary</b>			
4601	Strengthening the Anti-Money-Laundering Regime (Phase II)	400,000	24 Jun 2005
4832	Enhancing the Autonomy, Accountability, and Efficiency of the Judiciary, and Improving the Administration of Justice	800,000	30 Aug 2006
<b>National Government Administration</b>			
4686	Harmonization and Managing for Results	700,000	4 Nov 2005
9087	Supporting Information Sharing and Exchange Among Civil Servants	500,000	14 Mar 2006
<b>Public Finance and Expenditure Management</b>			
4185	Enhancing the Efficiency of Overseas Workers' Remittances	150,000	26 Sep 2003
4556	Local Government Finance and Budget Reform	850,000	23 Dec 2004
4717	Debt and Risk Management	720,000	7 Dec 2005
4778	Local Governance and Fiscal Management	1,800,000	3 Apr 2006
7019	Local Government Financing and Budget Reform	800,000	13 Dec 2007
7035	Enhancing Revenue Collection and Strengthening the Criminal Prosecution of Tax Evasion Cases	500,000	12 Dec 2007
<b>Subnational Government Administration</b>			
3859	Support for the Local Governance Performance Measurement System	200,000	30 Oct 2002
3966	Regional Capability Building and Governance for an Expanded Autonomous Region of Muslim Mindanao	600,000	4 Nov 2002
4512	Strengthening Provincial and Local Planning and Expenditure Management	350,000	20 Dec 2004
<b>Multisector</b>			
<b>Multisector</b>			
4293	Capacity Building for Housing Microfinance	1,500,000	18 Dec 2003
9102	Southern Leyte Landslide Disaster Assistance	3.000	15 Dec 2006
<b>Water Supply, Sanitation, and Waste Management</b>			
<b>Waste Management</b>			
3848	Metro Manila Solid Waste Management	1,250,000	18 Mar 2002

EAGA = East-Asia Growth Area, TA = technical assistance.

Source: Asian Development Bank database.

## EVALUATION APPROACH AND RATINGS

### A. Evaluation Framework and Questions

1. The country assistance program evaluation (CAPE) used the *Guidelines for the Preparation of Country Assistance Program Evaluation Reports* of the Asian Development Bank (ADB).<sup>1</sup> The framework for the evaluation is provided in Table A2.1.
2. The positioning and relevance of ADB's assistance program and strategy were assessed using the following criteria:
  - (i) **Relevance.** What were the priority development issues, trends, conditions, and needs in the Philippines? How were they addressed by the Government and other stakeholders? Did ADB country programs address relevant and priority development needs, consistent with the Government's development strategies?
  - (ii) **Selectivity.** Have ADB operations focused on relevant and priority sectors, geographic areas, and counterpart organizations considering potential development impact, Government priorities and reform initiatives, and ADB corporate objectives? Were activities focused on ADB's core competencies, and how do they complement the activities of other development partners?
  - (iii) **Sequencing and continuity.** Were ADB operations sequenced taking into consideration national development strategies, the Government's reform agenda, and capacity constraints? Was there continuity in ADB's assistance?
3. ADB performance was assessed by addressing the following aspects:
  - (i) **Responsiveness.** Given expectations, has ADB responded adequately, flexibly, and in a timely way to changing and emerging country needs and Government demand for ADB assistance? Did ADB properly assess and consider the implementation capacity of executing and implementing agencies during project processing and implementation?
  - (ii) **Suitability of ADB policies, systems, and lending instruments.** Were ADB policies, systems, lending instruments, and assistance modalities appropriate for country conditions? Is ADB responding to the requirements of the Paris Declaration on Aid Effectiveness?
  - (iii) **Capacity and core competencies.** Did ADB apply best practice in the program for the issues and circumstances? Were ADB's financial and human resources adequate for the design and implementation of the Philippines country strategies and programs? What was the quality of staff and consultant resources? How do the Government, civil society, and private sector perceive ADB's role and performance and areas for service improvement?
4. ADB's contributions to development results considered the following points:
  - (i) **Outcomes and impact.** What were the key outputs and outcomes of ADB's operations in the Philippines, and how do they compare to results envisaged under the country strategies? What factors affected outputs and outcomes compared to feasibility assessments? Were there common factors that affected program performance?
  - (ii) **Value addition.** Did ADB spearhead new development issues? Have synergies between ADB's private and public sector operations materialized? Did ADB's assistance make a difference to development in the Philippines?

<sup>1</sup> ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila.

5. The assessment of ADB's overall value added and development effectiveness at the sector level in the Philippines used the following criteria:

- (i) **Relevance.** Was ADB's assistance focused on critical impediments to sector development, focused on ADB country and sector strategies, aligned with government sector priorities, supportive of essential sector policy and institutional reforms of the government, designed to consider sector conditions in the country and scope for sector development, and designed to consider the potential for private sector involvement in the sector?
- (ii) **Effectiveness of response.** Was ADB's assistance responsive to needs? Did it achieve useful results in terms of outputs and outcomes and meet a level of effectiveness? Were its determinants aligned with good practices and international standards where appropriate and effectively coordinated with other key development partners in the sector?
- (iii) **Efficiency of results.** Did ADB sector operations maximize the ratio of outputs and outcomes to resource levels? Were they formulated and implemented in a cost-effective and efficient manner? Were procurement and consultant recruitment processes managed efficiently?
- (iv) **Sustainability of results.** What is the likelihood of sustaining achieved outputs and outcomes? Are conducive fiscal, political, and environmental conditions in place? To what extent has ADB assistance helped strengthen national institutional capacity for formulation of sector policies and the management of sector programs and investments?
- (v) **Impact.** How have ADB sector operations contributed to development?

6. The implications for ADB's future assistance strategy to the Philippines were assessed based on the evaluation of ADB's assistance program and strategy positioning, its contribution to development results in the Philippines, ADB's response and performance, and overall results and development effectiveness.

## **B. Methodology**

7. The CAPE assessed ADB's contribution to development results through a combination of data analyses and literature reviews involving desk studies at ADB headquarters, interviews of executing agencies and project officers, and field visits within the Philippines to interview local project staff and beneficiaries and conduct perception assessments.

8. The top-down evaluation assessed ADB's strategic positioning and contributions to development results, involving a review of Government development strategies and plans; ADB strategy documents; portfolio data; Operations Evaluation Department reports; and the activities of other development partners. ADB performance considered client feedback, evolution of ADB strategies and programs, strategic focus, resources allocated to implement the program and shifts, and effectiveness of dialogue and partnerships.

9. To connect the top-down and bottom-up evaluation, sector assistance assessments were organized around four themes: (i) economic management and public policy (covering law, economic management, public policy, health, and education sectors); (ii) private sector development (covering finance, energy, transport and communication, and infrastructure); (iii) urban development (covering urban-related operations and the Clark and Subic economic zone development) and rural development (covering agriculture, natural resources, and rural infrastructure); and (iv) water supply and sanitation (covering urban and rural water issues).

10. For the bottom–up evaluation, rapid sector assessments were prepared for major sectors covering (i) sector situation update over the past 10 years; (ii) summary of the Government’s plans during the CAPE period; and (iii) assessment of ADB assistance during the CAPE period. The assessment of ADB assistance during the CAPE period involved reviewing loan-assisted programs and projects approved and technical assistance (TA) projects provided. Loans were assessed by reviewing project preparation TA reports, back-to-office-reports, midterm reports, project performance reports, project completion reports, and project performance evaluation reports. Structured interviews were carried out with the executing agencies, project officers, and available consultants. The findings of these interviews or returned questionnaires and the results of the document review were entered into summary sheets.

11. TA projects provided during the CAPE period were reviewed in three stages: (i) review of documents—advisory TA papers, TA completion reports, TA performance audit/evaluation reports, and back-to-office-reports; (ii) structured interviews with executing agencies, project officers, and consultants, including using a simple questionnaire as a means of summarizing key interview findings; and (iii) findings from interviews were entered into summary sheets and used as the basis for deriving overall ratings of performance based on relevance, responsiveness, and results. The findings from individual TA project reviews were used to inform sector evaluations. Overall sector ratings combine existing TA completion report ratings, project completion report ratings, project performance evaluation report ratings, and CAPE TA and loan assessments.

**Table A2.1: Philippines CAPE: Evaluation Approach Framework**

Philippine's Situation and Government's Strategy	ADB's Analysis and Program	Evaluation Focus	Information Source and Analysis
Country Context	Country Analysis	<p>Summary of country performance, baseline indicators, trends, key policy issues, trends, fiscal situation, economic risks and management, government commitment and political economy influences</p> <p>Summary of key country development problems, causes, solutions, rationale for Government involvement</p> <p>ADB's approach, understanding and effectiveness in country analysis and policy dialogue</p>	<p>Review and analysis of country situation and national data and indicators over CAPE period</p> <p>Assessment of development needs, trends, and rationale for public involvement</p> <p>Review of CPS background reports and country assessments, ERD reports and binding constraints analysis, ADO, WB, IMF, comparative analysis of ADB's approach with other assessments, perception survey</p>
Government's Medium-Term Development Goals and Plan 2000–2010	Country Assistance and Program	<p>Government's MTPDP and rationale for public and ADB's involvement</p> <p><b>Relevance</b> and alignment of ADB's country strategy with the Government's MTPDP, including selectivity, sequencing, continuity</p> <p><b>Responsiveness</b> of ADB's assistance and performance, suitability of ADB procedures, capacity, competencies, harmonization with other donor programs</p> <p><b>Results</b> and contributions to Government's development goals, key outputs and outcomes, value addition and synergies, sustainability and synergies</p>	<p>Review of the Government's policies, strategies and MTPDPs, implementation, and public resource management during the CAPE period</p> <p>Review and analysis of ADB's CSPs, country portfolio, overall contribution of ETSW, adequacy of policy dialogue, perception survey of ADB, interviews with EA's, PhCO staff, ADB program and project staff, harmonization with other partner agency and donor parties</p> <p>Assess ADB's overall contribution to development results, performance, synergies</p>
Sector and Area Context	Economic and Thematic Sector Analysis, Monitoring, and Evaluation	<p>Sector performance, baseline indicators, trends, key sector policy issues, sector public expenditure and institutional issues, economic risks and management, government commitment, and political economy influences</p> <p>Summary of key sector development problems, causes, solutions, rationale for Government, and ADB involvement</p> <p>ADB's approach, understanding, and effectiveness in sector analysis and policy dialogue</p>	<p>Rapid sector assessments: literature review, sector reports, CSP sector results framework, TA reports, other donor analysis, field visits</p> <p>Perception surveys, comparative analysis of ADB's approach with government, nongovernment and other donor approaches</p>
Government Sector and Area Development Goals and Plans	Sector Assistance and Program	<p><b>Relevance</b> of ADB's sector strategy and alignment with Government's sector plan including selectivity, sequencing, continuity</p> <p><b>Effectiveness</b> of ADB's response to needs, design, practices, donor coordination, factors affecting implementation</p> <p><b>Efficiency</b> of sector-level outcomes and contribution to intended impacts (were costs minimized for reaching goals)</p> <p><b>Sustainability</b> (combined) of results and influences on sustainability</p> <p><b>Impact</b> of outcomes to sector development, contributions to government and ADB strategic and thematic areas, corporate commitments</p>	<p>Rapid sector assessments: Review of sector work, Government sector MTPDP, CSP sector strategy, program, results framework, perception surveys, other donor program and coordination, aggregation of individual program, project and TA evaluations</p>
Government Investments and Services	Programs, Projects, and Supporting TA Projects	<p><b>Relevance</b> of loan, TA to ADB's sector program and Government's sector program</p> <p><b>Effectiveness</b> of loan, TA to meeting needs, design, practices, donor coordination, progress and factors affecting implementation</p> <p><b>Efficiency</b> of loan, TA outputs and outcomes and contribution to intended impacts</p> <p><b>Sustainability</b> of loan, TA results and influences on sustainability</p> <p><b>Impact</b> of outcomes to sector development, contributions to government and ADB strategic and thematic areas, corporate commitments</p>	<p>Operations review: Review of designs, PPRs, MTRs, PCRs, PPERs; interviews with EAs, IAs, project officers, consultants, beneficiaries</p>

ADB = Asian Development Bank, ADO = Asian Development Outlook, CAPE = country assistance program evaluation, CPS = country partnership strategy, EA = executing agency, ERD = Economics and Research Department, ETSW = economic and thematic sector work, IA = implementing agency, IMF = International Monetary Fund, M&E = monitoring and evaluation, MTPDP = Medium-Term Philippine Development Plan, MTR = medium-term review, PCR = project completion report, PhCO = Philippine Country Office, PPER = project performance evaluation report, PPR = project performance review, TA = technical assistance, WB = World Bank.  
 Source: Operations Evaluation Mission.



**Table A2.2: Overall Assessment of the Country Assistance Program  
(Top–Down and Bottom–Up)**

<b>Item</b>	<b>Description</b>	<b>Rating</b>	<b>Score (Points)</b>
Positioning of ADB's Country Strategies	Positioning refers to the degree of coherence of ADB's country strategies, given existing constraints. Its assessment is based on (i) ownership/alignment with country and ADB priorities (relevance); (ii) basis for formulating the strategies and programs; (iii) ADB's comparative advantage and strategy coordination with development partners; (iv) focus/selectivity and synergies; and (v) long-term continuity.	Highly Satisfactory	8
		Satisfactory	6
		Partly Satisfactory	4
		Unsatisfactory	0
Contribution to Development Results	This assesses the extent to which ADB's overall country assistance program contributed to the achievement of development results such as pro-poor economic growth, inclusive social development, and good governance.	High	8
		Substantial	6
		Modest	4
		Negligible	0
ADB Performance	The assessment focuses on the processes that underlie ADB's discharge of responsibilities as a development partner. It reflects the perceptions/views of various groups and individuals who have dealings with ADB.	Highly Satisfactory	8
		Satisfactory	6
		Partly Satisfactory	4
		Unsatisfactory	0
Top–Down Assessment, Countrywide	This refers to the sum of the scores given to the three foregoing criteria (positioning, contribution to development results, and ADB performance).	Highly Successful	≥20
		Successful	≥15 and <20
		Partly Successful	>10 and <15
		Unsuccessful	≤10
Bottom–Up Assessment, Aggregate Sector Performance	This refers to the overall performance of the sector assistance program, using a weighted index of 2 for major sectors and 1 for minor sectors.	Highly Successful	≥20
		Successful	≥15 and <20
		Partly Successful	>10 and <15
		Unsuccessful	≤10
Overall Assessment	The overall assessment of the country assistance program combines the scores derived from the top–down countrywide assessment and the bottom–up assessment of aggregate sector performance. Equal weights are assigned to each assessment rating.	Highly Successful	≥ 40
		Successful	≥30 and <39
		Partly Successful	≥20 and <29
		Unsuccessful	≤ 19

ADB = Asian Development Bank.

Source: ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila.

**Table A2.3: Bottom–Up Assessment of the Sector Assistance Program**

<b>Evaluation Criterion</b>	<b>Description</b>	<b>Rating</b>	<b>Score (points)</b>
Relevance	Relevance refers to the alignment of ADB's sector strategy and program with evolving development challenges and priorities of the developing member country, and with the mission, policies, and strategies of ADB.	Highly Relevant	3
		Relevant	2
		Partly Relevant	1
		Irrelevant	0
Effectiveness	Effectiveness refers to the extent to which the outcomes of the assistance program were achieved.	Highly Effective	6
		Effective	4
		Less Effective	2
		Ineffective	0
Efficiency	Efficiency describes the extent to which ADB's resources were used to achieve results. Measures include cost effectiveness, economic internal rates of return, and the degree to which the benefits of the assistance program have reached the poor, among others.	Highly Efficient	3
		Efficient	2
		Less Efficient	1
		Inefficient	0
Sustainability	Sustainability focuses on the likelihood that the achievement of sector results will be sustained into the future and will prove resilient to identified risks. Sustainability has important fiscal, social, political economy, and environmental dimensions.	Most Likely	6
		Likely	4
		Less Likely	2
		Unlikely	0
Impact	Impact refers to ADB's contribution to long-term changes in development conditions, including attainment of the Millennium Development Goals, goals of the ADB assistance program, and improved institutional capacity.	High	6
		Substantial	4
		Modest	2
		Negligible	0
Performance of the Sector Assistance Program	The performance rating of the sector assistance program is derived by adding up the scores given to each evaluation criterion (relevance, effectiveness, efficiency, sustainability, and impact).	Highly Successful Successful Partly Successful Unsuccessful	≥20 ≥15 and <20 >10 and <15 ≤10
Aggregate Sector Performance	Aggregate sector performance score = $\sum (W_i * \text{Sector performance score}) / \sum W_i$ , where $W_i$ is equivalent to 2 for major sectors and 1 for minor sectors.	Highly Successful Successful Partly Successful Unsuccessful	≥20 ≥15 and <20 >10 and <15 ≤10

ADB = Asian Development Bank.

Source: ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila.

**Table A2.4: Top-Down Ratings**

Criteria	Rating
<b>ADB Positioning</b> <ul style="list-style-type: none"> <li>• Program Relevance and Country Alignment</li> <li>• Selectivity</li> <li>• Sequencing and Continuity</li> </ul>	<b>Satisfactory (6)</b> Satisfactory Satisfactory Satisfactory
<b>ADB's Performance</b> <ul style="list-style-type: none"> <li>• Application of ADB Strategies and Policies</li> <li>• Policy Dialogue and Aid Coordination</li> <li>• Provision of Knowledge Products and Advice</li> <li>• Portfolio Performance and Resource Management</li> </ul>	<b>Satisfactory (6)</b> Satisfactory Satisfactory Satisfactory Satisfactory
<b>Contribution to Development Results</b> <ul style="list-style-type: none"> <li>• Improved Fiscal Outlook (weighted x2)</li> <li>• Better Investment Climate</li> <li>• Contributions to MDGs</li> </ul>	<b>Modest to Substantial (4)</b> Substantial Modest Modest
<b>Total Top-Down Rating</b>	<b>Successful (16)</b>

ADB = Asian Development Bank, MDG = Millennium Development Goal.  
Source: Operations Evaluation Mission.

**Table A2.5: Bottom-Up Ratings by Sector**

Sector	Criteria					Overall
	Relevance	Effectiveness	Efficiency	Sustainability	Impact	
1. Law, Economic Management and Policy (weight 20%)	Relevant (2)	Effective (4)	Highly Efficient (3)	Likely (4)	Substantial (4)	Successful (17)
2. Energy (weight 20%)	Relevant (2)	Effective (4)	Efficient (2)	Likely (4)	Substantial (4)	Successful (16)
3. Finance (weight 20%)	Highly Relevant (3)	Effective (4)	Efficient (2)	Likely (4)	Substantial (4)	Successful (17)
4. Transport (weight 5%)	Relevant (2)	Less Effective (2)	Less Efficient (1)	Likely (4)	Modest (2)	Partly Successful (11)
5. Urban (weight 10%)	Relevant (2)	Effective (4)	Less Efficient (1)	Less Likely (2)	Modest (2)	Partly Successful (11)
6. Agriculture and Rural Development (weight 5%)	Relevant (2)	Effective (4)	Less Efficient (1)	Less Likely (2)	Modest (2)	Partly Successful (11)
7. Health (weight 10%)	Relevant (2)	Effective (4)	Less Efficient (1)	Likely (expected) (4)	Substantial (4)	Successful (expected) (15)
8. Water Supply, Sanitation, and Waste Management (weight 5%)	Relevant (2)	Effective (4)	Less Efficient (1)	Less Likely (2)	Substantial (4)	Partly Successful (13)
9. Education (weight 5%)	Relevant (2)	Effective (4)	Less Efficient (1)	Likely (expected) (4)	Substantial (expected) (4)	Successful (expected) (15)
<b>All Sectors</b>						<b>Successful (low side) (15)</b>

Source: Operations Evaluation Mission.

**PROGRESS ON ADDRESSING RECOMMENDATIONS FROM THE 2003 COUNTRY ASSISTANCE PROGRAM EVALUATION**

<b>2003 CAPE Recommendations</b>	<b>Actions Taken</b>
ADB should support a steady, modest, and selective program emphasizing a catalytic role and quality over quantity.	Selectivity in the country program was realized by focusing on key policy constraints in fiscal management, energy, financial, health, and local government; while project lending was reduced in volume and was subject to quality-at-entry controls.
ADB should develop time-bound plans to improve specific projects, especially institutional constraints, downscaling and redesigning projects where counterpart funds are not available, and canceling unused funds.	The portfolio cleanup resulted in fewer projects at risk. A total of 47 projects exited the program during the CAPE period.
ADB should improve conceptualization and design of projects.	Use was made of policy-based lending and a series of single tranche loans to support medium-term reform. Implementation of investment projects is still constrained by weaknesses in operational designs.
Assistance should be focused on reducing poverty by promoting social development through microcredit, health and education, rural roads, and development of lagging regions.	Related support was provided to improve rural incomes, access to water and sanitation, health, and education with a focus on the lagging regions in the southern Philippines.
The time frame for meeting conditionalities needs to be reviewed, as well as the political economy of decision making.	Political economy factors were considered in the design of fiscal, energy, and financial reforms; approaches to policy dialogue were improved; and support provided for reforms over the medium term.
The role for ADB's private sector operations in, for example, the energy sector as restructuring and privatization proceeds.	Support for fiscal, energy, and nonbank finance reforms contributed to improving the private sector enabling environment, and led to private sector investments in the energy sector.
Increased attention should be given to economic, sector, and thematic work on analysis of policy and institutional constraints in social sectors, regional cooperation, and the finance sector.	Of surveyed advisory technical assistance projects provided during the CAPE period, 73% made recommendations involving policy reform, reflecting the focus on supporting reform.
ADB should deepen its relationships with society beyond government, such as nongovernment organizations, other elements of civil society, women's groups, and ethnic minorities.	Interactions beyond government on the analysis by the private sector, academe, and civil society stakeholders on the needs for fiscal and other reforms, and multi-stakeholder consultation with the Government helped to improve the understanding and management of the political economy of fiscal and energy sector reforms.

ADB = Asian Development Bank, CAPE = country assistance program evaluation.  
Source: Operations Evaluation Mission.

## SUMMARY OF ADB COUNTRY PROGRAMS SINCE 1998

COS 1998	CSP 2001–2003	CSPU 2002–2004/ CSPU 2004–2006	CSP 2005–2007
<p>Strategic priorities are to meet the challenge of a sustained growth process. The strategy promoted equity and social development including strategic priorities for upgrading the country's infrastructure; rural development; and human resource development with a focus on improving access to basic education and primary health care facilities by the poor; promotion of more regionally balanced development especially in the southern Philippines; and environmental management. The strategy addresses issues relevant to the 1997 currency turmoil, including capital market development and sector reform initiatives to assist private sector participation and restore investor confidence.</p> <p>Sector strategies: 1. Transport: (i) invest in transport with emphasis on national and rural road expansion and improvement, and regional ports and airports; and (ii) provide policy advice/capacity building by enabling privatization of public enterprises, developing the regulatory framework for private sector participation, and building local government capacity.</p> <p>2. Energy: (i) invest in selected power transmission, consolidation of distribution operations, and rural electrification; (ii) provide policy advice/capacity building in power subsector restructuring, NPC privatization, development of the regulatory framework for private sector participation.</p> <p>3. Urban development, water supply and sanitation: (i) support urban services, and rural and urban water supply and sanitation; (ii) provide policy</p>	<p>Strategic priorities emphasize socio-environmental development and poverty reduction through a strategic emphasis on areas lagging in development; antipoverty features in operational designs; priority to southern Philippines development; capacity-building assistance to national and local governments; governance (judicial reform and local governance), trade policy, and the environment.</p> <p>Sector strategies: 1. Agriculture: (i) invest in rural development including removing infrastructure bottlenecks; strengthening and improving access to support services through innovative mechanisms; rationalizing the institutional framework and roles of national agencies, LGUs, NGOs, and local communities; identifying mechanisms for channeling additional funds to LGUs for devolved activities, building LGU capacity for project activity, expanding community involvement in the project process. (ii) Forestry and natural resources: rationalize and decentralize the institutional environment (national to local) support water resource development through better environmental management of watersheds, irrigation efficiency, strengthening community organizations and irrigators; promote integrated coastal resource management measures.</p> <p>2. Infrastructure: (i) Energy: support NPC privatization and strengthen regulation; support efficiency of the power industry including integrating the Luzon–Leyte and Mindanao grids; shift to equity concerns including rural electrification and renewable energy, and strengthen transmission and distribution in less developed areas; (ii) Transport and communications: (a) Formulate a policy framework for a rural roads investment program; (b) improve efficiency, quality assurance, and maintenance; and address axle overloading; (c) continue support for highway planning, improved sector management and operations; (d) in Metro Manila, provide capacity building assistance in traffic engineering, management and enforcement, and planning;</p>	<p>Strategic priorities are based on socially inclusive development that should result from (i) pro-poor, sustainable economic growth; (ii) social development, under which specific, targeted programs for the poor are envisioned; and (iii) good governance. The CSP updates took a thematic approach to update sector priorities.</p> <p>Thematic strategies: 1. Economic growth: (i) increase attention to rural development; (i) support more balanced regional development, with emphasis on the southern Philippines; (iii) promote a stable macroeconomic environment; (iv) improve the competitiveness of Philippine industries and labor force (v) improve infrastructure, especially rural roads and electrification, and (vi) emphasize greater private sector participation.</p> <p>2. Human development: (i) improve quality of basic social services (ii) support other safety nets for the vulnerable in rural and urban areas and (iii) support increased access to basic education, improved sector resource allocation, strengthening of higher education.</p> <p>3. Gender and development: (i) narrow gender gaps in basic education, (ii) address women's needs in Mindanao forest and upland rural communities development and microfinance, (iii) reduce women's domestic burden by extending municipal services to households, and (iv) improve women's health and safe motherhood</p>	<p>Strategic priorities are on fiscal consolidation, improved investment climate, accelerated attainment of the MDGs through enhanced public sector efficiency.</p> <p>The strategy aligns more clearly with the Government's MTPDP priorities supporting the focus on fiscal responsibility; the need to act on the fiscal imbalance, which affects all aspects of the ADB–Philippines partnership, and requires ADB to eschew a “business as usual” approach. The strategy builds on a shift to results-based portfolio management, with a focus on results management to reinforce the planning–budget-implementation linkage. Tighter selectivity for operational activities through a set of quality-at-entry criteria (EA absorptive capacity; availability of budgeted counterpart funds; results-focused outcomes; compliance with government readiness filters; LARPs complete).</p> <p>Emphasis is on targeted sector policy reforms to address fiscal and investment climate issues, with complementary investment projects targeted at off-budget agencies that support the MDGs and improved services in the following strategic areas:</p> <p>1. Deeper structural reforms: (i) in power, to enhance financial solvency, regulation, and governance; (ii) in finance, to improve efficiency of intermediation; and (iii) for LGUs, to strengthen fiscal management, capacity and governance.</p> <p>2. Private investment to</p>

COS 1998	CSP 2001–2003	CSPU 2002–2004/ CSPU 2004–2006	CSP 2005–2007
<p>advice/capacity building in water district consolidation, private sector participation in urban services, water supply and sanitation, commercialization of LWUA and water districts, and LGU capacity building.</p> <p>4. Agriculture and rural development: (i) invest in irrigation development emphasizing existing system improvement; provide rural infrastructure, research, and extension services; support forestry and fisheries resource management, crop diversification, provision of microcredit, and promotion of agribusiness; (ii) support LGU capacity building for rural development, and LGU/NGO coordination.</p> <p>Health: (i) invest in primary health care improvement, including integrated community health services, maternal health care, childhood development, and population planning; (ii) build capacity of LGUs and DOH to plan and implement health sector projects, improve coordination between LGUs and NGOs.</p> <p>Education (i) invest in basic education, including technical and vocational, and selected support for technical and higher education; and (ii) support policy decentralization of basic education, and capacity building of institutions, including LGUs, and policy reform.</p> <p>Finance (i) invest in capital market development and development of facilities for infrastructure finance; (ii) provide policy/capacity building in capital market development including bond segment and mutual funds, and secondary markets, policy reforms for capital market development, and capacity of</p>	<p>(e) prepare an intermodal national transport strategy and policy action plan to identify future sector assistance emphasizing private sector participation; (f) streamline civil aviation operations and promote restructuring of the Air Transportation Office, and improved regulation and safety standards;</p> <p>(iii) Finance and industry: (a) Focus financial sector reforms on nonbank financial subsector development; (b) focus industry and trade development on greater competitiveness, and SME development; (c) consider support for corporate and financial restructuring.</p> <p>3. Social infrastructure and environment (i) Education: support recommendations of the Presidential Commission for Education Reform for education financing, restructuring of higher education to increase cost recovery, rationalization of the skills development system, and decentralization including a focus on school-based management and curriculum development. (ii) Health and nutrition: assist the transition of DOH from a top-down service provider to catalyst of preventive and promotional services for the poor and as an enabling facilitator; support the transition of public health personnel to LGUs through local health partnerships and reorganizing public health services and merit-based career paths; support the transition to more accessible and affordable health care through prudent health financing reform; and improve public and private partnerships. (iii) Urban development: support urban sector policy reforms and institutional strengthening; rationalize the financing mechanism for urban development under the decentralized government system; build financial, institutional, and administrative capacities of LGUs; promote public-private partnerships for urban infrastructure and services development; and promote integrated approaches to urban development. (iv) Environment: support poverty reduction and environmental management linkages through participatory planning and management; support addressing urban environmental problems especially air pollution in large regional urban centers; support industrial and environmental policies for clean air and production including solid waste management, water supply and</p>	<p>4. Good governance: (i) improve transparency and accountability in public sector functioning, and tackling corruption; (ii) strengthen the decentralization and devolution process; (iii) enhance participation of civil society and stakeholders in policy making, public investment decisions, and monitoring of the quality of public services; and (iv) support peace and development, especially in the southern Philippines.</p> <p>5. Private sector development: (i) assess the private sector enabling environment, (ii) support continued development of capital markets and financial infrastructure, (iii) increase participation of private sector in infrastructure development, (iv) support restructuring of Philippines National Railways and privatization of NPC.</p> <p>6. Environment: Continue support for specific measures to address environmental protection; sustainability; and rehabilitation, including urban air quality, surface water quality, solid waste management, forest resources, and coastal resources.</p> <p>7. Regional Cooperation: Continue to support BIMP-EAGA through SME activity and ongoing complementary regional transport infrastructure links.</p>	<p>offset shortfalls in public investment due to fiscal consolidation, while restoring investor confidence, especially by (i) strengthening governance through legal and judicial reforms; and (ii) promoting infrastructure and finance development;</p> <p>3. Focused support for the MDGs through (i) improved health sector management and administration; (ii) water supply and sanitation; and (iii) microfinance, and small- and medium-sized enterprise development.</p> <p>4. Mitigating economic and social disparities through subregional development, especially Mindanao, reinforced by ADB's regional strategy and program.</p> <p>The strategy involves investment lending that does not encroach on national Government finances including (i) policy lending for sector reforms that depend on a conducive macroeconomic environment and commencement of substantive sector reforms consistent with political cover, macroeconomic fundamentals, and sector readiness; (ii) use of ADB's subsovereign, own recourse, and guarantee operations and private sector instruments; (iii) new financial instruments, approaches, and procedures being adopted by ADB (IEI); (iv) TA for knowledge products.</p> <p>Overall strategy sector strategies are 1. Energy: Further power reforms to reduce losses and fiscal drain of public power agencies. 2. Finance: Reforms to improve (i) financial market</p>

COS 1998	CSP 2001–2003	CSPU 2002–2004/ CSPU 2004–2006	CSP 2005–2007
<p>LGUs to access commercial and public funds and official development assistance.</p> <p>Environment: (i) invest in support for sustainable natural resource management and environmental protection; (ii) provide policy and capacity building in local or community resource management; enhance NGO/LGU participation in development project planning, decision making, implementation, and monitoring.</p>	<p>sanitation, and land use management in urban development projects.</p> <p>4. Governance: Address governance concerns by improving functioning of COA and public procurement; accelerating privatization and restructuring public enterprises; continuing dialogue on project performance; strengthening the decentralization process; supporting greater private sector participation, NGOs, and civil society; extending further efforts in the southern Philippines, especially areas affected by civil strife and support for BIMP-EAGA; supporting reform initiatives for controlling money laundering.</p> <p>5. Gender: Through ADB operations assist in closing gender gaps, particularly in the southern Philippines in key areas such as access to education, health and water, economic opportunity, and finance; and through increased use of community participation approaches.</p> <p>6. Private sector: assist the Government in its privatization program and developing the private sector enabling environment including financing infrastructure projects that address critical bottlenecks such as power generation and transmission, water supply and wastewater treatment, solid waste management, transport, and rural telecommunications; financial intermediation including capital market development and financial infrastructure, deregulation of industry, trade and investment, privatization of selected GOCCs, and improved capacity for BOO/BOT financing.</p> <p>7. Regional cooperation: Within the BIMP-EAGA area assist in developing roads and airports, in social development, capacity building initiatives for local governments, and development of private sector activity; resume assistance for capacity building of the Mindanao Economic Development Council as coordinating office for BIMP-EAGA and developing SMEs in the BIMP-EAGA area.</p>		<p>intermediation, regulation, and resolution of NPLs; and (ii) efficiency in rural banking, and access to operating and investment finance for rural SMEs. Investments in SME development and support.</p> <p>3. Governance: Reforms to (i) improve resource mobilization and budget operations of LGUs to reduce LGU dependence on national government transfers and improve LGU service delivery; (ii) improve transparency and reliability in the rule of law, and address problems of corruption</p> <p>4. Urban development, water supply and sanitation: investments in water supply improvement to Metro Manila, and urban services for the poor in Metro Manila.</p> <p>5. Agriculture and rural development: investments in integrated coastal resource management and rural road development.</p>

BIMP-EAGA = Brunei, Indonesia, Malaysia, Philippines-East ASEAN Growth Area; BOO/BOT = build-own-operate/build-operate-transfer; COA = Commission on Audit; COS = country operational strategy; CSP = country strategy and program; CSPU = country strategy and program update; DOH = Department of Health; EA = executing agency; GOCC = government-owned and -controlled corporation; IEI = innovation and efficiency initiative; LARP = Land Acquisition and Resettlement Plan; LGU = local government unit; LWUA = Local Water Utilities Administration; MDG = Millennium Development Goal; MTPDP = Medium-Term Philippine Development Plan; NGO = nongovernment organization; NPC = National Power Corporation; NPL = nonperforming loan; SME = small- and medium-sized enterprise.

Source: Asian Development Bank.

## HARMONIZATION AND DEVELOPMENT PARTNER ACTIVITIES

### Box A5: Using Sectorwide and Programmatic Approaches: Examples from the Philippines, Viet Nam, and Nepal

**Philippines' Health Sector Development Program.** The program loan aimed to improve the focus of primary health care on the poor, support structural reform of sector organizations, operationalize regulatory reform, and improve governance in the sector. The project loan aimed to improve the efficiency and effectiveness of delivery of health care to the poor by focusing on investments supporting clinical practice guidelines critical to the health of the poor using the sector loan approach. Interventions supported the implementation of practices in selected sites supporting streamlined services (convergence sites), and in DOH, PhilHealth, and other central and regional agencies. The project loan was released based on performance-based allocations to demonstrate the effectiveness and cost-efficiency of the Health Sector Reform Agenda (HSRA) in the selected provinces and thus provide the foundation for expanding the HSRA package into other provinces. Prior provincial expenditure reviews carried out with European Union assistance assessed identifiable outputs and achievements in provinces; this was a key innovation in assessing provincial readiness for implementing the reforms through investments. The subprojects followed ADB guidelines for procurement and disbursement.

**Viet Nam's Poverty Reduction Program.** As part of Viet Nam's comprehensive poverty reduction and growth strategy, ADB is supporting the Fifth Poverty Reduction Support Credit funded by the Government and its development partners. The strategy implements poverty reduction policies, programs, and actions over the medium term against targets for specific development outcomes from 2002 to 2006. Reforms include (i) developing the regulatory framework for private sector development; (ii) securing asset ownership; (iii) recapitalizing Government-owned banks; (iv) developing the safety net for redundant workers; (v) increasing education budget allocation and access to health services; (vi) increasing maintenance of transport infrastructure; and (vii) improving public finance accountability, developing and adopting medium-term expenditure frameworks, and coordinated plans and budgets. The budget implications for increased targeted spending during the program period justified the program amount and partner contributions. Financing was released through a series of single-tranche program loans through the Government's budget and in line with jointly agreed fiduciary requirements between development partners.

**Nepal's Education Sector Program.** An alternative approach was used in Nepal's Education Sector Program, which has three single-tranche cluster programs loans to provide phased support for the Government's medium- to long-term education sector reform and restructuring. The expected outcome is a more equitable, inclusive, effective, and holistic education system. Two subprograms have so far been developed and are being implemented in accordance with the time frame and progress of the education sector reform and restructuring from 2007 to 2012. The program, involving several development partners, is financed through the Government budget and reporting system to supplement the cost associated with implementing the school sector reform plan. A joint financial agreement provides details of the responsibilities of the Government and participating development partners; the funding mechanism through the Ministry of Finance to the Ministry of Education and Sports for specific reform activities; and fiduciary requirements including procurement, reporting, monitoring and auditing, and administrative requirements. The Ministry of Education and Sports provides an annual draft procurement plan to development partners for review with procurement of works, goods, and services following procedures specific in the Government's Procurement Act 2007 and Procurement Regulations 2007.

ADB = Asian Development Bank, DOH = Department of Health, HSDP = Health Sector Development Program, PhilHealth = Philippine Health Insurance Corporation.

Sources: ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of the Philippines for the Health Sector Development*. Manila (Loans 2136-PHI [Program] and 2137-PHI [Project], for \$200 million and \$13 million, respectively, approved on 15 December); ADB. 2006. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Socialist Republic of Viet Nam for Support the Implementation of the Poverty Reduction Program III*. Manila (Loan 2262-VIE[SF], for \$15 million, approved on 5 October); and ADB. 2008. *Report and Recommendation of the President on a Proposed Asian Development Bank Fund Grant to Nepal for the Education Sector Program Cluster (Subprogram II)*. Manila.



**Table A5: Other Development Partner Assistance**

<b>Development Partner</b>	<b>Key Sectors</b>	<b>Financing/Official Development Assistance</b>
Australia	Fiscal management, investment in infrastructure, rural development/ community assistance, basic education, human resource development, peace in Mindanao, counterterrorism, disaster protection and preparedness, land administration	2007–2008: A\$100.6 million in estimated aid flows.
Austria	Infrastructure—bridges, development of centers of excellence in modern manufacturing	\$15.2 million for an ongoing loan project (as of 31 December 2007)
Belgium	Agrarian reform, light rail transit rehabilitation, and modernization	\$17.3 for an ongoing loan project
Canada	Governance—decentralization, human rights, legal and judicial development, public sector performance and accountability, private sector development, child welfare, empowerment of women, support for civil society, peace-building in Mindanao, disaster relief, rural development	2007: C\$16.2 million expected 2006: C\$16.2 million expected
Peoples Republic of China	Agriculture, irrigation, fisheries, infrastructure, housing, mineral resource development, energy, trade facilitation	\$210.0 million for ongoing loan projects
Czech Republic	Infrastructure: hydropower and disaster relief, rebuilding	
European Commission	Agrarian reform, biodiversity conservation, rural development, support for Mindanao, governance, health sector reforms, trade facilitation	2007–2010: €61.0 million
Germany	Local government decentralization, local government finance, private sector development, dual education and training, health, water, environment—industrial pollution control and forest and mangrove management, fisheries, eco-industrial development, rural development, poverty reduction, social welfare—human rights, peace-building, support for Mindanao	2007–2008 allocation: €24.6 million, of which €0.0 million are new commitments  \$130.0 million for ongoing loan projects
International Fund for Agricultural Development	Rural microenterprise promotion, community development and resource management support for Mindanao and Cordillera	\$47.0 million for ongoing loan projects
International Finance Corporation	Local government finance	
Japan	Infrastructure—airports, ports, railroads, roads and bridges, energy, flood control, integrated infrastructure, irrigation, and solid waste management, agriculture, fisheries, secondary education, environment and rural development, local government administration, ecotourism, disaster mitigation, peace building and support for Mindanao	\$3,075.0 million for ongoing loan projects
Kuwait	Road improvement in Mindanao	\$19.8 million for an ongoing loan project

<b>Development Partner</b>	<b>Key Sectors</b>	<b>Financing/Official Development Assistance</b>
Republic of Korea	Infrastructure—airports, rail and roads, environment, sanitation, health and medical care, information technology	2007–2009: up to \$300.0 million planned; \$92.3 million in ongoing loan projects
Nordic Development Fund	Urban services for Mindanao, technical education	\$16.5 million for ongoing loan projects
Netherlands	Energy, health, and medicine	\$20.1 for an ongoing loan project
New Zealand	Natural resource management, indigenous people, governance, conflict resolution and peace building, human resource development, disaster relief	2007/2008 allocation: NZ\$4.0 million
OPEC	Technical education	\$7.0 million for an ongoing loan project
Saudi Arabia	Roads improvement in Mindanao	\$19.9 million for an ongoing loan project
Spain	Agriculture, agrarian reform, social support, environment, education, infrastructure—ports and bridges, remote island development	\$26.0 million for an ongoing loan project
Sweden	Environment, local government authorities	\$10.0 million for an ongoing loan project
United Nations	Child welfare, environment—biodiversity, climate change, forestry, coastal resources, renewable energy and solid waste management, crisis prevention and recovery, energy, water, government administration, governance, health, indigenous people, judicial development, peace building, poverty reduction, achieving the Millennium Development Goals (MDGs), microfinance, microentrepreneurship	
United Kingdom	Infrastructure—bridges	\$357.1 million for ongoing loan projects
United States	Economic reform—fiscal reform, trade facilitation, microfinance, banking and capital market reform, government administration—national and local, governance, legal and judicial development, private sector development, biotechnology, child welfare, conflict management, education, environment, fisheries, ecotourism, health, social welfare—anti-human trafficking, energy, water, support for Mindanao	For US fiscal year 2008: approximately \$80.0 million subject to final Washington approval (as of 28 February 2008)
World Bank	Economic reform—fiscal reform, tax administration, government administration—national and local, infrastructure—transport, energy, irrigation, roads, water and sewerage, agriculture, agrarian reform, environment, sustainable development, education, health, poverty reduction, judicial development, social welfare, peace building, support for Mindanao	\$1,017.7 million for ongoing program and project loans

\$ = United States dollar, C\$ = Canadian dollar, NZ\$ = New Zealand dollar, OPEC = Organization of Oil Exporting Countries, US = United States.

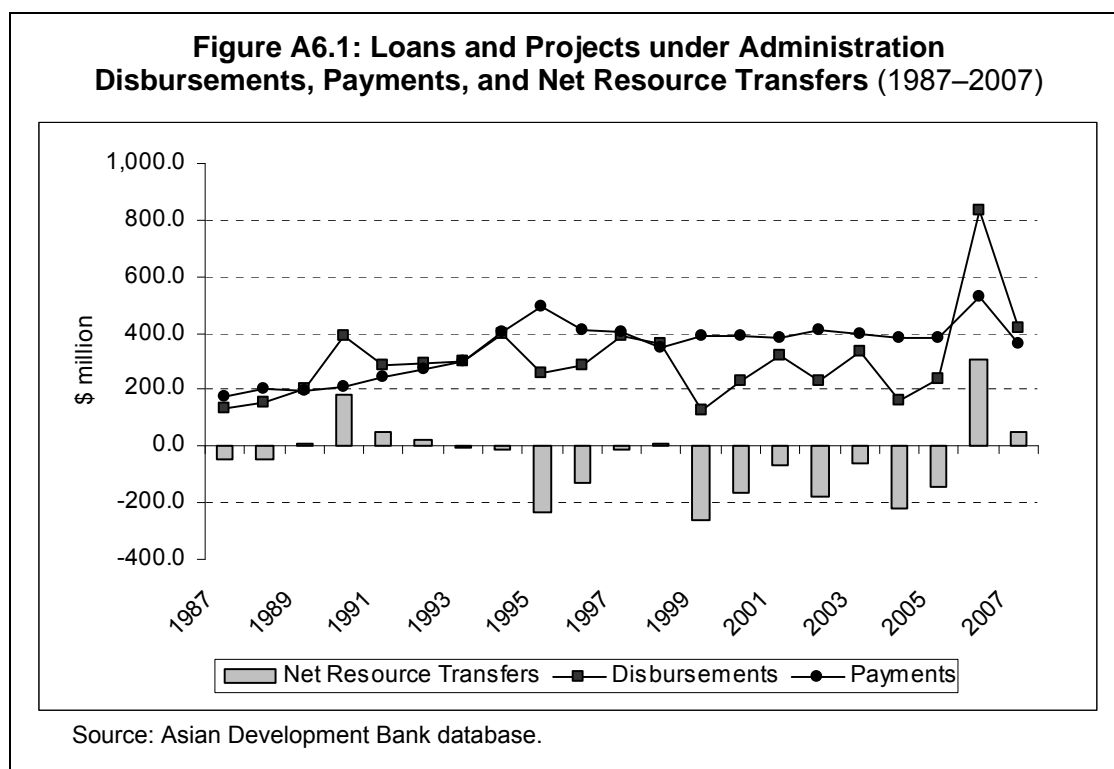
Source: Operations Evaluation Mission.

## ASIAN DEVELOPMENT BANK OPERATIONS, PORTFOLIO, AND TRENDS

### Table A6.1: Evaluated Public Sector Projects/Programs (2002–2007)

Loan Number	Project Name	Approval Date	Completion Date	Loan Amount (\$ million)	PPER No./ Circulation Date	Rating
<b>Energy</b>						
1042	Sixteenth Power (Masinloc Thermal Power Project)	30 Oct 1990	18 Jun 1998	200.0	PEO605 Oct 2002	S
<b>Finance</b>						
1363	Capital Market Development Program	22 Aug 1995	31 Dec 1999	150.0	PEO625 Sep 2003	PS
1435(SF)	Rural Microenterprise Finance Project	23 Apr 1996	31 Dec 2002	20.0	PEO686 Oct 2006	S
<b>Health, Nutrition, and Social Protection</b>						
1331	Women's Health and Safe Motherhood Project	10 Nov 1994	16 Oct 2002	54.0	PE 704 Jul 2007	PS
<b>Multisector</b>						
1033(SF)	Second Palawan Integrated Area Development Project	27 Sep 1990	30 Dec 1998	25.0	PEO611 Dec 2002	PS
1034				33.0		
<b>Water Supply, Sanitation, and Waste Management</b>						
1056(SF)	Metropolitan Cebu Water Supply	29 Nov 1990	Oct 1997	16.0	PEO615 Dec 2002	S
1057				6.0		

PPER = project/program performance evaluation report, No. = number, PS = partly successful, S = successful.  
Source: Asian Development Bank database.

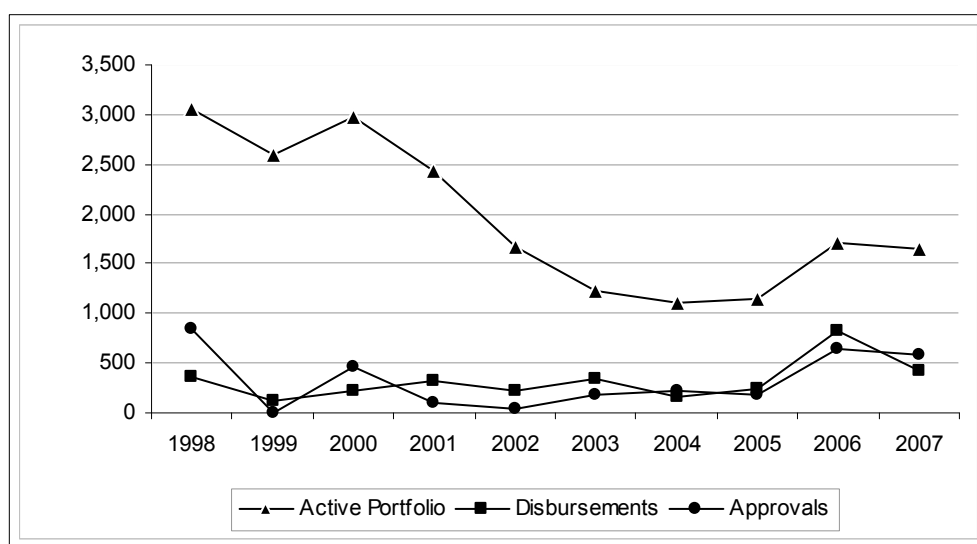


**Table A6.2: Trends in Active Loan Portfolio**

Year	Project and DFI		Program		Total (\$ billion)
	\$ billion	%	\$ billion	%	
1998	2.416	78.8	0.650	21.2	3.066
1999	2.087	80.7	0.500	19.3	2.587
2000	2.278	76.5	0.700	23.5	2.978
2001	1.662	68.2	0.775	31.8	2.437
2002	1.265	76.0	0.400	24.0	1.665
2003	1.080	87.8	0.150	12.2	1.230
2004	0.913	82.0	0.200	18.0	1.113
2005	0.804	69.7	0.350	30.3	1.154
2006	0.719	41.8	1.000	58.2	1.719
2007	0.552	33.3	1.105	66.7	1.657
ADB-Wide (2007)	33.249	83.3	6.658	16.7	39.907

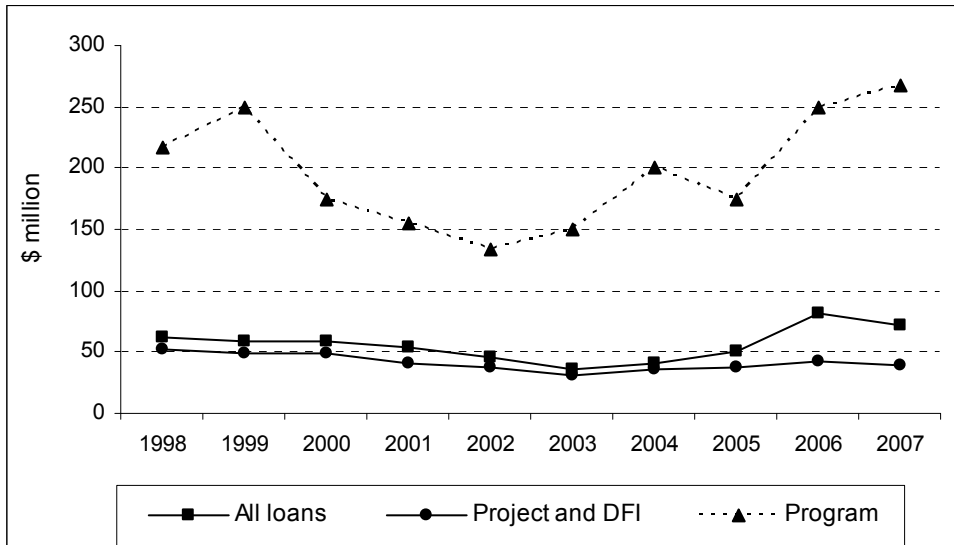
ADB = Asian Development Bank, DFI = development finance institution.

Sources: Asian Development Bank database and Operations Evaluation Mission.

**Figure A6.2: Trends in Portfolio Size and Determinants (\$ million)**

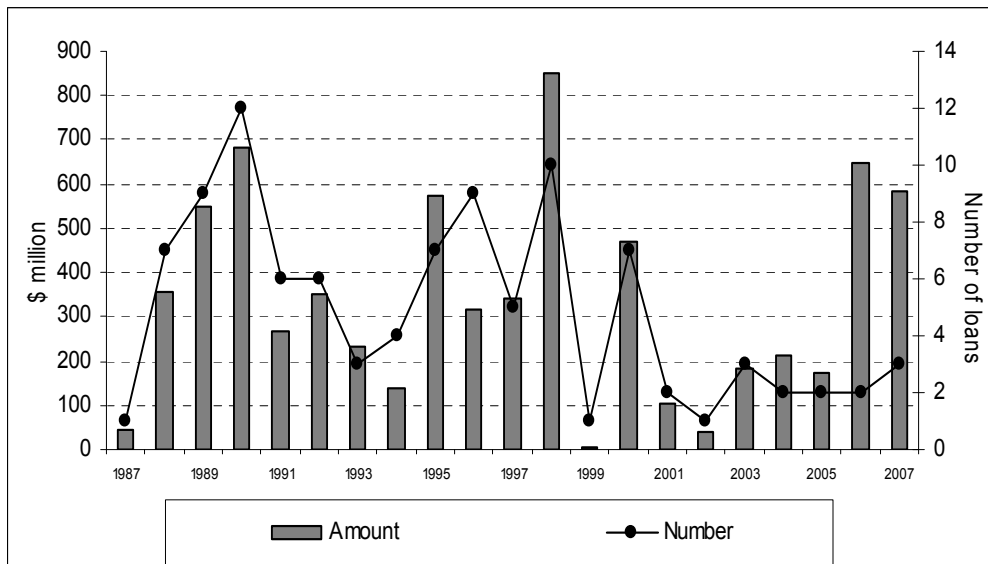
Source: Asian Development Bank database.

**Figure A6.3: Trends in Average Loan Size (1998–2007)**



DFI = development finance institution.  
 Source: Asian Development Bank database.

**Figure A6.4: Trends in Number and Amount of Loan Approvals (1987–2007)**



Source: Asian Development Bank database.

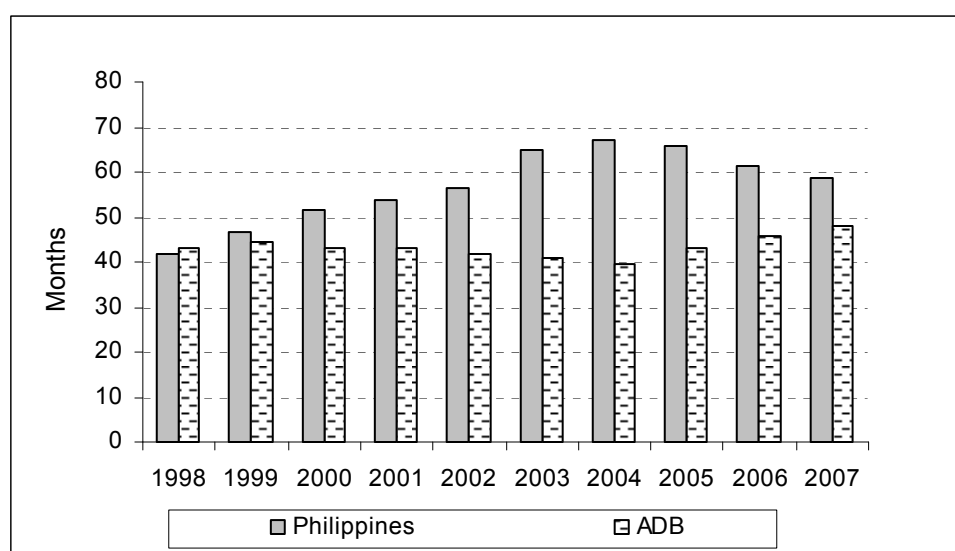
**Table A6.3: Loans and Projects under Administration for Southeast Asia Countries  
2002 and 2007**

Country	No. of Loans under Administration		No. of Projects under Administration	
	2002	2007	2002	2007
Cambodia	23	23	21	20
Indonesia	62	48	57	43
Lao PDR	24	24	23	22
Malaysia	3	1	3	1
<b>Philippines</b>	<b>46</b>	<b>20</b>	<b>34</b>	<b>20</b>
Thailand	8	1	7	1
Viet Nam	39	49	36	45
<b>Total</b>	<b>205</b>	<b>166</b>	<b>181</b>	<b>152</b>

Lao PDR = Lao People's Democratic Republic.

Sources: Asian Development Bank annual reports for 2002 and 2007.

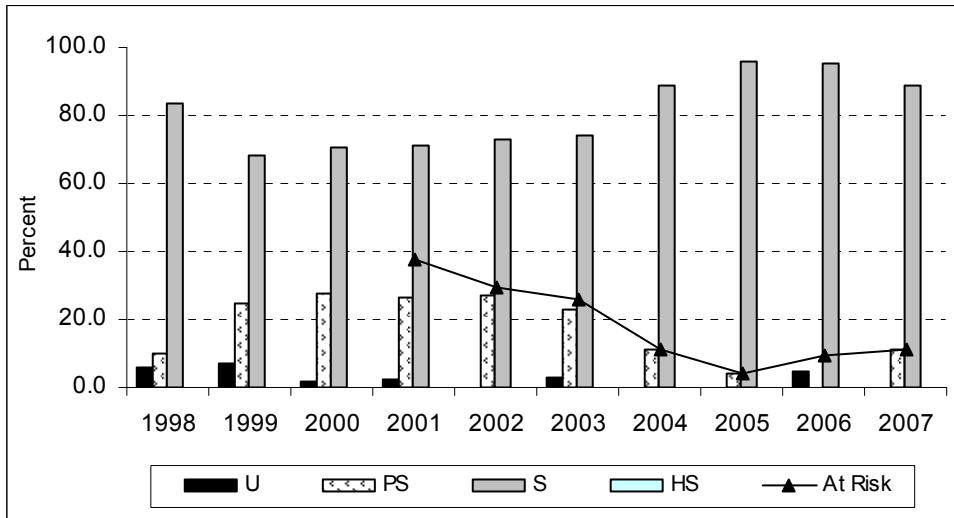
**Figure A6.5: Average Loan Age Philippines and Asian Development Bank**



ADB = Asian Development Bank.

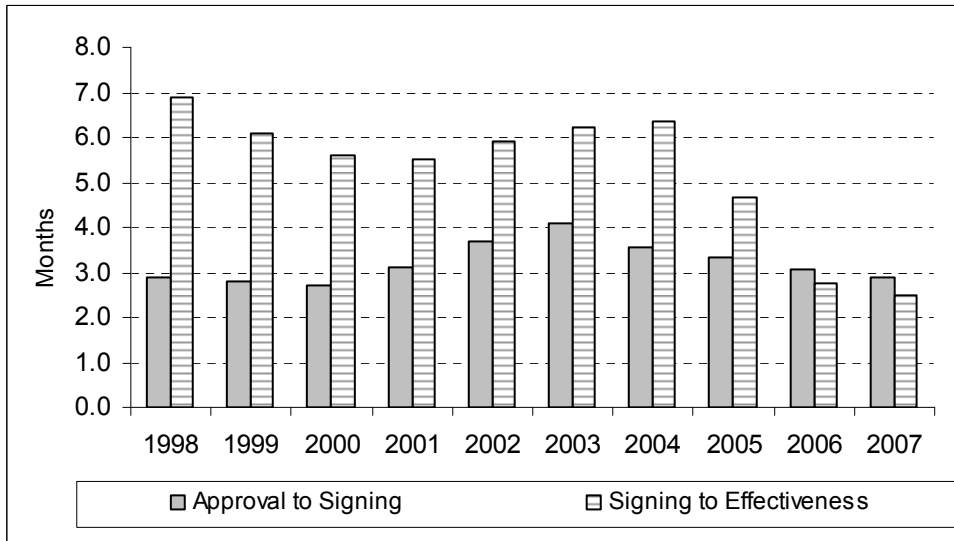
Source: Asian Development Bank database.

**Figure A6.6: Project Performance Ratings**



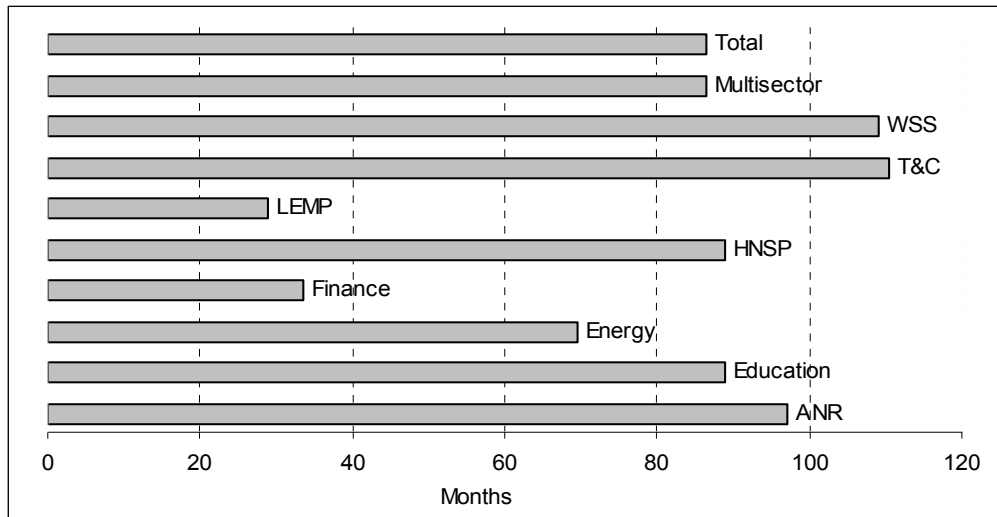
Source: Asian Development Bank database.

**Figure A6.7: Start-Up Performance (months)**



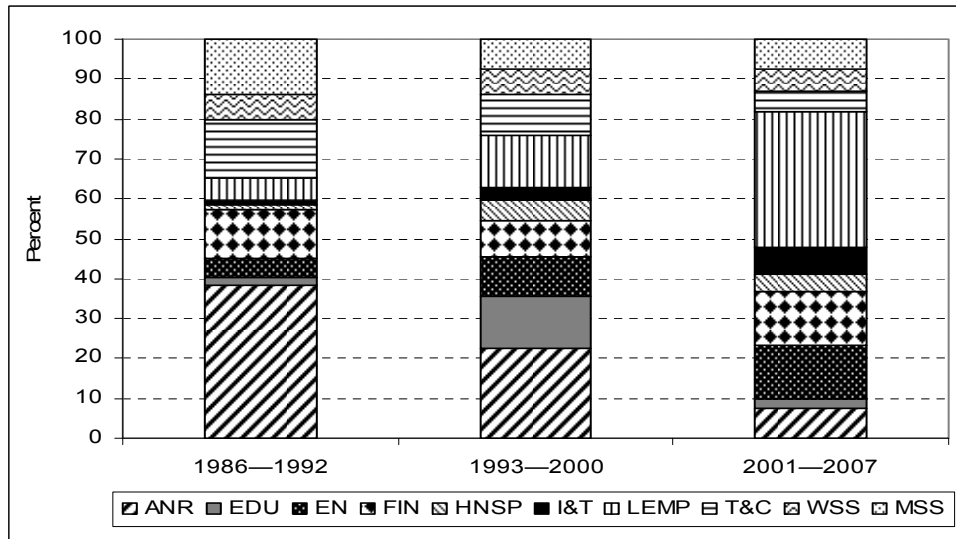
Source: Asian Development Bank database.

**Figure A6.8: Average Implementation Period per Sector as of December 2007**



ANR = agriculture, environment, and natural resources; HNRP = health, nutrition, and social protection; LEMP = law, economic management, and public policy; T&C = transport and communication; WSS = water supply and sanitation.  
 Source: Asian Development Bank database.

**Figure A6.9: Technical Assistance by Sector Allocation (%)**



ANR = agriculture, environment, and natural resources; EDU = education; EN = energy; FIN = finance; HNRP = health, nutrition, and social protection; I&T = industry and trade; LEMP = law, economic management, and public policy; MSS = multisector; T&C = transport and communication; WSS = water supply and sanitation.  
 Source: Asian Development Bank database.



## PHILIPPINES SOCIOECONOMIC TRENDS, GOVERNMENT RESPONSE, AND ISSUES

1. The 2003 country assistance program evaluation was prepared toward the end of a period of economic difficulty, with the Philippines emerging from the effects of the Asian financial crisis. By the end of 2007, the country had managed to achieve 6 consecutive years of gross domestic product (GDP) per capita growth at annual rates above 2%.<sup>1</sup> While slower than other Asian countries, this is notable considering the country's poor record at sustaining growth since the 1980s; the growth spurt that occurred before the Asian crisis lasted only 4 years.<sup>2</sup>
2. The economy has so far displayed resilience since 2002, with economic growth accelerating over the years to 7.3% in 2007.<sup>3</sup> This development is due largely to sustained global growth and the growing volume of income remittances from migrant workers. Since the Asian crisis, the Philippines's growth has increasingly revolved around these dollar inflows, which have steadily increased to 11% of GDP, up from 7% in 1997 and less than 3% in 1990 (Figure A7.1). These remittances have driven growth and helped shield the economy from various external (e.g., supporting the balance of payments against the impact of high oil prices in particular) and internal shocks (e.g., periodic political uncertainty) and through the peso's appreciation, which contributed to keeping inflation low.
3. Moreover, favorable developments have accompanied recent economic expansion:
  - (i) Low to moderate inflation has prevailed with the headline inflation rate remaining in single digits and generally trending downward (averaging 2.8% in 2007). This development has been credited to the benefits of trade liberalization and improved monetary management, and more recently, an appreciating currency.
  - (ii) Relatively low real interest rates have been below 3% since 2001. This reflects high domestic liquidity, a combination of low interest in domestic private investment on the demand side and a protracted period of bad asset cleanup by banks on the supply side. Improved fiscal performance since 2005 eased financing requirements even more.
  - (iii) Balance of payments was robust, with deficits in the current account reversing into surpluses by 2003 as increased income remittances from migrant workers made up for shortfalls in the trade account. A string of current account surpluses over 5 years (2003–2007) is unprecedented in the country's economic history. This contributed to the buildup in the country's foreign exchange reserves to \$34 billion by the end of 2007, equivalent to 6 months import cover and over three times maturing short-term debts.

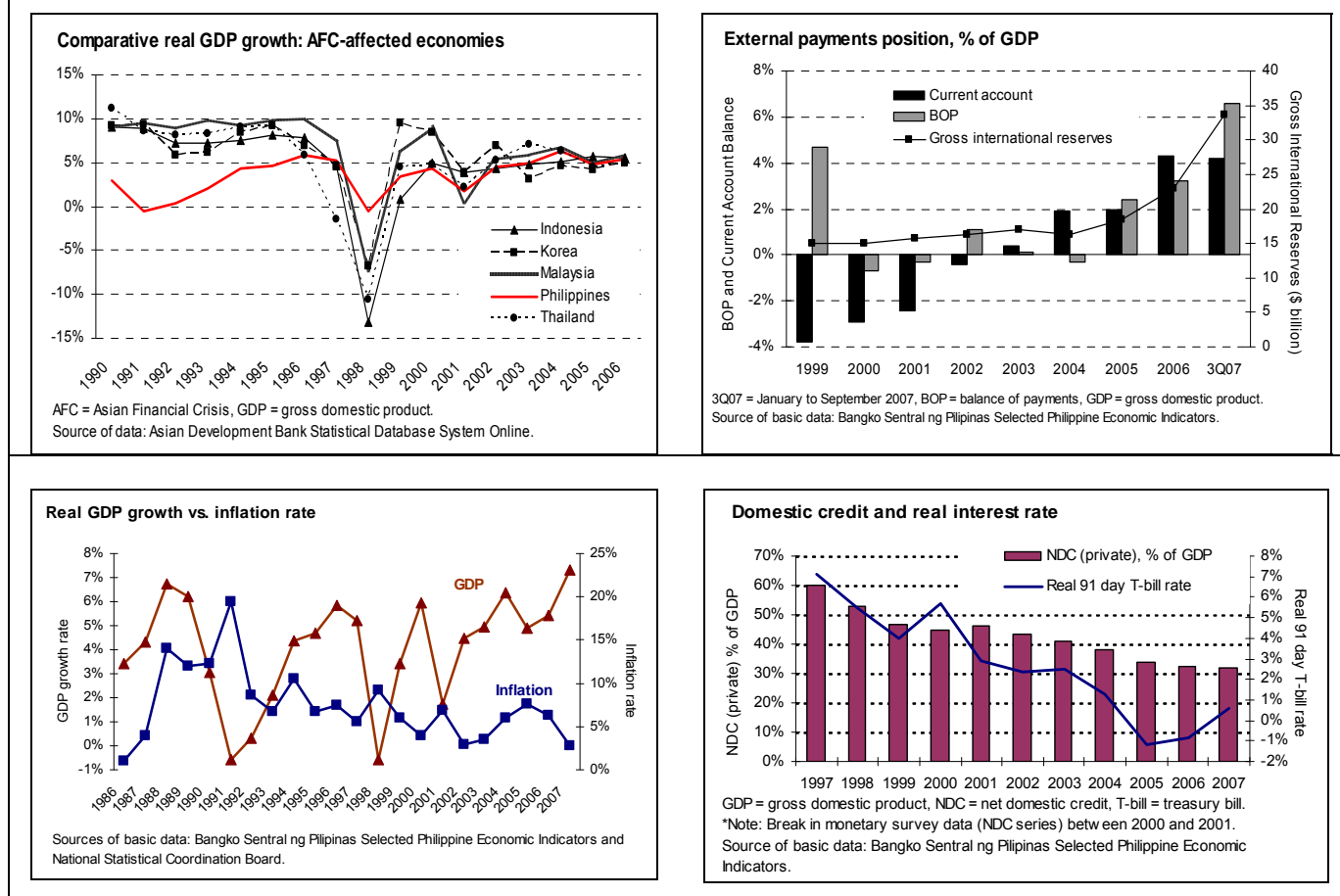
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<sup>1</sup> Based on data from the International Monetary Fund World Economic Outlook Database, December 2007.

<sup>2</sup> From 1994 to 1997, average annual growth rate of GDP per capita was 2.9%, slightly below the estimated 3.1% average growth rate from 2002 to 2007.

<sup>3</sup> The gross national product measure, which reflects factor payments (including remittances from migrant workers), typically yields a higher growth rate of as much as one percentage point.

Figure A7.1: Selected Macroeconomic Indicators



4. Significant concerns include the following:
- (i) The fiscal problem persisted through 2004, primarily from reduced tax collections, led to the budget deficit widening to more than 5% of GDP in 2002 before expenditure compression kept it below 5%. This, in turn, contributed to the further buildup of an already high debt ratio (peaking at 78% of GDP in 2004).<sup>4</sup> The drag on the fiscal side had broad implications for the economy—from investor confidence to public spending on goods and services needed to attract investments and to reduce poverty. A package of reforms, including power rate increases and two major tax measures (adjustments in value-added tax and excise taxes) implemented since late 2004 turned the situation around—the tax effort rose from 12.4% in 2004 to 14.3% in 2006 (falling however to 14% in 2007) and the overall fiscal deficit fell to 0.1% of GDP by 2007—and helped to boost investor confidence.
  - (ii) Sluggish investments are reflected in declining investment ratios, the lowest in the region, and the positive savings–investment gap. The lack of investments helps to explain low domestic credit growth and low imports that have contributed to the narrowing of the trade gap. Unfortunately, as growth studies reveal, investments are the major channels for technology transfers that enable

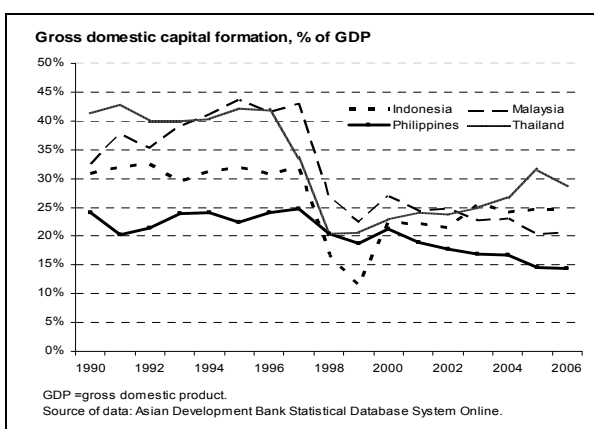
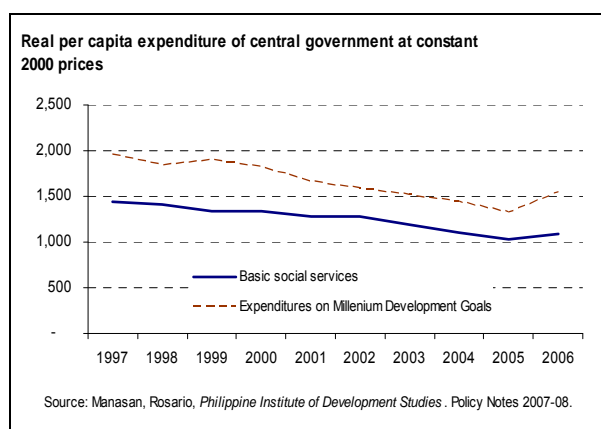
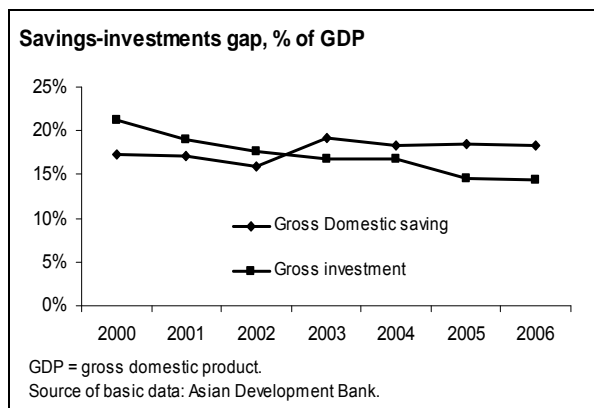
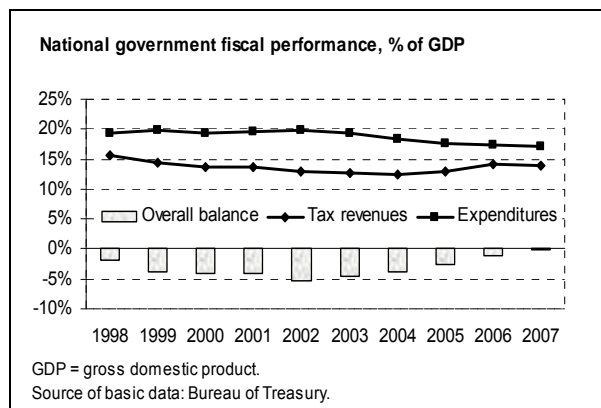
<sup>4</sup> Credit Suisse research on the Philippines shows the Government's net debt as a percentage of GDP about 20 percentage points higher than the S&P BB- median (Karacadag, Cem. April 2007. *Fiscal and Interest Rate Outlook, Emerging Markets and Economics Research*. Philippines).

economies to scale higher growth for a given stock of capital and labor inputs. Investment bottlenecks include macroeconomic instability, inadequate infrastructure, and weaknesses in the governance structure. While sentiments improved following the dramatic fiscal adjustment, investment as a share of GDP has yet to increase significantly.

- (iii) The slow process of asset cleanup and banking recapitalization has contributed to banks' reduced risk appetite, which when combined with weak loan demand resulted in a prolonged period of slow lending growth. The implementation in 2003 of the Special Purpose Vehicle Act helped banks to gradually bring down the average bad asset ratio to single digits by 2005. Nevertheless, lending has remained weak, with real growth of about 4% in 2007, from negative or flat real annual growth since 2002.
- (iv) High export concentration (almost 70%) in electronics products has persisted since 1997. These unfortunately have been a low value-added (approximately 30%) segment and tend to track the global electronics industry cycle. The decline in investments has contributed to an observed premature "hollowing out" of manufacturing. This may be seen in the loss of competitiveness of other traditional manufactures such as garments—its share of total exports declined from over 20% in the early 1990s to less than 6% by 2006.
- (v) Unsatisfactory job creation and loss of skilled workers is reflected in labor underutilization, which has generally remained above 25% in the past 10 years, dipping to 24.4% in 2007.<sup>5</sup> The lack of domestic job opportunities, coupled with rising overseas labor demand offering salaries several times those available locally, has encouraged migration. In 2006, the stock of Filipino migrant workers was estimated to number 8.2 million (about a fourth of the current labor force). The deployment of skilled workers, which had been rising in the early years of the millennium, has nevertheless fallen noticeably since 2005.
- (vi) The muted impact of growth on poverty reduction has been partly blamed on high income inequality and disparities in the populace's access to productive assets.

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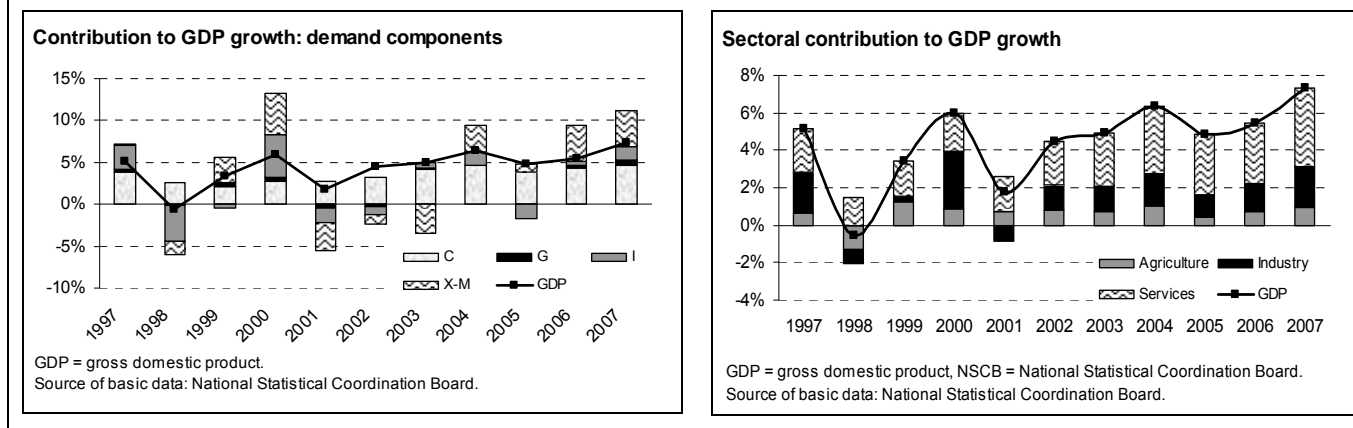
<sup>5</sup> Refers to the sum of unemployment and underemployment rates. Based on the October series of National Statistics Office's Labor Force Survey, National Statistics Office adopted a new definition of unemployment starting in April 2005. Hence, data before and after the change in definition are not directly comparable.

**Figure A7.2: Fiscal, Savings-Investment, and Capital Formation Indicators**

5. Overall, given limited contributions of government spending, investments, and at times, even exports, the economy has increasingly depended on private consumption spending to fuel growth. In the 5 years to 2007, private consumption spending, financed notably by overseas Filipino worker remittances, accounted for 75% of GDP growth on average. While structural reasons indicate remittance flows should be sustained given continuing opportunities for Filipinos to work abroad,<sup>6</sup> the heavy reliance on consumption to fuel growth has raised concerns about the quality and sustainability of growth and long-term impact.

6. **Structural Changes to the Economy.** Over the past years, the more labor-intensive services sector has expanded rapidly, growing on average 6.5% from 2001 to 2007, outpacing average GDP growth of 5%. The sector, which benefited from reforms in the 1990s (e.g., telecommunications, banking, transportation, retail trade) and includes the fast-growing business process outsourcing industry, has been accounting for from 50% to as much as 66% of GDP growth since 2002 (Figure A7.3). Sub-industries such as financial services and real estate have also recently benefited from the remittance phenomenon as banks have become more successful in capturing and leveraging off these flows.

<sup>6</sup> These include trends in globalization (greater labor mobility), large income differences between the Philippines and host countries, as well as differences in demographic profiles between developed countries (aging) and the Philippines (relatively young population).

**Figure A7.3: Sectoral Contribution to Gross Domestic Product Growth**

7. While service sector growth continues to accelerate (8.7% in 2007), an emerging issue is the diminishing supply of qualified workers to meet the sector's demands. This concern is ultimately linked to the quality and effectiveness of education. A recent study identified a mismatch as the education sector has not been able to produce the skills set required by the labor market,<sup>7</sup> posing a long-term risk to some of the economy's growth drivers.

8. In contrast, agriculture and industry, particularly manufacturing, have on average tailed GDP growth from 2001 to 2006. The fortune of the agriculture sector, which employs over a third of the labor force,<sup>8</sup> is largely dependent on good weather. At its worst in recent memory, a severe El Niño-induced drought in 1998 reduced farm output by 6.4%. From 2001 to 2007, the sector managed to grow an average 3.9%. Sadly, even as agricultural productivity has remained low, the dominant crop, i.e., rice, continues to enjoy trade protection.<sup>9</sup> The country's trade policy has contributed to high domestic food prices, which have in turn raised labor costs and negatively affected the country's overall competitiveness. Development of the sector would require government to spend on rural infrastructure and rethink its policies on land reform; trade; and the role of the National Food Authority, which currently assumes both regulatory and trading functions.

9. Industrial growth, which averaged 3.6% during the period—even lower than agricultural output—has been lackluster due to a prolonged slump in construction (following the Asian crisis and limited government spending in infrastructure) and the observed premature decline of manufacturing.<sup>10</sup> While public and real estate-related construction has started to recover, manufacturing continues to stagnate. Outside of electronics production for exports, domestic manufacturing has been consigned to low productivity, low technology, and scale products.<sup>11</sup> Manufacturing establishments in the Philippines are predominantly small- and medium-sized enterprises, which face various small firm constraints that affect their efficiency and ability to

<sup>7</sup> Son, Hyun H. *The Role of Labor Market in Explaining Growth and Inequality: The Philippine Case*. Manila.

<sup>8</sup> Based on National Statistics Office *Labor Force Survey*. October 2007 series.

<sup>9</sup> Rice is subject to quantitative restriction. See Executive Order 627 (June 2007).

<sup>10</sup> Joseph Lim notes that unlike other developed countries where services became the engine of growth only after high industrialization was achieved, the premature stop in the rise of industry in the Philippines may have affected the country's ability to achieve higher growth. See *Background Report on Trade and Investment*, Available: <http://www.adb.org/Documents/Events/2007/Country-Diagnosis-Analysis-Binding-Constraints/default.asp>

<sup>11</sup> The study notes that low technology and scale domestic manufacturing exists alongside a high technology export sector (i.e., electronics), which differs from the experience of other countries in the regions.

compete, such as access to financing, technology, market information, raw material sourcing, and supply chain integration.

## A. Poverty, Social Trends, and Millennium Development Goals

10. **Worsening Poverty.** Lack of progress in poverty reduction efforts (and high inequality) in the face of accelerating economic growth remained the key development challenge in the past decade. Based on available survey data since 1997, poverty incidence is estimated to have risen from 25% of the population in 1997 to 28% in 2006, with the number of poor increasing by over 5.4 million between the two periods.<sup>12</sup> Wide regional disparity is indicated by the poverty incidence in the four poorest regions, which is roughly four times that of Metro Manila. Further, government data show that poverty incidence in some of the poorest regions worsened between 2003 and 2006.<sup>13</sup> Moreover, income inequality, as measured by the Gini coefficient, changed only slightly from 0.4605 in 2003 to 0.4564 in 2006, and is high relative to Asian neighbors (and more in line with Latin American countries).

11. Major social sector trends in the past 10 years that help to explain the lack of progress in poverty reduction include the following:

- (i) Annual population growth is 2.1%, higher than in many other countries in the region.<sup>14</sup> Despite targets under the Medium-Term Philippine Development Plan (MTPDP) to reduce population growth (to 1.9% in 2005–2010), a coherent policy has yet to be put in place.
- (ii) Family incomes, as shown in Table A7.1, based on survey data, declined by 2.8% between 2003 and 2006 despite rising real per capita GDP. While the source of discrepancy between the family income and expenditures survey and national income accounts data remains unclear, the implications are that the statistics need to be studied more closely and statistical institutions strengthened. More fundamentally, the growth strategy needs to be reviewed to ensure that it filters to households, especially in the poorer segments.

**Table A7.1: Results of 2006 Family Income and Expenditures Survey**  
(2003 = 100)

Item	2006	2003
Number of families ('000)	17,403	16,480
Total family income (₱ billion)	2,478	2,437
Total family expenditure (₱ billion)	2,112	2,038
<b>Average family income (₱'000)</b>	<b>142</b>	<b>148</b>
<b>Average family expenditures (₱'000)</b>	<b>121</b>	<b>124</b>

Source: National Statistics Office.

- (iii) Unemployment remained above 7% of the labor force since 2004, falling to 6.3% only in 2007. The relatively high unemployment rate is coupled with declining labor force participation (63% in 2007, down from 67% in 2003) and high

<sup>12</sup> See Balisacan. 2008. Poverty reduction: What we know and don't. *University of the Philippines UP Centennial Lecture Series*. (31 January). Government statistics released in early March 2008, also based on the 2006 Family Income and Expenditures Survey (available: [www.nscb.gov.ph](http://www.nscb.gov.ph)), similarly showed that poverty incidence among the population rose from 30% in 2003 to 32.9% in 2006, not much changed from the 33% poverty incidence in 2000.

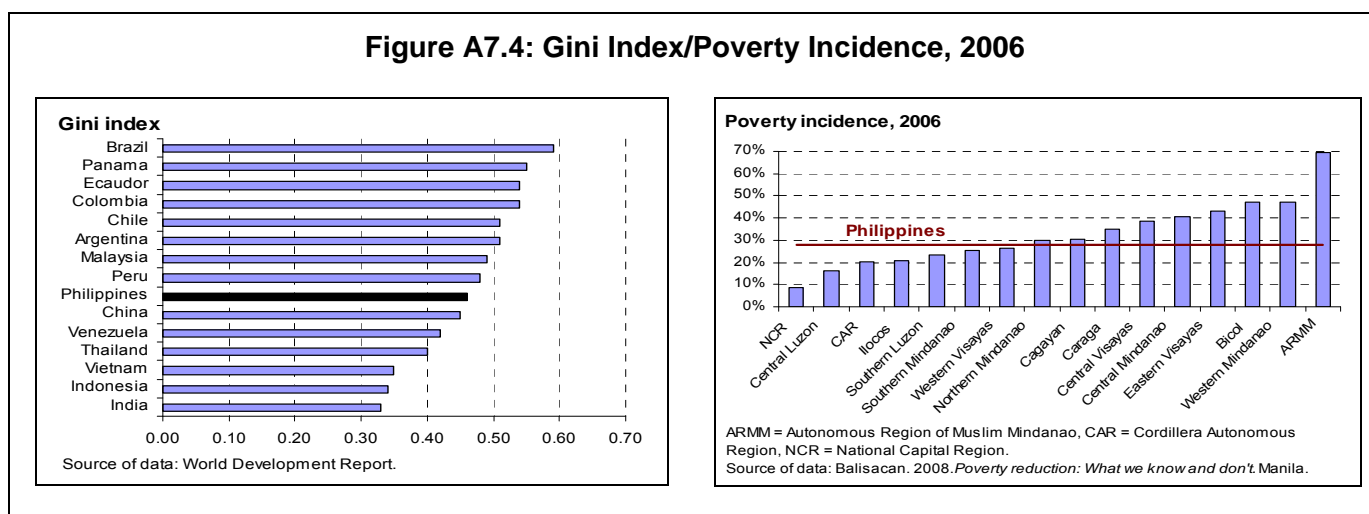
<sup>13</sup> These include Autonomous Region of Muslim Mindanao (ARMM), Region IV-B, Region V, Region VIII. Virola, Romulo. 2008. *2006 Official Poverty Statistics*. Manila (5 March). Available: [www.nscb.gov.ph](http://www.nscb.gov.ph)

<sup>14</sup> Data from ADB. 2007. *Key Indicators 2007*. Manila shows 1997–2006 average population growth of 0.6% in the Republic of Korea, 0.8% in Thailand, and 1.1% in Indonesia. Malaysia's 10-year average population growth (2.3%) is higher due to a spike in the population data in 2000, showing a 3.4% growth rate.

underemployment (at 18.1% in the 2007 survey, falling from a high of 21% in 2005). The growing migration of Filipino workers has helped to overcome insufficient domestic job creation. This has provided income support to families left behind but is widely recognized to carry high social costs for families, especially with women constituting the majority (60% to 75%) of deployed workers annually.

- (iv) Public expenditure compression, due to the Government's fiscal problem, has resulted in declining government spending on critical public goods and services, with for example the share of basic social sector spending in total expenditures dipping from 27% in 1998 to 18% in 2005.<sup>15</sup> Issues related to the effectiveness and accessibility of public services, i.e., providing the appropriate level and quality of services to those who are most in need, require attention as well.
- (v) Uneven progress in accomplishing the Millennium Development Goals (MDGs) with data showing national progress for measures related to poverty reduction, child mortality, combating diseases, and environmental sustainability. Subnational progress has been uneven with Mindanao having the most lagging regions. In terms of government spending, not only has real government MDG spending been on a downtrend but a cumulative financing gap is estimated ranging from ₱351 billion to ₱448 billion for attaining the 2015 MDGs.<sup>16</sup>

**Figure A7.4: Gini Index/Poverty Incidence, 2006**



12. Thus, priority development issues, trends, and MDG-related needs include (i) improving accessibility to economic opportunity in areas with high poverty incidence, and especially infrastructure that facilitates access to markets; (ii) focusing on the agriculture sector, including higher income-earning opportunities in the sector and backward-linked, rural-based value adding opportunities; (iii) improving health and education among the poor; and, (iv) providing a more coherent social protection strategy and better targeting social spending.<sup>17</sup> Likewise, improving the ability of local government units to plan, finance, and carry out devolved social sector functions is critical to facilitate the construction, operation, and maintenance of rural and small town infrastructure; and the provision of essential social services.

<sup>15</sup> Manasan, Rosario. 2007. *Risks and Opportunities in Securing Increased Resources for MDGs at the National Level*. Manila (Philippine Institute for Development Studies [PIDS] Policy Notes 2007–08, December).

<sup>16</sup> Manasan, Rosario. 2007. *Financing the Millennium Development Goals: The Philippines*. Manila (PIDS DP 2007–06, June).

<sup>17</sup> World Bank. 2007. *Philippines: Invigorating Growth, Enhancing its Impact*. Washington, DC (Report 39226-PH, May).

Table A7.2: Economic Indicators

Item	2000	2001	2002	2003	2004	2005	2006	2007
<b>Economic Growth (1985 = 100)<sup>a</sup></b>								
GNP	7.1	2.3	4.2	5.9	6.9	5.3	6.1	7.8
GDP	6.0	1.8	4.4	4.9	6.4	4.9	5.5	7.3
By Sector								
Agriculture	4.3	3.7	4.0	3.8	5.2	2.0	3.8	5.1
Industry	9.0	(2.5)	3.9	4.0	5.2	3.8	4.6	6.6
Services	4.4	4.3	5.1	6.1	7.7	6.8	6.7	8.7
By Expenditure								
Personal Consumption	3.5	3.6	4.1	5.3	5.9	4.8	5.5	6.0
Government Consumption	6.1	(5.3)	(3.8)	2.6	1.4	1.6	6.1	10.0
Capital Formation	5.5	(7.3)	(4.3)	3.0	7.2	(8.8)	2.7	9.3
Exports	17.0	(3.4)	4.0	4.9	15.0	4.8	11.2	3.1
Imports	4.3	3.5	5.6	10.8	5.8	2.4	1.9	(5.4)
(P billion)								
GDP (current prices)	3,355	3,631	3,964	4,316	4,872	5,438	6,033	6,651
GNP (current prices)	3,566	3,877	4,219	4,631	5,248	5,885	6,570	7,275
GDP (1985 = 100)	973	990	1,034	1,085	1,154	1,210	1,276	1,370
GNP (1985 = 100)	1,038	1,061	1,106	1,171	1,252	1,319	1,400	1,509
GDP per capita (\$)	—	909	957	967	1,038	1,158	1,352	1,625
Contribution to Growth (GDP) (%)								
By Sector								
Agriculture	14.6	41.8	17.9	15.3	16.1	8.2	13.4	13.0
Industry	51.8	(50.2)	29.6	27.4	27.4	25.7	27.4	29.3
Services	33.6	108.4	52.5	57.3	56.5	66.1	59.2	57.7
By Expenditure								
Personal Consumption	46.5	157.7	72.1	84.0	72.5	77.8	78.3	64.4
Government Consumption	8.4	(24.8)	(6.6)	3.7	1.5	2.2	7.1	8.7
Capital Formation	84.2	(102.1)	(21.7)	12.4	22.6	(36.5)	8.7	21.8
Exports	118.5	(89.8)	39.4	42.9	101.7	45.9	96.1	20.5
Imports	36.7	101.1	64.7	113.9	49.6	26.6	18.1	(37.9)
<b>Investment and Saving (% of GDP)<sup>b</sup></b>								
Gross Investment	21.2	19.0	17.7	16.8	16.7	14.6	14.3	14.7
National Saving	29.4	20.8	17.3	17.2	18.6	16.6	19.3	19.9
<b>Prices<sup>c</sup></b>								
Inflation Rate (%; 2000 = 100)	4.0	6.8	3.0	3.5	6.0	7.6	6.2	2.8
Peso per \$, average	44.2	51.0	51.6	54.2	56.0	55.1	51.3	46.1
<b>Central Government Finance<sup>d</sup> (P billion)</b>								
Total Revenues	515.0	567.5	578.4	639.7	706.7	816.2	979.6	1,136.6
Total Revenues (% of GDP)	15.4	15.6	14.6	14.8	14.5	15.0	16.2	17.1
Total Expenditures (inclusive of net lending)	649.2	713.5	789.1	839.6	893.8	962.9	1,044.8	1,149.0
Overall Balance (surplus/deficit)	(134.2)	(146.0)	(210.7)	(199.9)	(187.1)	(146.7)	(65.2)	(12.4)
Overall Balance (NG) (% of GDP)	(4.0)	(4.0)	(5.3)	(4.6)	(3.8)	(2.7)	(1.1)	(0.2)
CPSB (% of GDP)		(4.8)	(5.6)	(5.2)	(4.8)	(1.9)	0.2	0.5 <sup>e</sup>
NG Debt (% of GDP)	64.6	65.7	71.0	77.7	78.2	71.5	63.8	55.8
<b>Monetary and External Accounts<sup>c</sup> (\$ million)</b>								
Current Account	(2,225)	(1,744)	(279)	288	1,628	1,984	5,347	6,351
Balance of Payments	(509)	(202)	810	115	(280)	2,410	3,769	8,576
Gross International Reserves	15,063	15,692	16,365	17,063	16,228	18,494	22,967	33,751
Total External Debt		51,900	53,645	57,395	54,846	54,186	53,367	54,938
(% of GDP)								
Current Account	(2.9)	(2.4)	(0.4)	0.4	1.9	2.0	4.5	4.4
Balance of Payments	(0.7)	(0.3)	1.1	0.1	(0.3)	2.4	3.2	6.0
External Debt	67.5	72.9	69.8	72.1	63.1	54.8	45.4	38.1 <sup>f</sup>
Debt Service Burden	8.2	9.2	10.1	10.0	8.3	7.7	6.9	5.1

— not available, CPSB = consolidated public sector balance, GDP = gross domestic product, GNP = gross national product,

NG = national government.

<sup>a</sup> National income accounts from the National Economic Development Authority.

<sup>b</sup> From International Monetary Fund.

<sup>c</sup> Data on prices and monetary and external accounts from Bangko Sentral ng Pilipinas.

<sup>d</sup> Data on Central Government Finance from Bureau of Treasury and Department of Finance websites.

<sup>e</sup> International Monetary Fund (IMF) Country Report 08/119 dated April 2008 estimates for 2007 CPSB is 0.0.

<sup>f</sup> IMF Country Report 08/119 dated April 2008 reports the 2007 external debt to GDP ratio to be 43.3%. IMF includes monitored private sector accounts such as liabilities of foreign banks in the Philippines to their headquarters, branches, and agencies and some external debt not registered with the Bangko Sentral ng Pilipinas and private capital lease agreements.

Sources: Bangko Sentral ng Pilipinas, Bureau of Treasury, Department of Finance, IMF, and National Economic Development Authority.



Table A7.3 Social Indicators

Social Indicators	Philippines	ASEAN <sup>a</sup>	DMCs <sup>b</sup>
Population (million)	88.7 (2007)	102.9 (2004)	178.7 (2004)
Population (growth rate, %)	2.1 (2006)	1.2 (1975–2004)	1.3 (1975–2004)
Labor Force (million)	35.8 (2006)	51.1 (2006)	101.9 (2006)
Labor Force (growth rate, %)	1.4 (2006)	1.1 (2006)	2.2 (2006)
Unemployment Rate (%)	7.9 <sup>c</sup> (2006)	5.1 (2006)	4.4 (2006)
Life Expectancy at Birth (years)	70.2 (2005)	68.4 (2005)	65.2 (2005)
Poverty Incidence <sup>d</sup> (% of population)	32.9 (2006)	18.6 <sup>e</sup> (1999–2003)	32.4 (1999–2003)
Infant Mortality (per 1,000 live births)	24.0 (2006)	19.3 (2004)	58.3 (2004)
Adult Literacy Rate (% of population)	92.6 (2004)	90.6 (2004)	86.4 (2004)
Youth Literacy Rate (% of population)	95.1 (2004)	98.0 (2004)	92.1 (2004)
Children Underweight for Age (% under age 5)	28.0 (1996–2004)	17.7 (1996–2004)	34.1 (1996–2004)
Sustainable Access to Improved Sanitation (% of population)	86.2 (2004)	82.7 (2004)	58.1 (2004)
Sustainable Access to Improved Water (% of population)	80.2 (2004)	91.7 (2004)	76.8 (2004)

ASEAN = Association of Southeast Asian Nations, DMC = developing member country.

<sup>a</sup> Average of Indonesia, Malaysia, and Thailand.

<sup>b</sup> For all reporting developing member countries, except Pacific countries and ASEAN.

<sup>c</sup> Source for the Philippines' unemployment rate is the United Nations 2006 *Human Development Report*. Department of Labor and Unemployment puts unemployment rate at 7.4% for January 2008.

<sup>d</sup> Percent of the population below the national poverty line.

<sup>e</sup> Indonesia only.

Sources: Asian Development Bank. Various Issues. *Key Indicators*. Manila; and United Nations. 2006. *Human Development Report*. Washington, DC.

**Table A7.4: Country and Portfolio Indicators:  
Progress toward the Millennium Development Goals and Targets**

Goals and Targets/Indicators	Country Status				
	Baseline (1990)	Target (2015)	Actual	Probability <sup>a</sup>	
<b>Goal 1: Eradicate Extreme Poverty and Hunger</b>					
<b>Assessment</b>	<b>Mixed.</b> The proportion of the population below the national poverty threshold and the poverty gap ratio will likely be halved by 2015. But the Philippines has not made progress in reducing the share of the poorest quintile in national consumption, and has attained only a medium pace of progress in halving the incidence of hunger.				
<b>Target 1:</b>	<b>Halve, between 1990s and 2015, the proportion of people whose income is less than one dollar a day.</b>				
Indicator 1a:	Proportion of population below national poverty threshold	45.3 (1991)	22.7	30.4 <sup>b</sup> (2003)	High
Indicator 2:	Poverty gap ratio	13.0 (1991)	6.5	8.4 (2003)	High
Indicator 3:	Share of poorest quintile in national consumption	4.7 (1991)	2.4	4.7 (2003)	Low
<b>Target 2:</b>	<b>Halve, between 1990 and 2015, the proportion of people who suffer from hunger</b>				
Indicator 4:	Prevalence of underweight children under 5 years of age	34.5 (1990)	17.3	24.6 (2006)	Medium
Indicator 5:	Percent of households with per capita energy < 100% adequacy	69.4 (1993)	34.7	56.9 (2003)	Medium
<b>Goal 2: Achieve Universal Primary Education</b>					
<b>Assessment</b>	<b>Deteriorating.</b> High 1990 baselines in education are either trending down or not improving fast enough. The net enrolment ratio in primary education plunged from 99.1% in 1990 to 84.4% in 2005, making accelerating progress in increasing literacy and primary school completion rates difficult.				
<b>Target 3:</b>	<b>Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling</b>				
Indicator 6:	Net enrolment ratio in primary education	99.1 (1990)	100.0	84.4 (2005)	Low
Indicator 7a:	Proportion of pupils starting grade 1 who reach grade 6	69.7 (1990)	100.0	70.0 (2005)	Low
Indicator 7b:	Primary completion rate	63.0 (1993)	100.0	68.1 (2005)	Low
Indicator 8:	Literacy rate of 15 to 24 years old	96.6 (1990)	100.0	96.6 (2003)	Low
<b>Goal 3: Promote Gender Equality and Empower Women</b>					
<b>Assessment</b>	<b>Mixed.</b> The ratios of girls to boys in primary and tertiary education have both worsened since 1990. The ratio of girls to boys in secondary education and ratio of literate females to males in the 15–24 age group have both been constant and favorable. The share of women in wage employment in the nonagriculture sector has been increasing but at a slow pace. At 41.2% in 2003, it is unlikely to reach the target of 50% by 2015. The proportion of seats held by women in the national Parliament was still low at 17.6% in 2004 and unlikely to reach the target of 50% by 2015.				
<b>Target 4:</b>	<b>Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015</b>				
Indicator 9a:	Ratio of girls to boys in primary education	1.0 (1993)	1.0	0.9 (2005)	Medium
Indicator 9b:	Ratio of girls to boys in secondary education	1.1 (1993)	1.0	1.1 (2005)	High
Indicator 9c:	Ratio of girls to boys in tertiary education	1.3 (1993)	1.0	1.2 (2004)	Medium
Indicator 10:	Ratio of literate females to males of 15–24 year-olds	1.0 (1990)	1.0	1.0 (2003)	High
Indicator 11:	Share of women in wage employment in the nonagriculture sector	40.6 (1990)	50.0	41.2 (2003)	Low
Indicator 12:	Proportion of seats held by women in national Parliament	11.3 (1992)	50.0	17.6 (2004)	Low
<b>Goal 4: Reduce Child Mortality</b>					
<b>Assessment</b>	<b>Mixed.</b> Great strides in reducing the under-five mortality rate and the infant mortality rates mean that the country is highly likely to attain its 2015 target of reducing the former by two thirds. But achieving a 100% immunization rate against measles for 1-year old children is not likely as progress in this area has been slow.				
<b>Target 5:</b>	<b>Reduce by two thirds, between 1990 and 2015, the under-five mortality rate</b>				
Indicator 13:	Under-five mortality	80.0 (1990)	26.7	32.0 (2006)	High
Indicator 14:	Infant mortality rate	57.0 (1990)	19.0	24.0 (2006)	High
Indicator 15:	Proportion of 1 year-old children immunized against measles	77.9 (1990)	100.0	83.7 (2005)	Low
<b>Goal 5: Improve Maternal Health</b>					
<b>Assessment</b>	<b>Low probability of meeting targets.</b> Maternal mortality has been decreasing and the proportion of births attended by skilled health personnel has been increasing, but slowly.				
<b>Target 6:</b>	<b>Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio</b>				
Indicator 16:	Maternal mortality	209.0 (1990)	52.3	162.0 (2006)	Low
Indicator 17:	Proportion of births attended by skilled health personnel	58.8 (1990)	100.0	63.7 (2005)	Low

Goals and Targets/Indicators	Country Status				
	Baseline (1990)	Target (2015)	Actual	Probability <sup>a</sup>	
<b>Goal 6: Combat HIV/Aids, Malaria, and Other Diseases</b>					
<b>Assessment</b>	<b>Mixed.</b> Contraception prevalence has been increasing but is not sufficient to meet 2015 targets. Malaria prevalence and the death rate associated with it have been decreasing quickly. The proportion of tuberculosis cases cured under directly observed treatment short (DOTS) course has been increasing. Thus the Philippines is likely to meet its 2015 targets in both areas. But the prevalence of tuberculosis, the death rate associated with it, and the proportion of tuberculosis cases detected under DOTS have had either medium or slow progress and the probability of attaining the 2015 targets is medium or low.				
<b>Target 7:</b>	<b>Have halted by 2015 and begun to reverse the spread of HIV/AIDS</b>				
Indicator 19a:	Contraceptive use	1.0 (1993)	increasing	1.6 (2006)	Low
Indicator 19c:	Contraceptive prevalence rate	40.0 (1993)	100.0	50.6 (2006)	Low
<b>Target 8:</b>	<b>Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases</b>				
Indicator 21a:	Prevalence associated with malaria	118.7 (1990)	0.0	43.3 (2005)	High
Indicator 21b:	Death rate associated with malaria	1.5 (1990)	0.0	0.8 (1998)	High
Indicator 23a:	Prevalence associated with tuberculosis	246.0 (1990)	0.0	157.8 (2003)	Medium
Indicator 23b:	Death rate associated with tuberculosis	39.1 (1990)	0.0	37.4 (1998)	Low
Indicator 24a:	Proportion of tuberculosis cases detected under directly observed treatment short course (DOTS)	53.0 (2001)	70.0	63.0 (2006)	Medium
Indicator 24b:	Proportion of tuberculosis cases cured under directly observed treatment short course (DOTS)	73.0 (2001)	85.0	83.0 (2006)	High
<b>Goal 7: Ensure Environmental Sustainability</b>					
<b>Assessment</b>	<b>Generally high probability of meeting targets.</b> Except for the decreasing proportion of households with access to secure tenure and the medium pace of progress in halving the proportion of the population without sustainable access to improved water source, all other five indicators are on track.				
<b>Target 9:</b>	<b>Integrate the principles of sustainable development into country policies and programs to reverse the loss of environmental resources</b>				
Indicator 25:	Proportion of land area covered by forest	20.5 (1990)	increasing	23.9 (2003)	High
Indicator 26:	Ratio of area protected to maintain biological diversity to surface area	8.5 (1990)	Increasing	12.7 (2006)	High
Indicator 28:	Consumption of ozone-depleting CFCs (ODP tons)	2,981 (1990)	Decreasing	681 (2006)	High
Indicator 29:	Proportion of households using solid fuels for cooking	66.2 (1990)	Decreasing	42.1 (2003)	High
<b>Target 10:</b>	<b>Halve, by 2015, the proportion of population without sustainable access to safe drinking water and improved sanitation</b>				
Indicator 30:	Proportion of population with sustainable access to improved water source	73.0 (1990)	86.5	80.2 (2004)	Low
Indicator 31:	Proportion of urban population with access to improved sanitation	67.6 (1990)	83.8	86.2 (2004)	High
<b>Target 11:</b>	<b>By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers</b>				
Indicator 32:	Proportion of households with access to secure tenure	91.0 (1990)	Increasing	81.2 (2000)	Low
<b>Goal 8: Develop a Global Partnership for Development</b>					
<b>Assessment</b>	<b>Generally high probability of meeting targets.</b> Of the four indicators for this goal, the only area where the country is off-track is youth unemployment. The unemployment rate for 15–24 year-olds has been increasing rather than decreasing from 1990 to 2005.				
<b>Target 15:</b>	<b>Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term</b>				
Indicator 44:	Debt service as a percentage of exports of goods and services	27.2 (1990)	decreasing	12.0 (2006)	High
<b>Target 16</b>	<b>In cooperation with developing countries, develop and implement strategies for decent and productive work for youth</b>				
Indicator 45:	Unemployment rate of 15–24 year olds	10.9 (1990)	decreasing	16.4 (2005)	Low
<b>Target 18</b>	<b>In cooperation with the private sector, make available the benefits of new technologies, especially information and communications</b>				
Indicator 47a:	Telephone lines subscribers per 100 population	1.5 (1990)	Increasing	8.3 (2006)	High
Indicator 47b:	Cellular phone subscribers per 100 population	0.1 (1991)	Increasing	41.3 (2005)	High

<sup>a</sup> The assessment was made by the National Statistical Coordination Board based on the comparison of actual (from baseline to latest data) and required (from baseline to target year) rates of progress. The probability of achieving the goal was defined as: Low, if the pace of progress is less than 0.5; Medium, if the pace of progress falls between 0.5 and 0.9; and, High, if the pace of progress is greater than 0.9.

<sup>b</sup> Philippine Poverty Statistics by the National Statistical Coordination Board released in March 2008 shows that in 2006 poverty incidence was at 32.9%. Available: [http://www.nscb.gov.ph/poverty/2006\\_05mar08/table\\_2.asp](http://www.nscb.gov.ph/poverty/2006_05mar08/table_2.asp).

Source: Available: [http://www.nscb.gov.ph/stats/mdg/mdg\\_watch.asp](http://www.nscb.gov.ph/stats/mdg/mdg_watch.asp)

## ECONOMIC MANAGEMENT, PUBLIC POLICY, AND SOCIAL SECTORS

### A. Challenges

1. The economic reform agenda in the country assistance program evaluation (CAPE) period needs to be seen in the context of the Government's reform agenda from 1986. Box A8 summarizes reforms initiated and advanced by each administration since 1986, as the basis to understanding Asian Development Bank (ADB) support for government reforms.

#### **Box A8: The Political Economy Setting for Reforms Addressed during the CAPE Period**

Starting in 1986, the Aquino administration began opening the economy, setting the groundwork for succeeding reforms. The reforms gained momentum under the Ramos administration, with the resolution of the power crisis that emerged in the 1990s. Aside from forging peace pacts with communist insurgents and Muslim separatists, the Government accelerated trade liberalization, deregulation, and privatization of industries including oil, transportation, and water; dismantled monopolies such as telecommunications; and passed a build-operate-transfer law providing the framework for private sector participation in infrastructure projects. These reforms brought increased private investments and improved competitiveness. With continuing improvements in the tax effort and revenues from privatization, the Government began running budget surpluses that lasted through 1997. A more independent central bank was created. The Legislative-Executive Development Advisory Council mechanism was introduced to increase coordination and cooperation between the executive and Congress. The Asian financial crisis and the change in government in mid-1998 interrupted the progression to institutional-type reforms in the civil service, judiciary, and electoral systems; this affected reform momentum.

The Estrada administration committed to continue the market-oriented reform agenda of the previous administration and to jumpstart growth, which had dipped as a result of the Asian financial crisis and a severe El Nino drought. This was to be accomplished through countercyclical fiscal policy that focused on pro-poor programs.<sup>a</sup> The Government was able to rekindle growth by 1999 through pump priming efforts. Nevertheless, its achievements in reviving growth and pushing through key legislation (Retail Trade Liberalization (2000), General Banking Law (2000), E-Commerce Act (2000), and Securities Regulation Code (2000)) were overshadowed by political scandals. One of the Estrada administration's key reforms, the Electric Power Industry Reform Act, was repeatedly delayed and passed only in 2001 after a new government took over following the "people power" revolt in January 2001 popularly known as EDSA 2.

The manner of the change, however, raised legitimacy questions from political quarters for the new administration, as evidenced in Congress's failure to pass the budget in 2001 and 2002, forcing the Government to operate on a reenacted 2000 budget in both years. Increased public sector spending, including for subsidies in power and mass transport, at a time when the tax effort had started to decline saw the Government's fiscal position deteriorate rapidly. The resulting fiscal crisis left few alternatives. Perhaps, counter-intuitively, a high degree of political consensus was achieved among stakeholders in relation to fiscal and related issues. In addition to the tax laws—adjustment of excise taxes in 2004, Attrition Act of 2005, and RVAT in 2005—major laws passed were the EPIRA (2001), Anti-Money-Laundering Law (2001), Procurement Act (2002), Special Purpose Vehicle Act (2002), and Securitization Act (2004).

CAPE = country assistance program evaluation, EDSA 2 = Second People Power Revolution, EPIRA = Electric Power Industry Reform Act, RVAT = Reformed Value Added Tax.

<sup>a</sup> PIDS Development Research News, September–October 1998.

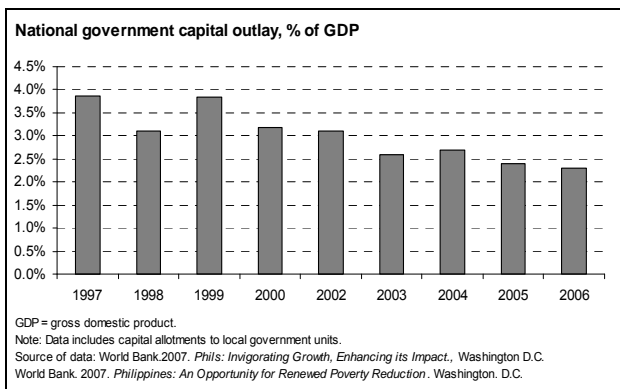
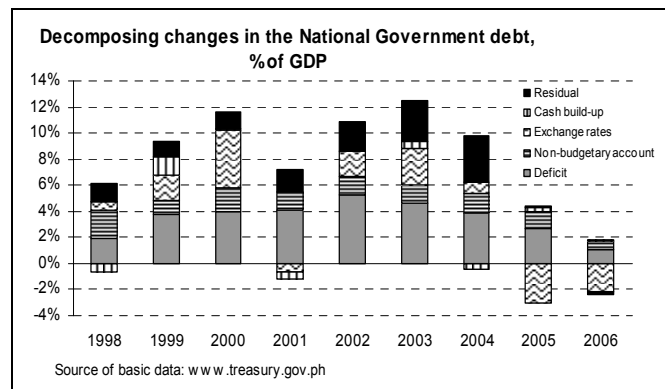
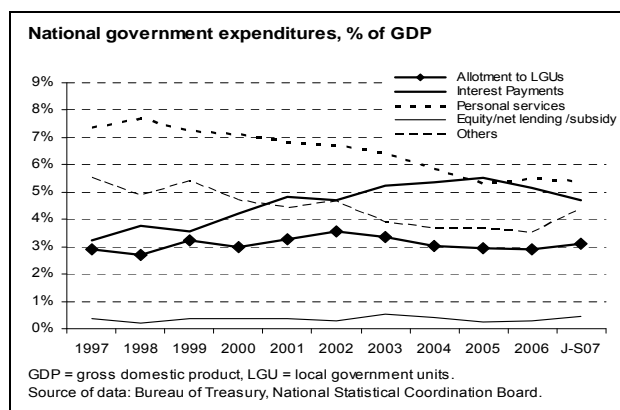
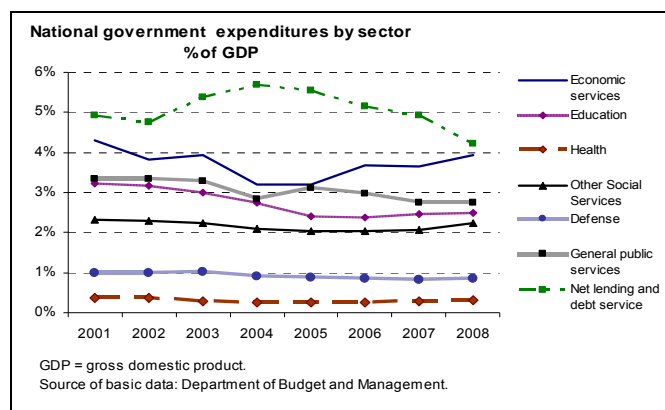
Source: Operations Evaluation Mission.

2. Over the past decade, economic management in the Philippines faced tremendous challenges, including the aftermath of the Asian financial crisis, political turbulence marked by people power-initiated leadership changes and coup attempts, deteriorating fiscal situation, heavy public debt overhang, low domestic resource mobilization effort, incomplete and inconsistent decentralization, a judiciary with limited capacity in providing sufficient checks and

balances to curb corruption, and widespread erosion in public trust (based on ratings). Starting in the late 1990s, the combined effect of a declining budget envelope due largely to the decline in the revenue effort, increasing interest payments on a rising stock of public debt, inflexible civil service wage costs, public utility subsidies, and rising transfers to local government units (LGUs) meant that resources left for discretionary spending continuously decreased and caused spending on infrastructure and social services (particularly education and health) to be severely compressed. By 2002, the fiscal situation had worsened considerably as dwindling revenues and a policy of keeping utility tariffs below operating costs caused the fiscal deficit to rise to more than 5% of gross domestic product (GDP). This, in turn contributed to the buildup of public debt, which ultimately peaked at 78% of GDP in 2004. Faced with decreasing fiscal space, spending on public investment and social services was scaled back.

3. The situation improved significantly following implementation of a package of fiscal measures from late 2004 to early 2006 (Figure A8). These included power rate adjustments, a 2 percentage point increase in the value-added tax rate, expansion of sectors covered under the value-added tax, and increases in excise taxes. The rapid decline in the national Government deficit—from almost 4% of GDP in 2004 to near balance (−0.1% of GDP) by 2007—allowed the country to attain macroeconomic stability, which translated into greater investor confidence as seen in financial market gains in 2006–2007 as well as the Government’s revitalized privatization program (particularly in energy).

**Figure A8: National Government Expenditures**



4. While the pace of fiscal consolidation has been impressive, slippages in tax collections in 2007 have renewed worries about fiscal sustainability, especially as the Government has heavily relied on one-off privatization receipts to make up for lost tax revenues. Total privatization receipts in 2007 reached ₱91 billion or about 8% of total government revenues, and roughly equivalent in nominal terms to combined privatization receipts in the 10 years prior to the Asian financial crisis (1987–1997).<sup>1</sup> Without privatization revenues, the Government's fiscal deficit actually increased from 1.2% of GDP in 2006 to 1.5% in 2007.

5. Off-budget risks arising from the Government's contingent liabilities received attention in recent years in view of their past contribution to the rise in national Government debt. For example, the national Government absorbed ₱44.5 billion of the National Power Corporation debt from 1999 to 2000.<sup>2</sup> This comprises explicit and implicit guarantees extended to public corporations, including those under the build-operate-transfer infrastructure schemes, which government with the help of development partners have inventoried, quantified, and risk-assessed in recent years. The Department of Finance estimated government contingent liabilities associated with guarantees to public corporations and build-operate-transfer projects (excluding power) at 25% of GDP in early 2006.<sup>3</sup> In addition, an earlier estimate of the unfunded liabilities of pension institutions showed government exposure reaching 55% of GDP<sup>4</sup> in 2001. Of note, the number of public corporations, decreased from over 300 in 1988 to 79 in 1992; in 2007 the number was reported to be 185 (counting parent companies and their subsidiaries).<sup>5</sup> The deficits of some of the major monitored corporations, including the National Food Authority, Light Rail Transit Authority, National Irrigation Administration, Local Water Utilities Administration, and Philippine National Railways are recurring issues that affect the public sector financial position and government efficiency in delivering goods and services.

6. **Revenues and Tax Administration.** The tax effort target for 2007 was missed, underlining the importance of accelerating tax administration reforms. Without new tax legislation (which appears unlikely under the present political environment and heading toward the 2010 presidential elections), a structural erosion of the tax effort can be expected to result from (i) the lack of indexation of excise taxes, with biennial adjustments provided under the Republic Act 9334 (January 2005) ending 2011;<sup>6</sup> and (ii) reduction of corporate income tax from the current 35% to 30% by 2009 as provided by law. Likewise, continuing expansion of relatively hard to tax sectors (e.g., business process outsourcing) can be expected. Some of the measures identified in a recent World Bank report<sup>7</sup> to improve tax administration include (i) in terms of compliance and enforcement, accelerate the pace of work on cleaning the taxpayer register, auditing tax arrears and stop-filers, and developing national audit plans and industry-based audit manuals; (ii) linking taxpayer information across government agencies, including the databases of the Bureau of Internal Revenue (BIR), Social Security System, Securities and

<sup>1</sup> Based on national Government's cash operation report. Privatization receipts declined to only ₱22 billion during 1998–2006.

<sup>2</sup> Source: University of the Philippines School of Economics. 2004. *The Deepening Crisis: The Real Score on Deficits and the Public Debt*. Quezon City.

<sup>3</sup> Department of Budget and Management. 2007. *Contingent Liabilities in the Philippines: Review of Policies and Recommendations*. Manila.

<sup>4</sup> Government of the Philippines, World Bank, and ADB. April 2003. *Improving Government Performance: Discipline, Efficiency, and Equity in Managing Public Resources*. Manila.

<sup>5</sup> Consultant's presentation, 2008. *The Philippines Government Corporate Sector—Challenges and Options for Reform*, Briefing for the Secretary of Finance. Weak public enterprise oversight is one of the areas cited in the 2007 Global Integrity Report, February issue.

<sup>6</sup> The ratio of excise tax to gross domestic product (GDP) declined from 2.6% in 1997 to about 1% of GDP in 2007.

<sup>7</sup> World Bank. 2007. *Philippines: Invigorating Growth, Enhancing Its Impact*. Washington, DC (Report 39226-PH).

Exchange Commission, Land Registration Authority, and Land Transportation Office; and (iii) institutionalization of reforms in BIR, starting with institutionalizing the newly created Tax Reform Administration Group that will manage the reform momentum.

7. **Government Spending and Allocative Efficiency.** Spending needs to be increased in a number of critical areas that have the greatest growth impact, principally infrastructure, health, and education (which the proposed 2008 budget appears to be addressing). The objective should not only be to increase the amounts spent by sector, but more importantly in many cases, to reallocate sector expenditures to increase budget efficiency. Examples include (i) shifting agricultural spending away from commodity-specific support to provision of public goods and market development support;<sup>8</sup> (ii) in education, reallocating resources away from tertiary to basic education;<sup>9</sup> and (iii) in infrastructure, funding projects with high economic return (e.g., road maintenance) rather than dispersing the budget for new infrastructure over a large number of small projects and/or projects of questionable economic viability or implementation readiness (footnote 7). For greater effectiveness, changing sector budget composition needs to be accompanied by policy changes (e.g., trade reform in agriculture, reform of state universities and colleges in education).

8. **Expenditure Efficiency.** Continuing efforts to strengthen the linkage between planning and budgeting through the medium-term expenditure framework, and supported by the sector effectiveness and efficiency reviews and the organizational performance indicator framework, are expected to promote greater flexibility, transparency, and accountability and to shift the focus of the budget process from inputs and rules-based compliance to outputs, outcomes, and results/performance orientation (footnote 9). Nevertheless, the 2003 Public Expenditure, Procurement, and Financial Management Review (footnote 4) notes that the medium-term expenditure framework needs to attain a greater degree of technical credibility among line departments, and political credibility among key political stakeholders to be able to attain its full potential and utility.

9. **Debt and Risk Management.** Continued attention to debt and risk management, especially of off-budget risks, reduces the interest burden and minimizes unexpected demands on the budget. Moreover, the management of contingent liabilities is not integrated with debt management and the Government's exposure to contingent liabilities or their link to other liabilities is not assessed systematically. As a result, management of contingent liabilities has been fragmented and lacks transparency, and data on contingent liabilities are dispersed.

10. **Civil Service.** The Philippines has about 1.6 million public sector employees. While fewer than similar countries,<sup>10</sup> this constrains the effectiveness of government due to problems of overlapping functions and overstaffing at certain levels in agencies. This limits Government's ability to attract and retain good civil servants as compensation packages are not competitive, especially for senior and midlevel officials. Efforts to reform the civil service have been noted to be "influenced and tainted by politics," haphazardly planned, and executed with minimal consultation and participation of the bureaucracy.<sup>11</sup> Some 11,000 political appointments—down to the level of directors—serve to politicize the bureaucracy, and contribute to staff turnover and limited institutional memory. The 2003 Public Expenditure, Procurement, and Financial Management

<sup>8</sup> World Bank. 2007. *Philippines: Agriculture Public Expenditure Review*. Washington, DC (Technical Working Paper 40493).

<sup>9</sup> Manasan, Rosario. 2007. *Financing the Millennium Development Goals: the Philippines*, Manila (PIDS DP 2007–06).

<sup>10</sup> World Bank. 2005. *Philippines: From Short-Term Growth to Sustained Development*. Washington, DC (Report 32055-PH, p. 48). This encompasses both permanent and contractual national and local employees and employees of public corporations.

<sup>11</sup> ADB. 2005. *Country Governance Assessment: Philippines*. Manila.

Review reports difficulties related to verifying information on the number of filled and unfilled positions, as well as the need to modernize the legal and institutional framework and capacity building, particularly for the oversight agency, the Civil Service Commission. The World Bank has noted institutional weaknesses linked to capacity constraints within the bureaucracy that “limits its ability to absorb much larger amounts of budgetary resources and execute them efficiently” (footnote 7). Proposals for civil service reform to increase budget flexibility and government efficiency must be revisited. Since 1991, a major decentralization effort was launched to improve public sector service performance, but due to capacity constraints, short local election cycles, heavy reliance by LGUs on central government transfers, overlapping functions, and a narrow local government revenue base, performance gains are sporadic.

11. **Decentralization.** The Local Government Code was introduced in 1991, but the expected benefits of decentralization have yet to be fully realized. Complications arising from the weak legal and institutional framework for decentralization and capacity constraints both locally and nationally have been noted. These include (i) ambiguities and contradictions in expenditure assignments between national and local governments; (ii) inadequate LGU resource mobilization leading to heavy reliance on national government transfers and insufficient infrastructure investments; and (iii) gaps in LGU tax administration, budgeting, and financial management processes needed to manage a decentralized system; and in national government structures, procedures, and information systems needed to perform its oversight function (Local Governance and Fiscal Management TA). LGUs have had limited success in raising the share of local revenue sources to total revenues, relying on the national Government for over three fifths of their income during the period. Expenditures meanwhile have been declining as a percentage of GDP (from 3.8% in 2001 to 3.2% in 2006), with the decline attributable to spending on general public services, economic services, and health. In 2006, an aggregate 60% of expenditures were for “general public services” and “other purposes;” with 15% spent on economic services, 10% on health, and 7% on education. Strengthening LGU capacity to carry out devolved functions was particularly critical in light of their role in meeting the Millennium Development Goals. Manasan reports real per capita decline in LGU spending on social services and Millennium Development Goal expenditures during 1997–2006.<sup>12</sup> Hence, the need became more evident to make decentralization work better including clarifying national versus local government roles in various activities, improving the internal revenue allotment and equalization objectives, revenue mobilization, financing and budgeting, and resource management and capacity building.

## B. Asian Development Bank Program, Results, and Rating

12. **Strategy.** In line with the 1998 country operational strategy study<sup>13</sup> at the beginning of the CAPE period, ADB assistance strategies aimed at building better capacity for economic management in many areas, including improving functioning of the Commission on Audit and public procurement; accelerating privatization and restructuring of public enterprises; improving project performance; strengthening the decentralization process; promoting private sector, nongovernment organization, and civil society participation in development efforts; supporting institutional development in the southern Philippines especially in areas affected by civil strife; and providing support for the Brunei, Indonesia, Malaysia, Philippines-East Asia Growth Area (BIMP-EAGA). As the fiscal situation deteriorated, the 2002–2004 strategy focused more on supporting Government efforts to reduce incentives for corruption, reforming the public expenditure management and procurement system, improving financial and corporate

<sup>12</sup> Manasan, Rosario. 2007. *IRA Design Issues and Challenges*. Manila (PIDS Policy Notes 2007–09).

<sup>13</sup> ADB. 1998. *Philippines Country Operational Strategy Study*. Manila.



governance, increasing the effectiveness of national and local governments, and completing agreed policy reforms. Macroeconomic imbalances were brought to the forefront of strategy formulation in 2005 with the country strategy and program (CSP)<sup>14</sup> focusing on fiscal consolidation. New lending was to focus on policy-based operations contingent on demonstrable progress in fiscal and structural reform. Strategies aimed at supporting fiscal consolidation to improve resource mobilization and budget operations of LGUs to reduce LGU dependence on national government transfers and improve LGU service delivery. They were also to improve transparency and reliability of the rule of law, and address problems of corruption. Until 2005, much of the effort to support decentralization was through national line agency projects involving LGUs and communities. After 2005, support for decentralization took on a more systemic approach including support for capacity building in local government planning, budget and expenditure management, combined with support for local government finance reform, in part because of the national Government's strained fiscal situation.

13. **Pre-2007 Assistance Program.** A series of advisory technical assistance (ADTA) projects were launched to build capacity in different areas of law, economic management, and public policy. ADTA projects were provided to (i) help improve the fiscal situation and strengthen the performance orientation of public spending by building Government capacity for procurement, (ii) establish an official development assistance unit, (iii) strengthen results monitoring and evaluation for poverty monitoring, (iv) strengthen oversight of Government-owned and -controlled corporations, and (v) improve public debt and risk management. To help combat corruption, two large-scale ADTA projects were dedicated to improving the independence of the judiciary with an emphasis on fiscal and administrative independence, accountability, greater transparency, improved incentive systems, and continuing judicial education. Issues addressed under the Strengthening Provincial and Local Planning and Expenditure Management TA, Local Government Finance and Budget Reform TA, and Local Governance and Fiscal Management TA in terms of local governance, included broadening LGU financing options, building capacity for local planning and project management, and developing an automated system for local government performance assessment. Assistance was also provided to build capacity for private sector development and included a series of ADTA projects aimed at building capacity to prepare a competitiveness assessment, establish anti-money-laundering legislation, and develop an enabling policy environment for small- and medium-sized enterprises.

14. **Post-2007 Assistance.** Prior to January 2007, ADB had not provided loans specifically geared to systemic support for fiscal policy and management. In January 2007, ADB provided financial and capacity-building support, together with the World Bank and other development partners, for the Development Policy Support Program (DPSP). This was a program cluster operation to support three single-tranche program loans, the first of which provided \$250 million to support the budget. Reforms supported under the DPSP were designed around four core areas to (i) restore fiscal sustainability, maintain macroeconomic stability, and improve creditworthiness by enhancing the quality of fiscal management by increasing tax revenues, strengthening tax administration, reducing inefficient spending, and strengthening the debt management strategy; (ii) enhance governance in public expenditure management and support government measures to reduce corruption in the revenue-collecting agencies of BIR and Bureau of Customs; (iii) improve the investment climate by clarifying and strengthening the legal and regulatory framework for investments and infrastructure; and (iv) protect the social sectors by improving access to and quality of social services, and enhancing poverty monitoring and targeting.

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<sup>14</sup> ADB. 2005. *Country Strategy and Program 2005–2007: Philippines*. Manila.

15. To build capacity in support of the DPSP's four core areas, ADB, World Bank, United States Agency for International Development, Australian Agency for International Development, European Commission, and United Nations Development Programme provided ADTA projects, with ADB support concentrated on the first two pillars, in the areas of local government fiscal capacity, financial market regulation, local governance, management for development results, and enhancing the efficiency and independence of the judiciary (para. 13).

### C. Economic Management and Public Sector Policy Performance Assessment

16. ADB assistance to economic management and the public sector consisted of loans and TA projects (Tables A8.1 and A8.2). ADB assistance in this sector is assessed as "successful."

**Table A8.1: Project Support for Economic Management and the Public Sector**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$ million)	Cofinancing (\$'000)
2315	8 Feb 2007	DOF	Development Policy Support Program Subprogram I	250.0	none
2387	13 Dec 2007	DOF	Local Government Financing and Budget Reform Cluster	300.0	none

ADB = Asian Development Bank, DOF = Department of Finance.  
Source: Asian Development Bank database.

**Table A8.2: Technical Assistance to Support Economic Management and the Public Sector**

TA Number	Date Approved	Project Title	Amount (\$)
3411	8 Mar 2000	Joint ADB, UNDP, and World Bank Poverty Consultations	123,200
3421	23 Mar 2000	Establishment of an Official Development Assistance Unit in the Flagship Committee	100,000
3656	24 May 2001	Improving Poverty Monitoring Surveys	347,000
3932	25 Sep 2002	Improving the Climate for Investment and Productivity in the Philippines: An Approach to Long-Term Poverty Reduction	120,000
3940	16 Oct 2002	Capacity Building of the Mindanao Economic Development Council to Enhance Private Sector Activity in the Philippine EAGA	200,000
4809	29 Jun 2006	Government-Owned and -Controlled Corporations Reform	750,000
4920	8 Feb 2007	Strengthening Investment Climate and Competitiveness	800,000
4185	26 Sep 2003	Enhancing the Efficiency of Overseas Workers' Remittances	150,000
4556	23 Dec 2004	Local Government Finance and Budget Reform	850,000
4717	7 Dec 2005	Debt and Risk Management	720,000
4778	3 Apr 2006	Local Governance and Fiscal Management	1,800,000
7019	13 Dec 2007	Local Government Financing and Budget Reform Program	800,000
7035	12 Dec 2007	Enhancing Revenue Collection and Strengthening the Criminal Prosecution of Tax Evasion Cases	500,000
9070	8 Aug 2005	Developing the Philippine Business Registry	700,000
9087	14 Mar 2006	Supporting Information Sharing and Exchange Among Civil Servants	500,000

ADB = Asian Development Bank, EAGA = East-Asia Growth Area, UNDP = United Nations Development Programme.

Source: Asian Development Bank database.

17. **Relevance.** Assistance in the sector was closely aligned with national priorities and designed to provide support to address critical development constraints, i.e., fiscal instability, decentralization, and weaknesses in the judiciary that allowed corruption to flourish. The assistance was designed to assist the Government implement its national policy priorities,

particularly the Medium-Term Philippine Development Plan, the 1991 Law on Local Government, and the Action Program for Judicial Reform. ADTA projects were identified in the CSP and adopted objectives that were a high priority in the forward plans of executing agencies. The DPSP strengthened the Government's resolve to turn around from its crisis situation, thereby helping it out of the crisis and providing credibility to its programs and medium-term prospects. The ADTA projects appropriately address key elements needed for the economy's long-term recovery, with focus on the investment climate and fiscal sector. With one or two exceptions, ADTA support was demand-driven with executing and implementing agencies playing a major role in the design and delivery of the assistance. Moreover, ADB assistance was realistic in terms of identifying critical policy and institutional constraints, and identifying realistic objectives. Project implementation periods (and project designs) were overly ambitious for a number of TA projects, particularly when complex institutional reforms and passage of new legislation were required. However, only in those cases where the assistance was partly aid-driven was relevance an issue, as appears to be the case for the ADTA for building capacity for results-based monitoring and evaluation. Prior to the DPSP, ADB assistance was loosely coordinated with support provided from other development partners; under the DPSP umbrella, harmonization of advisory assistance was substantially improved. ADB's assistance to the sector was "relevant."

18. **Effectiveness.** ADB assistance has contributed to the country's substantial accomplishments. ADB engaged government in a 3-year process of policy dialogue on measures required to address the fiscal crisis, and to design a suitable reform program. Through public statements in support of the importance of the expanded value-added tax (EVAT), ADB gave political credibility to a difficult measure and insulated it from partisan politics. Through its contributions to the analytical process in high-level economic policy making, it reinforced government commitment to follow through on contentious reforms (e.g., EVAT, power tariff hikes), despite pressure from segments of government concerned with maintaining political popularity. However targets for revenue mobilization in 2007 were missed. BIR issues arising from the DPSP experience revealed capacity and resource constraints within the agency that help to explain its short-term orientation (e.g., resorting to advanced collection of next period's tax liabilities from corporations) and absence of programs to deal with medium-term challenges (e.g., tax arrears and prosecution of tax offenders). Development partner support to BIR is thus focusing on building up the database, revenue forecasting, risk-based audit system, and tax prosecution.

19. A significant development was the enactment and implementation of the Government Procurement Reform Law in 2001, which helped streamline rules and regulations, and increase competition and transparency in government procurement. The setting up of an electronic procurement system that posts procurement opportunities in the public sector and helps consolidate the purchase of common use items has been an important step in this area. Cost savings<sup>15</sup> have been reported as a result of the introduction of the new systems, most notably in textbook procurement. On the other hand, recent controversies arising from supply-driven procurement in large official development assistance-funded infrastructure projects<sup>16</sup> reveal the need for greater transparency in project selection, award, and implementation. Steps have been taken to introduce competitive bidding into these projects and involve the private sector in a procurement transparency group led by the Department of Budget and Management.<sup>17</sup>

<sup>15</sup> The Medium-Term Philippine Development Plan 2004–2010 notes a 30% cost savings in government procurement. The DPSP reports ₱400 million overall savings in 2005, and 50% reduction in cost of textbooks since 2000.

<sup>16</sup> Examples include the canceled National Broadband Network project and a World Bank-funded road project.

<sup>17</sup> This was the rationale, according to the Government, for putting 11 official development assistance projects on hold (as reported in the press).

20. An ADTA project to address debt and risk management identified the lack of a formal debt management strategy and dispersed organizational responsibilities as the most pressing issues.<sup>18</sup> A new debt and risk management office is recommended to lead this work, integrating it with work on portfolio management. Developing the domestic bond market is viewed as a way to reduce foreign currency exposure of the current debt portfolio.

21. In terms of local governance, ADB assistance has made a significant contribution to broadening LGU financing options, building capacity for local planning and project management, and developing an automated system for local government performance assessment. The local government public expenditure and planning guidelines, prepared with assistance from the Strengthening Provincial and Local Planning and Expenditure Management TA, are technically sound, relatively simple, and user friendly; and training programs have succeeded in building capacity to use the new system. In addition, the signing of the Joint Memorandum Circular 1, Series 2007, is a landmark achievement of ADB assistance in local government reform. It strengthens collaborative arrangements among concerned national agencies and provincial governments, and helps solidify the link between provincial plans and budgets. Support to local governance in Mindanao resulted in major changes to legislation governing the Local Government Code, Courts Act, Administrative Code, and Code of Muslim Commercial Laws; as well as the development of handbooks and procedures that are now used for planning and budgeting purposes.

22. ADB assistance has helped build a general consensus that judicial reform is necessary, and a blueprint for establishing fiscal and administrative independence of the judiciary has been adopted. A new administrative structure involving the delegation of responsibilities to regional courts has been agreed upon and steps taken to reform the operations of the Supreme Court, and hence address a key logjam in the judiciary. In operationalizing a decentralization policy, key changes to the previous administrative structure were proposed. First, the judicial institutions under the management of the Supreme Court would all become self-managing decentralized units. At the central level, the Supreme Court would be a policy making body with two new central oversight offices to be established—a central court administration office (CCAO) and central financial management office (CFMO)—to oversee all administrative and financial matters. Second, the operational management of the more than 2,000 court stations (lower courts), previously conducted by the central Office of the Court Administrator (OCA), was to be transferred to 19 regional court administration offices (RCAOs), with OCA staff reassigned to the RCAOs, CCAO, and CFMO. After approving the new administrative structure, in May 2004, the Supreme Court established a change management committee with representatives of all the judicial offices to prepare a plan to operationalize the new structure. In August 2004, the committee submitted a revised administrative structure. The revision maintained the two central oversight bodies and the decentralized RCAOs, but it reinstated the OCA as a decentralized unit without clearly assigning functions with reference to the RCAOs, or to the CCAO or CFMO. On 17 August 2004, the Supreme Court approved this revised administrative structure. While increasing remuneration for judges and other court personnel has been difficult during a period of fiscal consolidation, the Government has increased the special allowances for judges as a sign of its commitment to boosting incentives in the judiciary. Support to local governance in Mindanao resulted in major changes outlined in para. 21.

23. Not all ADTA projects were successful in achieving their stated objectives. Assistance in the area of results-based monitoring and evaluation suffered from a dearth of suitable results indicators, and a lack of buy in from senior Government managers. The ADTA for developing new

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<sup>18</sup> See final report under Debt and Risk Management TA.

financial instruments for local governments proposed an umbrella facility—an LGU apex loan comprising a liquidity facility, a public–private financing facility, pooling of LGU loans, and injecting capital into the LGU Guarantee Corporation; none of which were ultimately deemed suitable by the Department of Finance. Operations undertaken during the CAPE period were “effective.”

24. **Efficiency.** Advisory assistance was generally delivered on time; and with the exception of support for building judicial capacity, assistance was disbursed in a timely manner. The mix and experience of national and international consultants was appropriate, and with few exceptions, these resulted in an efficient use of resources to achieve the outputs. In terms of public sector lending support, the DPSP was negotiated and released relatively quickly, triggered by the passage of the reformed value-added tax and after the dialogue process with the Government. ADB operations were assessed “highly efficient.”

25. **Sustainability.** In the case of fiscal reforms, sustainability is assured by the commitment of Government officials at the undersecretary level who will oversee succeeding tranches, and accomplishment of the DPSP milestones and ADTA objectives. However, risks include the apparent lack of political will to improve tax administration, shifting government priorities in infrastructure and social services, and understaffing in key government line agencies. In terms of decentralization, efforts to develop performance-based budgets linked to local programs, and the development of local sources of revenue, are both at an early stage of development, and will require considerable support in institutionalizing these new approaches. However, higher public investment, as a result of fiscal reform, should increase opportunities for local government to pilot test new planning, budgeting, resource mobilization, performance assessment, and private sector financing tools/systems. In the case of judicial reforms, while the former chief justice, who initiated the reform agenda exhibited strong ownership and leadership, the lack of broad-based support for reforms among midlevel judicial officials and new chief justices has slowed the pace and scope of reform implementation. The commitment of the executive and Congress to approve the necessary budgetary resources and pass some prerequisite laws further limits the pace of reform implementation. The effectiveness of ADB’s follow-up ADTA project, which is pilot testing the proposed systems and structures in one region, will illustrate the degree to which the reforms supported in the law subsector are sustainable. At this stage, ADB assistance was assessed “likely sustainable.”

26. **Impact.** Fiscal reforms have led to a reversal of the public sector financial position from a deficit of 5% of GDP in 2002 to just 1% in 2007, creating additional space for development spending and social outlays. The tax effort has steadily climbed from 12.4% of GDP in 2002 to 14.3% in 2006, because of the improvement in excise taxes and the EVAT law. Power rate adjustments reduced the National Power Corporation’s deficit from 1.5% of GDP in 2004 to 0.3% in 2005. Although targets for revenue mobilization in 2007 were missed, indications are that the Government remains committed to sustaining a fiscal balance that provides sufficient resources for public investment and social outlays. ADB support for fiscal consolidation can be assumed to have contributed to recent macroeconomic stability and the environment for recent growth. This may be seen in reduced credit spreads, improved credit outlooks of international rating agencies, lower hurdle rates on investments, modest sentiment improvement in some quarters of business, and reduced public sector financing requirements.

27. In terms of decentralization, early results, such as less duplication of reporting forms and tracking of progress in decentralization through a common national and local classification of budgeting, spending, reporting, and auditing systems, indicate these activities have the potential to provide meaningful and timely information. Such initiatives, if followed through, are

instrumental to supporting renewed efforts to further decentralization as a step toward benefit incidence measurement.

28. The impact of the judicial reforms cannot be measured yet. If the judicial institutions under the management of the Supreme Court do become self-managing decentralized units, this should contribute to a reduction in judicial delays and should enhance judicial transparency and accountability. At present, such reforms are being pilot tested, and significant opposition to change has been voiced from those who would be directly affected by structural reform in the judiciary. Incentives in the judiciary still need to be increased substantially, and reforms advanced to improve transparency and accountability. Changes in the composition of the Supreme Court have brought in a new set of reform objectives and priorities. Efforts to build a broad-based consensus in favor of well-defined judicial reform are needed to secure the political support required to see such changes through. Overall, ADB assistance is rated “substantial.”

## **D. Health Sector**

### **1. Sector Challenges**

29. Performance on the health-related Millennium Development Goal (MDG) targets for 2015 has been mixed, with maternal and HIV/AIDS control showing the poorest performance, and child health and malaria control showing the best chances of attaining the targets. At present, Filipinos are suffering from a double burden of illness and lifestyle diseases, while malnutrition and nutrition deficiencies, major factors influencing the health of mothers and children, remain public health issues. With a national contraceptive prevalence rate of only 45%, much lower than its neighbors, the Philippines has a high unmet demand for effective family planning. Public health systems have deteriorated in recent years, while support for preventive health care for the rural and poor segments of the population has not kept up with the increases in the number of people that must be served. Access to quality care is severely limited, especially for the rural poor. The poor use private facilities less than the rich. Rich and poor use public hospitals to the same degree, suggesting that even the highest income groups benefit from subsidized services in public hospitals.

30. The main causes of stalled development in the health sector include inadequate health financing, inefficient sector priorities, poor quality and cost-effectiveness of service delivery, financial and physical constraints to access for the poor, and inadequate sector governance. To address health service delivery improvements, the Health Sector Reform Agenda (HSRA) was adopted in 1999, with an implementation strategy, called the “convergence” strategy, aimed at rolling out reforms in 2001, combined with reengineering of the Department of Health (DOH), and a sector-wide assistance program starting in 2004, organized around health sector reforms.

### **2. ADB Assistance**

31. In parallel with Government’s medium-term plans, ADB’s country programs from 1998 consistently included involvement in the health sector, aimed at fostering investment in human resource development or in terms of strengthening local government service delivery (CSP update 2002–2004)<sup>19</sup> and fostering sector management reform. At the start of the CAPE period, the focus of ADB assistance was on investment in primary health care facilities, and building LGU capacity for decentralized health planning. The 2001 CSP focused on health service decentralization and improved health sector financing, with subsequent strategies emphasizing

<sup>19</sup> ADB. 2001. *Country Strategy and Program Update (2002–2004) Philippines*. Manila.

equitable access to health services and health management reform. At the start of the CAPE period, three health sector operations were ongoing, including the Women's Health and Safe Motherhood Project (WHSMP) (approved November 1994, completed in October 2002); Integrated Community Health Services Project (approved October 1995, completed February 2005); and Early Childhood Development Project (approved January 1998, completed November 2005). ADB assistance to the health sector consists of loan and ADTA projects listed in Table A8.3.

**Table A8.3: ADB Project Support to the Health Sector**

<b>Number</b>	<b>Date Approved</b>	<b>Executing Agency</b>	<b>Title</b>	<b>ADB Finance (\$ million)</b>	<b>Cofinancing (\$ million)</b>
<b>A. Loan</b>					
1606	27 Jan 1998	DSWD	Early Childhood Development	15.7	22.4
1607(SF)	27 Jan 1998	DSWD	Early Childhood Development	8.8	
1331(SF)	10 Nov 1994	DOH	Women's Health and Safe Motherhood	54.0	none
1396(SF)	17 Oct 1995	DOH	Integrated Community Health	25.9	15.2
2136	15 Dec 2004	DOF	Health Sector Development—Program Loan	200.0	none
2137	15 Dec 2004	DOH	Health Sector Development—Project Loan	13.0	None
<b>B. TA</b>					
4647	15 Sep 2005		Support for Health Sector Reform	1.0	None

DOF = Department of Finance, DOH = Department of Health, DSWD = Department of Social Welfare and Development, SF = Special Fund, TA = technical assistance.  
Source: Asian Development Bank database.

32. Ongoing projects had a range of severe implementation problems due to time-consuming procurement procedures and coordination problems between the DOH and the LGUs. Consequently, the initial focus of ADB support was on accelerating implementation of ongoing operations.

33. The WHSMP experienced implementation delays for two main reasons: (i) time-consuming national procedures for procurement of goods and civil works; and (ii) serious coordination difficulties between DOH and LGUs for a project designed for a centrally managed sector, not the recently devolved health sector setup. The WHSMP provides valuable lessons, particularly with respect to the need to fundamentally rethink modalities for relationships between the central Government and LGUs under devolution. Under devolution, LGUs play the major role in health care delivery and DOH can only act in conjunction with them. This project had funding from several development partners—five of which closely coordinated project monitoring. This served as a precursor for more-structured aid coordination that followed with the 2004 Health Sector Development Program (HSDP).

34. The Integrated Community Health Services Project experienced much the same problems with coordination between the central and local governments in delivering health services. After initial problems, it became an effective vehicle to reestablish collegial partnerships between DOH and various levels of LGUs in planning, managing, and financing health services in a devolved setting. The integrated approach to community health service delivery provided valuable lessons for the convergence approach to implementation of the HSRA, and this project developed tools for systems management and planning that were applied on a wider scale under the HSRA.

35. The Early Childhood Development Project was a multisector project, including the Department of Education (DOE) and Department of Social Welfare and Development, which managed the project. DOH was an implementing agency. Multiagency coordination proved problematic and, if anything, DOH probably learned to avoid this type of project. This project was jointly financed with the World Bank, but efforts at coordination were not as successful as with the WHSMP.

36. In December 2004, the HSDP, consisting of a program loan of \$200 million and a project loan of \$13 million, was approved; it became effective in January 2006. The HSDP's policy matrix was organized around the five reform themes identified in the HSRA. The second tranche of the program loan was approved in November 2006, and the project loan is ongoing. An ADTA project for Health Sector Reform was attached to the loan.

### 3. Performance Assessment

37. Evaluation of ADB assistance performance in the health sector is based on the assessment of the likely benefits of the single operation (HSDP) undertaken during the CAPE period. Health sector performance is assessed as "successful."

38. **Relevance.** The HSDP focused on critical constraints to sector development as outlined in the HSRA; the program loan enhanced DOH's role in setting the policy environment and the project loan provided support to LGUs willing to work within the HSRA framework. Timing of the HSDP was appropriate in that it helped restart HSRA implementation after a period of policy reform dormancy. Moreover, it was consistent with ADB country and sector strategies, including support for human resource development, and provided a ready instrument to respond to an urgent need for budget support. As such, ADB's assistance was "relevant."

39. **Effectiveness.** To the extent that the policy matrix addressed the broad reform areas requiring attention as identified in the HSRA, the program is assessed as "effective" in supporting a program of government-led health sector reform. Particularly important were measures aimed at introducing performance-based funding approaches and taking steps to rationalize hospitals. An effort appears to have been made to have a large number of reform conditions, rather than to focus attention on those with the greatest policy impacts. Project assistance (para. 34) included a participatory approach to investment planning and determining specifics of reform in different local settings. The ADTA project helped to disseminate policy decisions adopted as part of the program loan to participating LGUs, but with long delay because of late start-up. Regulatory powers of DOH have been enhanced to increase efficiency in health care provision.

40. **Efficiency.** The HSDP loan was efficient in the sense that it built on policy actions already ongoing or planned with assistance of other development partners, and timely completion of its second tranche conditions facilitated disbursement of resources to the budget. But, "soft" conditions resulted in a missed opportunity to leverage such a large amount of budget support to trigger national and LGU policy change. More selective policy conditions, but with greater impact, would have been a more efficient way to leverage reforms. The HSDP project experienced long delays in implementation partly due to the time needed to organize development partners for the sectorwide approach; failed procurement bids; problems in the fund transfer mechanism to LGUs (via the Municipal Finance Corporation) which did not materialize; and loosely defined terms of onlending because of last minute changes in Government policies on onlending or ongranting, which were subsequently changed during implementation. Thus, ADB operations were assessed "less efficient."



41. **Sustainability.** The HSDP helped raise awareness about the HSRA and build a national constituency, including key agencies such as the National Economic Development Authority, Department of Budget and Management, Department of Finance, and LGUs. The process of preparing policy actions increased understanding of the HSRA among DOH technical staff and helped build a critical mass of in-house supporters; while enhanced DOH credibility among economic managers has resulted in substantive increases in the budget for 2007 and 2008. Moreover, through participation in sectorwide approach activities, ADB helped DOH strengthen its institutional capacity for formulation of sector policies and management of sector programs and investments. However, the limited effectiveness of reform measures means that the more critical but difficult measures are still not in place (complacency could result soon) and earlier achievements could be reversed if gains in service delivery are not realized. Overall, however, ADB assistance at this stage was rated “likely sustainable.”

42. **Impact.** Impact cannot yet be measured, although ADB has contributed to restoring the policy foundations for more efficient, equitable, and effective delivery of health services. ADB’s ongoing project assistance, which pilots evidence-based response to health sector challenges, could have an important impact, although this effort is limited to only 2–3 provinces. As such, impact is assessed “likely substantial.”

43. **Key Lessons.** Overall, the projects provide a number of common lessons, including (i) LGUs play an important role in the devolution of health service delivery; (ii) crosscutting management problems (weak financial management, procurement, and human resource management) must be resolved up-front in project design; (iii) a detailed monitoring and evaluation plan is needed at appraisal, and be used in management and supervision; (iv) project inputs should be introduced in an integrated and synchronized manner for a given project area; (v) financing arrangements should be planned at the outset; (vi) resources for communication among stakeholders should be ensured; (vii) resources for subproject preparation and tendering should be provided; (viii) implementation must be supported, especially in the initial stages; (ix) the sectorwide programmatic approach is a best practice to provide a supportive environment for a sector development program; (x) TA is important for reform-based operations; and (xi) the importance of having a well-articulated reform agenda to guide implementation of a sector development program.

## **E. Education Sector**

### **1. Sector Challenges**

44. The Philippines, once known for the best education system in the developing world, has gradually lost its place in the lead over the past two decades. Education outcomes reflect this turnaround. In 2003, Trends in International Mathematics and Science Study ranked the Philippines in the lowest 10% of participating countries in both subjects in grades 4 and 8, well below Asian neighbors. Halfway into the MDG implementation period, the country is lagging on all four education MDG indicators. Net enrollment rates in primary education have been declining. There are large variations in education outcomes geographically and among socioeconomic groups. Functional literacy rates vary across regions. Boys lag behind girls in achievement, participation, and drop-out rates. Access has improved as a result of substantial improvements in school, classroom, and teacher numbers, but many children are unable to have access to school. Per capita government spending on basic education continues to lose ground to population growth and inflation. Between 2000 and 2004, the DOE’s nominal budget increased an average of 4.5% per year; however, real spending per student fell by an average of 3% per year over the same period.

45. At the higher education level, state universities and colleges represent a significant expenditure of government resources, constituting 13.7% of total government expenditures on education in 2004 although down from 15.5% in 1998. Most public sector funding goes toward direct subsidies to state universities and a small proportion goes to scholarship funds. Unplanned creation and conversion of state universities and the use of direct subsidies without corresponding incentives for greater efficiency and revenue generation explain inefficiencies. The Technical and Vocational Education and Training (TVET) system consists of school-based training, center-based training, and enterprise-based training. The system is predominantly private, with 80% of enrollment in TVET in private institutions.<sup>20</sup> Financing comes almost exclusively from non-public sources. The prominence of the private sector in provision of TVET and the wide variety of available options make regulatory and advocacy functions critical and are the responsibility of TESDA. At present, there are wide variations in the quality of technical and vocational schools, with many of them being substandard. In addition, there is a mismatch between the needs of the business sector and the supply, with the problem exacerbated by the rapidly changing patterns of demand in the labor market.

46. The National Coordinating Council on Education was created in 2000. The Council's tasks were to coordinate and harmonize crosscutting education issues, formulate sector-wide policies, and decide on the rationale allocation of resources across different parts of the education system. The council, however, has barely functioned since its creation. In 2007, President Arroyo created a Presidential Task Force on Education tasked to review priorities across all levels of the education system. The Basic Education Sector Reform Agenda is the most current overarching articulation of a reform agenda for the basic education sector to achieve the goal of Education for All by 2015. It applies lessons from international and local research on reforming education systems in a decentralized environment and from successful pilots in the Philippines. The components of the reform agenda include (i) school-based management, (ii) competency-based teachers standards, (iii) quality assurance and accountability framework, and (iv) outcome-focused resource mobilization. The reform agenda identifies decentralization of the education system and empowerment of local governments to plan and manage education effectively as key strategies for improving access and quality of the education sector.

## 2. ADB Assistance

47. Education development has figured consistently in ADB strategies, although relatively little new lending and ADTA support was provided during the CAPE period. Initially, the 1998 education sector strategy was to invest in basic education, including technical and vocational education, and provide selected support for technical and higher education. Policy reforms on decentralization of basic education, capacity building of LGUs, and related policy measures were also envisaged. From 2001 to 2005, ADB's strategy for the education sector was to support the recommendations of the Presidential Commission for Education Reform with assistance for reforms for education financing, restructuring of higher education to increase cost recovery, rationalization of the skills development system, and decentralization including a focus on school-based management and curriculum development. To upgrade skills and raise productivity for global competition, interventions were planned to support basic education, enhance teacher development, improve resource allocation across the sector, and rationalize and strengthen higher education. The 2005 CSP focused ADB assistance on a more limited number of core sectors; and given limited demand for new loans in the sector, education was eliminated as a strategic priority. ADB's programmatic response to sector challenges was the

<sup>20</sup> Data from ADB and World Bank 1999.

Secondary Education Development Improvement Project (SEDIP) in 1998, whose aim was to reduce inequality and geographic disparity in the quality of secondary education in poverty-affected provinces with low rates of enrollment, completion, and student achievement. The project also aimed to help the process of management decentralization that encourages school-based management with local community participation in school planning and management. The project had components to (i) improve the quality and relevance of secondary education, (ii) increase participation rates and completion of secondary education in underserved areas, and (iii) facilitate the decentralization process to establish the conditions for school-based management. The project was implemented in 14 provinces<sup>21</sup> in two batches and an additional 12 provinces were provided with textbooks and prepared for decentralization. This project was accompanied by the Decentralization of Basic Education Management ADTA. Its main objectives were to develop a 10-year plan for decentralization of the basic education system and conduct a cost-benefit analysis of a decentralized basic education organization. The loans and TA grants to support the sector are listed in Tables A8.4 and A8.5.

**Table A8.4: Project Support to the Education Sector**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$ million)	Cofinancing (\$ million)
1254(SF)	30 Sep 1993	DOE	Nonformal Education	25.2	1.6
1654	11 Dec 1998	DOE	Secondary Education Development and Improvement	53.0	54.3
1750	24 Aug 2000	TESDA	Technical Education and Skills Development	25.0	25.0
1751	24 Aug 2000	TESDA	Fund for Technical Education and Skills Development	20.0	

DOE = Department of Education, SF = special funds, TESDA = Technical Education and Skills Development Authority.

Source: Asian Development Bank database.

**Table A8.5: Technical Assistance to Support the Education Sector**

TA Number	Date Approved	Project Title	Amount (\$)
3482	24 Aug 2000	Strengthening Management Capacity and Improving Quality of Technical Education and Skills Development System	775,000
3609	21 Dec 2000	Studies on the Access of the Poor to Education	150,000
3954	31 Oct 2002	Organizational Development of the Commission on Higher Education	500,000
4524	23 Dec 2004	Development of Basic Education in the Autonomous Region in Muslim Mindanao	375,000

TA = technical assistance.

Source: Asian Development Bank database.

48. Implementation of the SEDIP was inefficient, especially during the initial stages when consultant performance was mixed, some training provided to the first batch of provinces had to be repeated as it was not in line with project objectives, and various component and subcomponent support was not sufficiently interlinked to generate positive synergies. Substantial delays during the initial period also meant that some key components such as results monitoring and the evaluation framework were insufficiently developed, and insufficient time was available for revising the completed outputs to improve the usability of teachers'

<sup>21</sup> The provinces supported were Agusan del Sur, Antique, Benguet, Biliran, Guimaras, Ifugao, Leyte, Masbate, Negros Oriental, North Cotabato, Romblon, Surigao del Sur, Southern Leyte, and Zamboanga del Sur.

manuals. However, project performance improved substantially during the second phase of project implementation and most of the output targets were ultimately achieved.

49. Concerns about long delays in implementation of the then-ongoing SEDIP coincided with a period of consolidation of ADB's portfolio. Agreements were reached between the Government and ADB management to concentrate assistance on sectors in which performance was good and results would likely be delivered. Hence, they decided to not prepare new operations in the sector until implementation of the ongoing SEDIP was improved. Moreover, the reform agenda in the education sector was ill-defined, and concerns centered on the need for greater fiscal space for public investments and the social sectors. Pursuing investments that would have large new counterpart funding requirements would be counterintuitive. Hence, during the current CAPE period, the only education sector activity pursued was the continued implementation of the SEDIP and the companion ADTA.

### 3. Performance Assessment

50. Evaluation of ADB assistance performance in the education sector is based on the assessment of the SEDIP and the associated TA. Education sector performance is assessed as "successful."

51. **Relevance.** The SEDIP was consistent with Government priorities and ADB strategies and program of supporting human development and poverty reduction. Considerable efforts were put into harmonizing the project's design and support with other education projects in the region/provinces, in particular the Third Elementary Education Project, financed by the World Bank and Overseas Economic Cooperation Fund of Japan. The project targeted the same rural provinces and shared complementary strategies to jointly support the improvement in school access and learning outcomes, and decentralization of basic education management. The project provided basic essential support needed for improving the secondary education system. Programs for increasing the participation of deprived provinces and completion rates for secondary schools were appropriate for local settings, and the strategies and approaches used to facilitate school-based management were widely recognized as appropriate and necessary by various stakeholders intensifying their efforts to ensure increased access to quality education. ADB assistance was assessed "relevant."

52. **Effectiveness.** The project exceeded output targets in providing instructional support to teachers and improving teachers' subject knowledge and teaching skills. Sufficient learning resources, textbooks, school supplies, equipment, and teaching materials were delivered. More than 300 schools have pilot tested the High School Innovation Fund. Increased student participation was achieved through the development and delivery of 20 modules for the effective and affordable secondary education package. Divisional and school heads were trained in school improvement and school management, and some progress was made in enhancing capacity for policy research and education advocacy. School-based management, in particular, proceeded well and continues to contribute to improving the quality and responsiveness of education services at schools that received project assistance. However, limited progress was made on broader aspects of regional and central coordination of the education system. Moreover, at the project conceptualization stage, several output targets were set at levels too low to generate the expected outcomes—resulting in a rather unusual situation of overachievement when judged purely in terms of the output targets specified. Thus, ADB operations undertaken during the CAPE period were "effective."

53. **Efficiency.** The substantial delays in project commencement, poor coordination between the National Project Management Office and line agencies of the DOE, design changes and lack of clarity on targets and performance indicators, poor supervision and performance of consultants, procurement delays, and some inappropriate interventions substantially increased the overall project cost. The project activities were poorly coordinated and managed. The lack of capacity in the project management office coupled with the change in ADB project officer soon after the loan processing contributed to confusion during the initial stage of implementation. The revised design and monitoring framework came into operation in 2004, more than half way through the start of the Project. In addition, consultants were generally poorly supervised. When consultants were changed, the work already completed by the previous consultants was not properly handed over to the new consultants. This led to some degree of duplication and lack of continuity resulting in higher costs. Finally, in addition subsequent delays occurred during implementation. The lengthy review procedures caused delays in the delivery of library books and other school materials. Some trainees didn't receive their stipends and had to withdraw from the training due to financial difficulties. This problem was acknowledged during the initial batch of training but the problem continued and the trainees in 2006 and 2007 faced similar problems. Long delays ultimately compromised the quality of some of the support provided, since little opportunity was available to review and revise project outputs during implementation. ADB operations were, therefore, "less efficient."

54. **Sustainability.** Recent developments in the secondary education system provides opportunities to mainstream project-initiated reforms nationwide. Key project components have been mostly sustained. During the CAPE site visits, the textbooks, equipment, and, teacher and school-head manuals were found to be in relatively good condition and well utilized. Application of student-focused learning methods promoted through the training of teachers and school heads was evident, and the school-based management systems are firmly rooted in the assisted schools. However, there are some concerns over the sustainability of outcomes, such as sufficient future budget to cover current costs and a clear role for regional departments. The Government is implementing the Basic Education Sector Reform Agenda (BESRA) nationwide from 2008 to improve operations in basic education to achieve the goal for "Education for All" by 2015. This provides opportunities for up-scaling the project's outputs nationwide. The BESRA is now implementing four core outputs of the project: (i) school-based management, (ii) competency-based teacher standards, (iii) quality assurance and accountability framework, and (iv) outcome-focused resource mobilization. External funding for BESRA implementation is secure, which gives added reason to believe that ADB-supported education initiatives will be sustained and scaled-up. At this stage, however, ADB assistance was rated "likely sustainable."

55. **Impact.** While the SEDIP had to be scaled back, most of the school and district targets were achieved. These included enhancing the capacity for management of schools, provision of office materials and equipment, and use of new teaching methods that promote students' participation and encourage more proactive responsibility for their own learning. The school-based management component is well established with school operation plans being developed in a consultative manner. Some remote and poorer provinces that received project support reported improvements in the achievement rates in core subjects—English, mathematics, and science. Principles demonstrated by project assistance that are now recognized in participating schools include (i) application of the school-based management system, (ii) more authority for school heads for financial management and selection of teachers, (iii) reduced number of student dropouts, and (iv) wider stakeholder consultation/involvement in developing educational plans. The project demonstrated that better learning outcomes can result from various interventions geared to enhancing an interactive and student-focused learning approach. The SEDIP has contributed to implementing some components of the education decentralization

process as advocated in the implementing rules and regulations of BESRA, providing an unanticipated opportunity to mainstream the SEDIP's output nationwide. Thus, impact is assessed "substantial."

56. **Key Lessons.** The ADTA highlights the need to ensure that education reforms have a constituency if assistance is to have an impact. Eventually this did occur; its poor initial reception points to the need for careful assessment of the willingness-to-change at fact-finding. Nevertheless, maintaining a policy dialogue eventually facilitated application of the ADTA project's recommendations. Slow progress in the SEDIP in its initial stages was due to lack of clarity in design and understanding with the executing agency, which was resolved by accommodating a timely mid-implementation redesign and change of scope aligned with a new generation of instructional policies introduced at the time. Once designed appropriately, the SEDIP provided a sound demonstration effect anchored in recent efforts to further decentralization of education services, despite significant remaining challenges.

## PRIVATE SECTOR DEVELOPMENT

### A. Sector Challenges

1. Since the country returned to democracy in 1986, successive administrations have espoused a private-sector-led growth strategy with government concentrating on providing the enabling environment for the strategy to succeed, and free up public resources for spending in critical development areas not conducive to private participation. Reforms in the 1990s, started under the Aquino administration and continued under the Ramos administration, hewed closely to “Washington consensus” policy prescriptions and were directed at easing entry restrictions for foreign investments (i.e., liberalization of investment rules, deregulation of industries); getting government out of its various business ventures (i.e., privatization of state enterprises); and taking steps to reduce government’s drag on economic growth (i.e., reducing the fiscal deficit). These measures yielded substantial reform dividends for the country; creating, for a while, a virtuous investment-economic growth cycle that saw the private sector thriving even in the provision and management of infrastructure traditionally run by government. From 1986 to the end of the 1990s, the Government privatized about 450 of the 562 government-owned and controlled corporations.<sup>1</sup> The private sector generates about 95% of gross domestic product (GDP), a situation that has persisted since the early 1990s.<sup>2</sup>

2. After the Asian financial crisis, global investors adopted a more bearish and discriminating stance in country and project selection. Together with the Philippine’s subsequent struggle with its own fiscal crisis that increased investment risks, this led to stagnation in private sector development. This was evident in, until recently, the stalled privatization program and reduced interest in public–private partnership schemes in infrastructure. Foreign investment inflows in the 5 years to 2006 averaged \$1.4 billion annually, significantly below amounts received by other crisis-affected economies in the region.

3. The Philippines’ inability to attract more investments is a reflection of its declining competitiveness vis-à-vis its neighbors, indicated by its poor ranking versus regional competitors in the Global Competitiveness Report of the World Economic Forum (in 2007 the Philippines ranked 71st worldwide compared to Malaysia 21st, Thailand 29th, Indonesia 54th, and Viet Nam 68th). The report found that the major factors investors reported as most problematic for the Philippines are consistent with an earlier Asian Development Bank (ADB) Investment Climate Survey (Table A9.1). These factors may be categorized under macro fundamentals (e.g., macro instability, government instability); infrastructure; and governance and institutions (e.g., corruption, regulations, government efficiency). The World Bank reports high avoidable costs of business in the Philippines of as much as 25% of sales (higher for smaller firms).<sup>3</sup> The ADB Investment Climate Survey notes that Philippine international competitiveness has been seriously eroded by the relatively high cost of labor that has not been supported by increases in labor productivity.<sup>4</sup>

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<sup>1</sup> Finlayson, Bob. 2007. *Philippines: Case Studies on Private Sector Development and Operations*. Manila: ADB.

<sup>2</sup> ADB. 2006. *Assessment of Private Sector Development in the Philippines*. Manila.

<sup>3</sup> These avoidable costs are attributed to unproductive costs arising from poor infrastructure, labor market rigidities, regulatory uncertainty and corruption. See World Bank. 2005. *Philippines: From Short-Term Growth to Sustained Development*. Washington, DC. Report 32055-PH (p. 31).

<sup>4</sup> ADB. 2005. *Improving the Investment Climate in the Philippines*. Manila (p. 26).

**Table A9.1: Major Constraints to Doing Business**

<b>Global Competitiveness Survey<sup>a</sup></b>	<b>Asian Development Bank Investment Climate Survey<sup>b</sup></b>
Corruption	Macroeconomic instability
Inadequate supply of infrastructure	Corruption
Policy instability	Electricity
Inefficient government bureaucracy	Tax rates
Government instability/coups	Economic policy uncertainty
Tax rates	Crime, theft, and disorder
Tax regulations	Tax administration
Access to financing	Cost of financing
Restrictive labor regulations	Anticompetitive practices
Crime and theft	Labor regulations
Poor work ethic in national labor	Customs and trade regulations
Inflation	Transportation
Inadequately educated workforce	Access to land
Foreign currency regulations	Access to financing
	Licensing and permits
	Workers' skills and education
	Telecommunications

<sup>a</sup> From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country and rank them between 1 (most problematic) and five.

<sup>b</sup> Improving the Investment Climate in the Philippines, 2005.

Source: Available: [www.gcr.weforum.org](http://www.gcr.weforum.org)

4. Macro uncertainties, both economic and political, have given rise to perceptions of policy instability, which has in turn contributed to increased risk premiums on Philippine investments.<sup>5</sup> On the macroeconomic side, instability in the half decade to 2005 was due in large part to the Government's fiscal deficits and debt burden, which have not only led to higher cost of capital for private investments but also reduced government capacity and willingness to take on direct and indirect (through guarantees) exposure for critical infrastructure facilities. Lack of public investments coupled with structural bottlenecks in key industries (e.g., agriculture, air and sea transport, power, cement, mining, banking) have led to low marginal product of capital, discouraging investments.<sup>6</sup> On the political side, the seeming lack of coordination in setting policy directions within government itself, as seen in earlier episodes of policy flip-flopping in the grains subsector, build-operate-transfer (BOT) ground rules, microfinance, tax incentive proposals, and some retreat from trade liberalization, have also (based on surveys) made the investment climate less attractive. Perceived security risks have dampened investor confidence.

5. While markets have reacted positively to recent improvements on the fiscal front, this has yet to translate into a significant buildup of investments of the brick-and-mortar type. Particularly puzzling is why despite robust GDP growth, especially in the past 2 years, investment to GDP has remained low, either historically or in comparison to peers, despite indications of exhaustion of capacity. Over the longer-term, second generation reforms focused on strengthening institutions, including for electoral reform and computerization of elections, are needed to help minimize political instability.

6. Weak governance and institutional capacity issues created perceptions of widespread corruption. The World Bank notes that within and outside government the broad consensus is

<sup>5</sup> From 2002 to 2003, the Economist Intelligence Unit country risk scores assigned higher risk to the Philippines.

<sup>6</sup> Bocchi, Allesandro Magnoli. 2008. Rising Growth, Declining Investment: The Puzzle of the Philippines. *Policy Research Working Paper 4472*. Washington, DC: World Bank (January).



that corruption in the Philippines is pervasive and deep-rooted, and touches even the judiciary and the media.<sup>7</sup> As a consequence, it is more than just a tax on business that markedly raises the risks of doing business, which may help explain the country's declining investment ratios. Corruption issues may be addressed by strengthening formal rules and their implementation, increasing the credibility of the legal and judicial system, and strengthening the government procurement system; all of which are being pursued in cooperation with development partners, albeit with different degrees of political commitment and success.

7. Another dimension of governance that has remained weak in certain sectors is regulatory quality. While improvements have been made over the years in certain sectors, notably banking supervision and the corporate sector, the regulatory framework for utilities continues to suffer from weak institutional capacities and perceived political interference in tariff setting. For instance, regulatory experience and capacity in power, water, and telecommunications have been noted to be limited; while in transport, lack of coordination among different regulatory agencies has constrained effective decision making.<sup>8</sup> Perceptions of regulatory capture and increased regulatory uncertainty, both deterrents to investments, have led to frequent judicial involvement in basic infrastructure issues, creating perceptions of an "activist judiciary" that is already overburdened with a large backlog of cases (footnote 8). The inability to charge cost-recovery prices has reduced investors' appetite for these projects (including various government assets up for sale), or such risks have led to insistence on strong sovereign guarantees for BOT/concessions or (until recently) a high discount when bidding for assets. In the Philippines, large enterprises, while small in number, account for 30% of GDP. This sector is highly concentrated, being dominated by large family businesses that operate in diversified fields as conglomerates.

8. Inadequate infrastructure, as seen in relatively higher costs, and facility access and coverage, ranks high among investor concerns. It has been noted to have a constraining impact on economic growth and poverty reduction (Table A9.2).<sup>9</sup> The World Bank (footnote 8) identifies the following key issues: (i) spending on infrastructure at 2.8% of GDP in 2002 is well below the estimated 5% of GDP infrastructure spending needed by middle-income countries in East Asia; (ii) inefficient use of existing resources as seen for example in power (excess capacity in Luzon accompanied by sporadic shortages in other regions), water (high nonrevenue water), and roads (high procurement costs coupled with low quality); (iii) poor business environment due to inadequate cost recovery, corruption, insufficient competition, and low credibility of institutions; (iv) unsatisfactory performance in long-term infrastructure planning and coordination, and in resource mobilization; and (v) decreased private sector involvement with private infrastructure commitments declining from a peak of 6% of GDP in 1998 to 1% in 2002.

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<sup>7</sup> See World Bank. 2000. *Combating Corruption in the Philippines*. Washington, DC (May). In a more recent report (footnote 3), the World Bank also noted that the Bureau of Internal Revenue (BIR) is widely recognized as an agency in which, with exceptions, corruption has become entrenched, with the source of rents extracted found in the discretion exercised by BIR staff over taxpayers.

<sup>8</sup> World Bank. 2005. *Philippines: Meeting Infrastructure Challenges*. Washington, DC (p. 23). An example of the negative impact of this is the United States Federal Aviation Administration's decision in January 2008 to lower the Philippine's civil aviation safety rating from category 1 to category 2 on concerns over deficiencies in laws and regulations needed to comply with international safety standards. This means that Philippine carriers flying to the United States will be under heightened Federal Aviation Administration surveillance.

<sup>9</sup> Llanto, Gilberto. November 2007. *Background Report on Infrastructure*. Manila. Available: <http://www.adb.org/Documents/Events/2007/Country-Diagnosis-Analysis-Binding-Constraints/default.asp>.

**Table A9.2: International Comparison of Infrastructure**

Country	Electrification Rates in 2000	Telecommunications		Water and Sanitation		Total Road Network (km/1,000 people)
		Main Lines (per 100 people)	Mobile Subscribers in 2003	Access to Improved Sanitation in 2002	Access to Improved Water	
Australia	100	54.23	71.95	100	100	—
Korea, Rep. of	100	53.83	70.09	—	92	1.8
Singapore	100	45.03	85.25	100	100	0.8
China, People's Rep. of	98	20.90	21.48	44	77	1.4
Malaysia	96	18.16	44.20	—	—	2.9
Mongolia	90	5.62	12.98	59	62	20.1
Thailand	82	10.49	39.42	99	85	3.1
Philippines	80	4.12	26.95	73	85	2.5
Viet Nam	75	5.41	3.37	41	73	1.2
Sri Lanka	62	4.90	7.27	91	78	—
Indonesia	53	3.94	8.74	52	78	1.7
India	43	4.63	2.47	30	86	3.2
Philippines rank	8 of 12	11 of 12	6 of 12	5 of 10	5 of 11	6 of 12

— = not available, km = kilometer.

Source: World Bank. 2005. *Philippines: Meeting Infrastructure Challenges*. Washington, DC.

9. In the case of private sector participation, through for example BOT schemes, issues identified include uncertainty over government policy on contracts and contract review, regulatory and political risks, inability of government line agencies to identify and prepare good projects for tender, corruption, and constraints in the provision of guarantees due to budgetary problems of the government.<sup>10</sup> Stimulating new private investment in infrastructure requires the development of coherent sector plans supported by capable public sector agencies that include independent regulators, unbundled competitive operations, and clear rules on procurement using public–private partnership instruments, tariffs, and dispute resolution (footnote 10). Improving the performance of both the public and private sectors may involve “reducing the inherent short-term perspective in infrastructure policymaking and improving the poor business environment.” Resolving ambiguities in the BOT Law and improving the selection and preparation of projects can help renew private sector interest (footnote 8).

10. Inadequate investment in human capital, especially health and education, will eventually affect private sector growth. The downward trends in primary and secondary school enrolment, dropouts, and completion rates; as well as findings of insufficient reading comprehension among grade school pupils point to the need for government to devote more resources to education. Education and health issues are closely linked, as hunger deters interest in learning. Inability to educate school-age children properly in turn affects the quality of the labor pool and the country's long-run competitiveness. This is evident in investor concerns over the country's inadequately educated workforce, ability to provide a workforce that can adapt to advanced manufacturing practices, or supply technical personnel with advanced degrees in engineering and the sciences (footnote 3, p. 36). Apart from the human aspects of these statistics and their consequence on long-term growth, unless these are reversed, the pool of Philippine human capital—now fueling the healthy growth, balance of payments and fiscal positions—risks being arrested. The rapid growth of various information technology-enabled industries such as call

<sup>10</sup> ADB. 2007. *Special Evaluation Study on Private Sector Development and Operations: Harnessing Synergies with the Public Sector*. Manila.

centers and business process outsourcing is the offshoot of a pool of English-proficient college-educated workers, and the liberalization of the telecommunications sector in the early 1990s and the massive investments in the telecommunications infrastructure that followed. Furthermore, the marketability of Filipino workers overseas is a consequence of past investments in education, an area that has shown deterioration in more recent periods.

11. Access to financing remains an issue for large, long-gestating projects as well as extreme microenterprise and small- and medium-sized enterprises (SMEs), which comprise 99.5% of registered private enterprises in the Philippines.<sup>11</sup> The relatively small and shallow domestic capital market, both equities and bonds, except Treasuries, remains a key challenge for large long-gestating projects. Domestic credit for microenterprises and SMEs since the Asian financial crisis has been affected by the slowness of bad asset cleanup in banks. Nevertheless, lending has expanded recently. While recently banks have been showing more interest in microfinance, the technology of microlending and the cost to banks of servicing these loans invariably means that many less “credit-worthy” firms, according to banks’ stringent credit standards, would continue to be left out.

12. On the whole, the lack of investments since 1997 helps explain the present structure of the Philippine economy, where agriculture and manufacturing have stagnated leaving the service sector to drive growth. Lack of market access, including rural roads for transporting agricultural produce, is an important constraint. Likewise, the economy’s narrow industrial base and low integration between high-technology manufactured exports and low-technology/scale domestic manufactures is the outcome of scarce direct investments that are the primary source of technology transfer, as well as a different sort of investment in research and development.<sup>12</sup> Given the predominance of small firms,<sup>13</sup> coordination mechanisms in terms of logistical support and spread of market information need strengthening.

## B. Finance Sector

### 1. ADB Assistance

13. Tables A9.3 and A9.4 indicate ADB assistance to the sector.

**Table A9.3: Project Support to the Finance Sector, 2001–2006**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$ million)	Co-financing (\$'000)
1858	15-Nov-01	DOF	Nonbank Financial Governance Program	75.0	none
2003	02-Sep-03	DOF	Second Nonbank Financial Governance Program	150.0	none
2199	15-Dec-04	DOF	Microfinance Development Program	150.0	none
2278	8-Dec-06	DOF	Financial Market Regulation and Intermediation Program	200.0	none

ADB = Asian Development Bank, DOF = Department of Finance.

Source: Asian Development Bank database.

<sup>11</sup> Microenterprises employ less than 10 people, while SMEs employ more than 10 but less than 200.

<sup>12</sup> Lim, Joseph. *Background Report on Trade and Investment*. Available: <http://www.adb.org/Documents/Events/2007/Country-Diagnosis-Analysis-Binding-Constraints/default.asp>

<sup>13</sup> Microenterprises and SMEs account for 32% of value added, 99% of business establishments, and 68% of employment (Source: ADB. 2005. *Private Sector Assessment for Philippines*. Manila).

**Table A9.4: Technical Assistance to Support the Finance Sector, 2001–2006**

TA Number	Date of Approval	Project Title	Amount (\$'000)
3773	15-Nov-01	Strengthening Regulatory and Market Governance	1,000
3847	19-Mar-02	Strengthening the Anti-Money-Laundering Regime	1,000
4168	02-Sep-03	Support for the Nonbank Financial Sector	500
4321	18-Mar-04	Strengthening Governance of Securities Trading Markets	250
4544	23-Dec-04	Enhancing Access of the Poor to Microfinance Services in Frontier Areas	250
4693	22-Nov-05	Support the Implementation of the Microfinance Development Program	500
4884	06-Dec-06	Strengthening Regulation and Governance	800

TA = technical assistance.

Source: Asian Development Bank database.

## 2. Performance Assessment

14. **Relevance.** ADB sector assistance was aligned with the Government sector priorities and ADB country and sector strategies to support the development of the nonbank financial subsector and microfinance. The nonbank financial subsector program loans and advisory technical assistance (ADTA) projects focused on critical constraints to sector development, particularly (i) the weak and fragmented regulatory and policy framework; (ii) inadequate compliance by market participants; (iii) weak enforcement by the securities regulator; (iv) small and underdeveloped equity and corporate bond markets; (v) lack of investor confidence in the stock exchange due to its weak governance structure and low quality of financial information available to the public; and (vi) absence of a conducive policy and regulatory framework for collective investment schemes. Assistance to the microfinance sector helped to address the lack of viable microfinance institutions, and lack of knowledge and awareness among the general population of available microfinance services. ADB's assistance to the sector was "highly relevant."

15. **Effectiveness.** ADB assistance resulted in (i) a significantly improved securities regulatory framework through the enactment of the Securities Regulation Code; (ii) an organizationally stronger and more capable securities regulator through reorganization of the Securities and Exchange Commission and the training it received; (iii) improved governance structure of the stock exchange; (iv) establishment of an effective anti-money-laundering regime; (v) establishment of a fixed income exchange; (vi) increased transparency and quality of financial information through the adoption of international accounting and auditing standards; (vii) adoption of a blueprint for capital market development; (viii) development of a national financial literacy program; and (ix) increase in the number of viable microfinance institutions. However, ADB assistance was less effective in (i) strengthening prudential standards for all nonbank financial institutions (NBFIs) because risk-based capital adequacy standards have been adopted only for brokers and dealers; (ii) facilitating the mobilization of savings to increase the supply of investment funds (mutual funds and pre-need plans); (iii) providing adequate protection for pre-need plan holders; and (iv) diversifying ownership of the stock exchange. Much of the success of ADB's assistance may be attributed to strong Government ownership of the reforms advocated in the program loans and ADTA projects, the good relationship of ADB with the executing and implementing agencies, and the high quality and appropriate mix of international and national consultants engaged for the projects. Hence, ADB operations were "effective."

16. **Efficiency.** The four program loans were prepared, negotiated, and started in a timely and efficient manner. The three loans that have been completed were, in fact, closed ahead of schedule. The efficient manner in which the program loans were implemented was due to the Government's commitment to finance sector reforms and the design of the programs, which took into account lessons from previous programs. For instance, one of the lessons from the Capital Market Development Program was to avoid excessive reliance on enactment of legislation that may make implementation of policy actions unpredictable. The subsequent program loans to the sector therefore ensured that existing market regulations, if found satisfactory, were adequately enforced. If enactment of legislation is absolutely necessary and has a high likelihood to be passed by Congress (as in the case of the Securities Regulation Code), then it was front-loaded as a first tranche release condition of a program loan to ensure up-front compliance and timely implementation. Efficiency of the ADTA projects was more problematic. All the ADTA projects experienced delays in commencement ranging from 4 to 7 months. This was attributed to changes in project officers, changes in ADTA design, and delays in the recruitment and fielding of consultants. In addition, the completion of three ADTA projects took 15 to 28 months longer than initially anticipated, mainly because the time required to complete all the planned outputs and activities was underestimated. Generally, ADB operations were assessed "efficient."

17. **Sustainability.** The Government has exhibited strong ownership and commitment to continue reforms in the sector. For example, with assistance from ADB, the Government has developed and published the Capital Market Development Blueprint, which will serve as a roadmap to development of the nonbank financial subsector. In addition, the Securities and Exchange Commission, Bangko Sentral ng Pilipinas, Insurance Commission, and Philippine Deposit Insurance Corporation have established a multilateral agency forum to facilitate consultations and exchange of information among members on matters relating to the supervision and regulation of financial institutions. However, some factors are beyond the administrative branch's control and may affect the sustainability of ADB-supported reform efforts. For example, Congressional action is needed to enact tax measures that would ensure equity between bank and nonbank products; legislation is required to promote the development of mutual funds, private pension funds, and other collective investment schemes. While such legislative action is anticipated, it can certainly not be guaranteed. In general, ADB assistance was assessed "likely sustainable."

18. **Impact.** ADB operations in the nonbank financial subsector have contributed to strengthening the regulatory and policy framework, building the capacity of regulatory agencies, improving governance structures and prudential standards among market participants, enhancing investor protection, and improving market infrastructure. However, the main objective of ADB's finance sector assistance was to develop a vibrant and resilient nonbank financial subsector that can adequately support economic growth. This has not been achieved. Banks continue to dominate the finance sector. The ratio of bank resources to NBFIs resources as of year-end 2007 was 4:1, exactly the same ratio as in 1996. Perhaps more troubling is the fact that NBFIs resources as a percentage of GDP declined from 24.3% in 1996 to 20.8% in 2001 and 18.2% in 2007. This means that growth in NBFIs resources has not kept up with the expansion of the economy. Even though the stock market was thin, the market capitalization of the PSE grew from 5.9 trillion in 2005 (109.4% of GDP) to nearly 8.0 trillion (120.0% of GDP) in 2007. However, the ₱2.1 trillion increase in market capitalization from 2005 to 2007 was brought about almost exclusively by the increase in stock prices; only ₱147 billion of capital was raised or 7% of the increase. In terms of enhancing access of the poor to financial services, the impact of ADB assistance was direct and immediate: active microfinance clients nearly doubled from 1.4 million in June 2004 to 2.7 million in June 2007, of which more than 90% of the borrowers

were women. Impact is, therefore, “substantial.” Overall sector performance is assessed “successful.”

19. **Key Lessons.** An effective and efficient finance sector requires time and difficult governance reforms in regulation and supervision, combined with structural diversification of financial channels to promote competition and improved private sector governance. Reforms of this nature need a continuous process. Initially, ADB’s sector assistance program emphasized establishment of the legal and regulatory frameworks, governance codes, and basic market infrastructure required for developing capital markets. To increase the benefits from the infrastructure now set in place, the following are needed: deepening of the product mix, further measures to reduce transaction costs, promotion of the corporate bond market, and awareness programs to encourage greater use of the capital markets for mobilizing investment capital. Success of reforms also depends on the success of reform programs in associated sectors (for example, macroeconomic, judicial, infrastructure, industry); and the political and economic environment requiring political and economic stability to restore confidence in capital market institutions, and encourage the private sector to make more use of them as viable alternatives for bank financing. The integrated nature of financial markets increases their sensitivity to regional and global developments. The development of NBFIs, and particularly those that serve the poor, remains an important challenge. The main lesson from ADB assistance for NBFIs is that development of institutional infrastructure takes time, and as market confidence improves the development of the capital markets will likely play an important role in mobilizing and channeling investment finance, both from domestic sources and from abroad.

## C. Energy Sector

### 1. ADB Assistance

20. For the past three decades, ADB was the lead development partner in support of power reform, supporting investments in distribution, privatization of generation and distribution systems, and capacity building in energy sector regulation. Since 1971, ADB has provided 30 loans with a combined value of \$2.95 billion to the energy sector. This included 20 loans to National Power Corporation (NPC), guaranteed by the Government, with a combined value of \$1.6 billion. In addition to lending, ADB provided two partial credit guarantees to help NPC raise long-term funds totaling \$642 million. ADB has also provided 34 TA grants to the energy sector with a combined value of \$16.5 million, covering areas such as (i) coal industry development, (ii) rural electrification, (iii) energy conservation, (iv) tariff and pricing studies, (v) regulation, (vi) consumer impact assessment, (vii) geothermal steam and natural gas pricing studies, (viii) power development planning, (ix) feasibility studies, and (x) environmental assessments. During the country assistance program evaluation period, ADB provided lending support for the Power Sector Restructuring Program (PSRP) in 1998, Electricity Market and Transmission Development Program in 2002, Power Sector Development Program (PSDP) in 2006, and a private sector project for the acquisition and rehabilitation of the Masinloc Coal-Fired Thermal Power Plant in 2008.<sup>14</sup> The first of the two projects were cofinanced with the Japan Bank for International Cooperation, and the others were financed solely by ADB.

21. In 1998, the focus of ADB’s power strategy was to invest in selected transmission and distribution operations and support rural electrification, while providing policy advice to help restructure the subsector, foster NPC privatization, and develop the regulatory framework for

<sup>14</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of the Philippines for the Acquisition and Rehabilitation of the Masinloc Coal-Fired Thermal Power Plant*. Manila (Loan 2405-PHI, for \$200 million, approved on 15 January).

private sector participation. The 2001 CSP highlighted the need to assist NPC prioritization and strengthen regulation, while supporting the overall efficiency of the power industry by integrating the Luzon–Leyte and Mindanao grids. More emphasis was to be placed on rural electrification, use of renewable resources, and strengthening the transmission and distribution system in less developed areas to improve access to electrification. As NPC losses soared, the focus of ADB assistance shifted to NPC privatization from 2002 to 2005. The CSP for 2005–2007 focused ADB support on improving energy sector governance to improve financial solvency and regulation, and to further power reforms to reduce system losses and the fiscal drain of power agencies.

**Table A9.5: Project Support to the Energy Sector, 1998–2008**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$'000)	Finance (\$'000)
1662	16-Dec-98	DOF	Power Sector Restructuring Program	300.0	300.0
1984	19-Dec-02	NPC	Electricity Market and Transmission Development	40.0	45.5
2282	8-Dec-06	DOF	Power Sector Development Program	450.0	
–	15-Jan-08	MPPCL	Acquisition and Rehabilitation of Masinloc Coal-Fired Thermal Power Plant	200.0	

ADB = Asian Development Bank, DOF = Department of Finance, MPPCL = Masinloc Power Partners, NPC = National Power Corporation.  
Source: Asian Development Bank database.

22. ADB provided significant assistance through policy dialogue, support for institutional capacity building, as well as by reviewing and monitoring the power reform and privatization process. Eleven TA grants were provided to support different aspects of sector policy reform (e.g., pricing, consumer impact, competition policy, and privatization), institutional strengthening, rural electrification, and use of renewable energy sources. Of these, four were for project preparation and seven were ADTA projects aimed at developing institutional capacity and supporting policy reform. Of the seven ADTA projects, six were standalone TA projects and one (Transition to Competitive Electricity Market TA) was attached to the Electricity Market and Transmission Development Project.

**Table A9.6: Technical Assistance to Support the Energy Sector, 1998–2007**

TA Number	Date of Approval	Project Title	Amount (\$'000)
3126	16-Dec-98	Electricity Pricing and Regulatory Practice in a Competitive Environment	600
3127	23-Mar-00	Consumer Impact Assessment	720
3422	23-Mar-03	Rural Electrification Institutional Strengthening	750
3516	10-Oct-00	Rural Electrification	600
3820	19-Dec-01	Competition Policy for the Electricity Sector	990
4073	19-Dec-02	Transition to Competitive Electricity Markets	800
4151	18-Jul-03	Promoting Good Governance in the Restructured Power Sector	800
4174	16-Sep-03	Rehabilitation of Renewable Energy Projects for Rural Electrification and Livelihood Development	800
4198	18-Oct-03	Institutional Strengthening for the Development of Natural Gas Industry	800
9042	19-Jan-04	Renewable Energy and Livelihood Development Project For The Poor In Negros Occidental	1,500
4557	28-Dec-04	Institutional Strengthening of ERC and Privatization of NPC	1,200

ADB = Asian Development Bank, ERC = Energy Regulatory Commission, NPC = National Power Corporation, TA = technical assistance.  
Source: Asian Development Bank database.

23. The PSRP and PSDP were the main instruments through which policy reform in the sector was pursued. The PSRP's policy matrix included 60 actions and measures to be completed by the Government within 3 years. The objectives included (i) create an enabling legal and regulatory environment to support competitive electricity markets, (ii) restore the financial viability of NPC through privatization, (iii) unbundle and corporatize NPC's operations to facilitate introduction of competitive electricity markets, (iv) establish open access transmission and distribution systems needed to support competitive electricity markets, (v) improve the operating efficiency of the distribution subsector so that it can actively participate in competitive markets, and (vi) promote energy efficiency and demand-side management to supplement efficiency gains from competitive markets. In April 2004, the program completion review evaluation found high formal compliance, with 80% of these measures fully implemented and 20% partly implemented. The legal, regulatory, and institutional framework was largely established; NPC was unbundled and corporatized; and the preparations for privatization and wholesale competition were advanced. However, the objectives of making the sector financially viable, and privatizing NPC's assets were not achieved. In addition, the technical expertise of the Energy Regulatory Commission (ERC) under the new regulatory regime was uncertain. Building on the lessons of the PSRP, the 2006 PSDP was designed with two subprograms, each with 2-year time horizons, covering 2007–2008 and tentatively 2009–2010. Target dates were set only for subprogram 1 to allow flexibility in the overall implementation schedule and to allow the results of the first phase to help define the scope and phasing of the second subprogram. Objectives of the first phase include (i) ensuring and sustaining financial viability of the power subsector, (ii) strengthening regulatory framework and performance, (iii) restructuring the market toward competition, (iv) promoting and increasing private sector participation in power generation and transmission, and (v) enhancing consumer welfare and protection. ADB has played a role in aid coordination in the sector. In particular, to improve coordination of ADB and World Bank assistance, an understanding was reached in 1998 whereby ADB would take the lead in providing policy advice to the Government on power restructuring, while continuing support to NPC before its privatization; the World Bank would assume a more prominent role in rural electrification programs.

## 2. Performance Assessment

24. **Relevance.** ADB sector strategies and assistance program were closely aligned with what was required in the country over time, and with Government sector priorities. ADB support for restructuring power into a competitive market, in parallel with support for rural electrification and promotion of renewable energy, was appropriate given the significant challenges. The Electricity Market and Transmission Development Project supported commencement of commercial operations of the wholesale electricity spot market in Luzon in June 2006,<sup>15</sup> which then facilitated the privatization of NPC's power generation assets. This loan was responsible as well for resolving transmission constraints in Luzon and improving system reliability in Mindanao. Both program loans confirmed ADB's resolve to work with the Government to restructure power; and to establish a legal, regulatory, and institutional framework for privatization and competition. The TA projects and policy dialogue were supportive of the reform process, and designed to fill knowledge gaps necessary to successively advance policy and institutional reform. ADB's assistance to the sector was "relevant."

25. **Effectiveness.** The key objectives of ADB support to the power subsector have largely been achieved. ADB assistance resulted in (i) a power subsector that has been restructured and exhibits improved financial viability, a stronger regulatory framework, greater competition and

<sup>15</sup> The market management system is a component of the Electricity Market and Transmission Development Project, which provided the computer hardware and software required to manage the bidding, dispatch optimization, and market settlement functions of the wholesale electricity spot market.



private sector participation in power generation and transmission, and enhanced consumer welfare and protection; (ii) a working electricity spot market using the market management system procured under the Electricity Market and Transmission Development Project, (iii) improved awareness among rural communities of the importance of community and cooperative activities in support of rural electrification using new and renewable energy resources; and (iv) accelerated progress in power privatization. The ADTA project was generally effective in generating the outputs expected, but less successful in building institutional capacity, largely because of excessive reliance of the executing agencies on the consultants. Operations completed during the CAPE period were “effective.”

26. **Efficiency.** Delays in securing policy reforms under the PSRP were due to the time required to secure approval of new legislation. Wisely, changes in legislation were avoided in the design of the PSDP loan. Moreover the use of a single tranche disbursement under the PSDP helped ensure that the Government secured sufficient support for reform prior to launching the program. There were, however, delays in the start-up of operations for power ADTA projects ranging from 7 to 10 months due to a lengthy recruitment process and difficulties in scheduling consultant selection meetings. ADB headquarters provided regular and timely supervision of assistance activities, which played an important role in encouraging timely implementation of reforms that were both technically and politically demanding. As such, ADB operations were assessed “efficient.”

27. **Sustainability.** An action plan for the power subsector was developed through the PSDP to sustain progress made in the restructuring process and address critical challenges. Development of a more competitive and private-sector-led energy market has coincided with the loss of substantial numbers of officials to the private sector who were trained under ADB-supported TA. This increases the risk that the Government will have insufficient capacity to exercise its regulatory and oversight functions, and to carry necessary reforms forward. In some areas, such as rural electrification, a combination of personnel turnover and excessive reliance on consultants, has substantially weakened the Government’s capability to carry forward electrification development efforts. Hence, ADB assistance was assessed “likely sustainable.”

28. **Impact.** ADB operations in the power subsector contributed to the policy framework governing the ongoing restructuring for power. The overall impact of ADB assistance is therefore assessed as “substantial.” The restructuring program, as outlined in the Electric Power Industry Reform Act, has contributed to a financially sustainable, efficient, and secure power supply. It has reversed the drain on the budget caused by power subsidies, which peaked in 2002–2003, and succeeded in overcoming the crippling power shortages of the late 1990s. As a result of the restructuring, privatization of generation assets is expected to reach 70% by the end of 2008. The wholesale electricity spot market has been in operation since June 2006, and shortly thereafter, ERC promulgated rules on energy sector competition. While these rules may need to be revised and strengthened, the essential first steps toward establishing the regulatory infrastructure for a competitive power industry were taken with ADB support. ADB assistance helped strengthen ERC’s capacities by developing an operations manual and a case tracking system. This had led to a substantial reduction in challenges to ERC rulings starting in 2007. ERC has promulgated performance-based regulation for transmission and distribution businesses. The Department of Energy has been reorganized to perform its expanded mandate of supervising implementation of power reforms, including power planning. Private sector participation in rural areas has been aggressively pursued, leading to the entry of several new participants in rural power markets. ERC has introduced a Magna Carta for residential consumers, and the Department of Energy has initiated other customer awareness and empowerment programs. Thus, overall ADB assistance is assessed “successful.”

## URBAN SECTOR

### A. ADB Assistance

1. Over the last decade, the pattern of urbanization throughout the country has been evolving. Rapid urbanization, coupled with poor planning, was responsible for the largely uncontrolled spread of development into suburban locations, resulting in many existing problems. Economic activities and residential areas are moving outward into adjacent rural municipalities forming urban clusters or small metropolitan areas. In 2000, about 72% of the urban population are squatters and slum dwellers, living in unserved or poorly served communities.

2. Urban sector development has been a long-standing strategic priority of the Asian Development Bank (ADB). ADB's assistance has been generally aligned with the Government's priorities and strategies in the sector. The 1998 Country Operational Strategy Study defined ADB urban assistance strategy as (i) supporting urban services, (ii) providing policy advice and capacity building in managing water supply and sanitation (WSS), (iii) fostering private sector participation in urban services and WSS, and (iv) building local government unit (LGU) capacities. Urban sector initiatives were extended in the 2001–2003 Country Operational Strategy Study to include support for urban policy reforms, such as the Manila Air Quality Act and to rationalize the financing mechanism for urban development. The 2002–2004 Country Strategy and Program Update emphasized the need to improve the urban environment, with a focus on ADB support for improved urban air quality, surface water quality, and solid waste management. The 2005–2007 Country Strategy and Program emphasized investments in water supply improvement to Metro Manila and urban services for the poor in Metro Manila.

3. The assistance of ADB in the urban sector has been varied, sometimes targeting a particular enterprise zone (e.g., Clark and Subic), or an entire region (i.e., Mindanao Basic Urban Services), or covering a particular aspect of the management of a major metropolitan city (e.g., Metro Manila Air Quality Improvement and Pasig River Environmental Management programs), or particular types of urban services (e.g., Development of Poor Urban Communities Sector Project, which introduced microfinancing in the housing sector) (Table A10.1). Nonlending assistance focused on project preparation and on building capacities for urban management, in areas such as regulating metropolitan waterworks and sewerage, and developing a housing microfinance system (Table A10.2). Compared to other development partners, ADB has played a relatively small role in financing urban development. As of 2005, total net loan commitments for urban infrastructure amounted to \$4.34 billion, of which ADB provided \$216 million (5%); while Japan Bank for International Cooperation provided \$3.22 billion (74%); World Bank, \$388 million (9%); and other development partners, \$512 million (12%).

**Table A10.1: Project Support to the Urban Sector, 1997–2003**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$ million)	Cofinancing (\$'000)
1599	19-Dec-97	SBMA	Subic Bay Area Municipal Development	22.0	1,000
1658	15-Dec-98	DILG	Clark Area Municipal Development	24.3	none
1663	16-Dec-98	DENR	Metro Manila Air Quality Improvement SDP	200.0	170,000 (tentative)
1664	16-Dec-98	LBP	Metro Manila Air Quality Improvement (Air Pollution Control Facility)	25.0	none
1665	16-Dec-98	DENR, DPWH, MMDA, DOH, DOTC	Metro Manila Air Quality Improvement (Investment Loan)	71.0	4,500 plus 1,490 (3 TA grants)
1745	20-Jul-00	DOF, PRRC	Pasig River Environmental Management and Rehabilitation SDP (Program Loan)	100.0	none
1746	20-Jul-00	PRRC	Pasig River Environmental Management and Rehabilitation SDP (Project Loan)	75.0	Cofinancing grants were negotiated
1843	27-Sep-01	LBP, DILG	Mindanao Basic Urban Services Sector	30.0	6,000
2063	18-Dec-03	DBP, HUDCC	Development of Poor Urban Communities Sector	30.5	none

DBP = Development Bank of the Philippines, DENR = Department of Environment and Natural Resources, DILG = Department of the Interior and Local Government, DOF = Department of Finance, DOH = Department of Health, DOTC = Department of Transport and Communication, DPWH = Department of Public Works and Highways, HUDCC = Housing and Urban Development Coordinating Council, LBP = Land Bank of the Philippines, MMDA = Metro Manila Development Authority, PRRC = Pasig River Rehabilitation Commission, SBMA = Subic Bay Metropolitan Authority, SDP = sector development program, TA = technical assistance.

Source: Asian Development Bank database.

**Table A10.2: Technical Assistance to Support the Urban Sector, 2001–2006**

TA Number	Date of Approval	Project Title	Amount (\$)
3469	20-Jul-00	Capacity Building Support for Pasig River Environmental Management and Rehabilitation	1,000,000
4293	18-Dec-03	Capacity Building for Housing Microfinance	1,500,000

TA = technical assistance.

Source: Asian Development Bank database.

4. The first two projects, i.e., Subic Bay Area Municipal Development and Clark Area Municipal Development were in response to the development of the two former American Bases—Subic Naval Base in Zambales and Clark Airfield in Pampanga—into free ports or economic processing zones. They were also in response to two major policy developments—the Local Government Code of 1991 and the National Urban Development and Housing Framework (2000). Both projects aimed to support economic growth in the municipalities around the economic zones by providing necessary infrastructure facilities and services. They were designed to improve the planning and administrative capacity of LGUs and to contribute to poverty reduction in the project areas. While the basic objectives of the Mindanao Basic Urban Services were similar—provide basic infrastructure to support economic growth; improve access to basic urban services for the poor; strengthen institutional capacity and capability of LGUs to provide, manage, and maintain adequate municipal services and basic urban infrastructure—it has an added goal of overcoming inequities in access to urban services in Mindanao.

5. All three of these urban development projects were developed based on substantial sector analysis, and designed in close coordination and dialogue with concerned government agencies; LGUs; and in the case of the Pasig River Environmental Management Program, with nongovernment organizations and project-affected families. While some problems during project

implementation hampered the attainment of stated objectives, many of the factors may have been difficult to foresee during project design and appraisal. These include the change in leadership in Subic Bay Metropolitan Authority, the delay in the organization of the Municipal Development Fund Office, changes in the leadership of Department of Interior and Local Government, and a change in Government leadership in 2001.

6. ADB had two projects during the country assistance program evaluation period that focused on providing an integrated array of policy and investments aimed at improving the urban environment. The first was the ADB Pasig River Environmental Management Program. This was designed in 1999 to be the first 5-year slice of support to the Pasig River Development Program, which was completed in April 1998 and proposed a 15-year program aimed at improving water quality of the river to class “C” standard and encouraging urban renewal along the Pasig River basin. President Estrada considered it a flagship project and provided more than ₱1 billion to resettle informal settlers living along the riverbanks even before the ADB loan became effective. Under the project, ADB supported the creation of the Pasig River Rehabilitation Commission; and with its transfer to the Department of Environment and Natural Resources, the institution may evolve to become a strong technical arm of the department for river environmental management and rehabilitation not only of the Pasig River but for other river systems that have been severely polluted. Relocation efforts of residents along the Pasig River basin has had short-term costs—income-earning opportunities in the resettlement sites are limited, except for the Taguig Resettlement Site (which is still in Metro Manila)—but in the long-run, the resettled communities may evolve to become economically viable. Some quality improvement in the Pasig River water supply is evident, although this needs to be scientifically validated.

7. In support of the Clean Air Act of 1999, ADB’s second project during the country assistance program evaluation period aimed at improving the urban environment was the Metro Manila Air Quality Project, which provided assistance for policy reforms, technical improvement and monitoring of air quality in Manila, and reduction in vehicle emissions. After a series of project extensions, about half of the investment support was canceled, and prospects for achieving project goals in the areas of air quality monitoring and vehicle emission control appear doubtful.

8. The newest project in the urban sector is Development of Poor Urban Communities. This project is aimed at helping the poor gain access to credit by improving their tenure rights, and generating start-up income-generating activities (i.e., enterprise building). The project has built on lessons from previous urban projects, and introduces an innovative market-based shelter-financing and microcredit facility for low-income households.

## **B. Performance Assessment**

9. **Relevance.** All of the technical assistance (TA) and loan projects were consistent with Government and ADB sector strategies for urban development. All of the projects were designed to meet priority urban development challenges, were aligned with the Government’s urban development strategies, and designed in a well-informed and consultative manner. However, particularly in the case of the Subic and Clark projects, ownership of the various subprojects was insufficient. In general, assistance to the sector was rated “relevant.”

10. **Effectiveness.** The projects provided much-needed municipal infrastructure, environmental hazard mitigation measures, and pilot schemes, which have proven effective in instances where ownership by participating mayors was strong and coordination among the

agencies involved was good. The Metro Manila Air Quality Program has been delivering intended results with respect to selected project components, but the intended outcome of improved air quality has yet to be realized. The Subic and Clark projects achieved less than was intended when the projects were formulated and were subject to substantial cancellations. The Pasig River Environmental Management and Rehabilitation Project and the Manila Air Quality Improvement Program progressed on project components. The Mindanao Basic Urban Services Sector (MBUSS) Project and the Poor Urban Communities Project are delivering intended results. Overall, operations undertaken during the CAPE period were “effective” in terms of improving outputs and outcomes.

11. **Efficiency.** Assessing efficiency is difficult, because four of the five loans are not yet completed. However, a combination of slow loan disbursement and subproject cancellation would imply that resources have not been deployed in an efficient manner. In the case of the Subic Project, 22 subprojects out of 27 were canceled with only \$5.2 million out of the total \$37 million disbursed; In the case of the Clark project; only 5 of 24 infrastructure subprojects were completed, with only \$7.2 million out of the total \$41.8 million disbursed. As such, ADB operations were assessed “less efficient.”

12. **Sustainability.** Much of the infrastructure developed under ADB projects is being properly maintained, except for the Pasig sewerage management plant. Sustainability is threatened by insufficient tariffs, and inadequate funding for operation and maintenance. In addition, many project staff are unable to continue working for project executing agencies after project completion because they were hired on a contract basis for the project. Thus, ADB assistance was assessed “less likely sustainable.”

13. **Impact.** The projects have introduced new concepts and approaches to managing the urban environment. Basic infrastructure projects, such as roads and bridges, water supply, drainage, transport terminals and public markets have made a substantial contribution to the quality of life of project beneficiaries, particularly the poor. Better municipal services, for example, have been provided to more than 700,000 beneficiaries in Mindanao as a result of the 17 completed subprojects under the MBUSS Project. Equally important, water supply subprojects under the MBUSS Project have increased the number of household connections resulting in improved access to better water quality; savings for water expenses, and day-long availability of water supply. In addition, ADB projects introduced new capacities for environmental hazard mitigation, for ambient air quality control, traffic exhaust monitoring and control, river water control, and riverbank management. In the long run, this should have a positive impact, particularly on human health. However, at this stage impact is assessed “modest.”

14. The three LGU-focused projects implemented through the Department of Interior and Local Government, the Subic Bay Area Municipal Development Project, Clark Area Municipal Development Project, and MBUSS Project included measures aimed at building capacity in project planning, project design, contract management, environmental management, water supply provision, municipal enterprise management, resource generation, budgeting, programming, and financial management. LGUs are generating additional local revenues from the supply of bulk water in some municipalities, and ADB urban projects have assisted LGUs in their efforts to improve local resource conditions through better tax administration, expanded tax base due to increased economic activities, and efficiently managed municipal enterprises. The urban projects have provided opportunities for financial intermediaries such as Development Bank of the Philippines, Land Bank of the Philippines, and Municipal Development Fund Office to better understanding the potential LGU market and to improve their approaches and

processes to become more responsive to LGU needs, political culture, and administrative constraints.

15. Overall, ADB assistance performance in the urban sector is assessed “partly successful.”

16. **Key Lessons.** ADB assistance has contributed to innovative solutions to the provision of urban services, particularly in some small- and medium-sized cities, and helped to improve municipal management policies. A key lesson from relatively weak project implementation performance is that urban development is hampered by a wide range of contextual factors that must be considered in project design. ADB’s urban development projects suffered from multiple institutional layers, fiscal constraints, the 3-year mayoral tenure cycle, bureaucratic inefficiencies including complicated multiagency mandates and project management unit set-up, and a series of difficult land acquisition issues. Another key lesson is the need for a more thorough assessment of local institutions and risks at the design and appraisal stage. In the case of sector projects, a rigorous assessment of institutional capacity is needed prior to committing new subprojects. Moreover, success factors and good practices between project and nonproject municipalities can provide insights on design and implementation issues between municipalities.<sup>1</sup> The mixed results in the urban development sector suggests a need for assistance approaches that foster widespread participation in design and implementation, combined with designs for operations that can more effectively anticipate and address complex cross-sector concerns. In view of the small role which ADB plays on urban sector financing, harmonization and coordination with other donors should be continued to strengthen complementarities. Facilitation of greater private sector involvement in the provision of urban infrastructure and services should also be encouraged through strengthening of public-private sector partnerships.

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<sup>1</sup> For example, successful management of land acquisition for Marikina by a committed municipal government with strong leadership was key to riverside environmental cleanup, improved flood management, lowered flood damage costs, and improved common recreational facilities.

## AGRICULTURE AND RURAL DEVELOPMENT SECTOR

### A. Government Policy and Plans

1. The Medium-Term Philippine Development Plan 2004–2010 aims to develop at least 2 million hectares of new agribusiness lands to create 2 million jobs in the next 6 years, and make food plentiful at competitive prices. To accomplish these, the Government aims to (i) establish the framework/mechanisms, including public-private partnership arrangements that will facilitate the transformation of farmlands into agribusiness enterprises; (ii) organize a large-scale community-based and environment-friendly program of crop and fishery production intensification and diversification; (iii) transform idle agricultural lands, offshore and inland bodies of water, as well as marginal lands into productive agribusiness enterprises; (iv) promote off and nonfarm enterprises to increase and stabilize rural income; and (v) make Mindanao as the country's main agro-fishery export zone. Other envisaged initiatives include (i) raising factor productivity to approach the regional average within 6 years; (ii) increasing effectiveness, adequacy, and efficiency of the agricultural sector's transport and logistical support system for both farm inputs and produce to approach regional standards; and (iii) implementing critical governance reforms to be responsive to the demands of the sector.

2. A key locus of government plans has been the implementation of the Fisheries Code and the Agricultural and Fisheries Modernization Plan, which focus limited Government resources on a few strategic interventions in partnership with farmers and fisher folk and other supporting Government and nongovernment institutions. This plan was intended to produce a critical mass of rural sector development outcomes leading to a positive socioeconomic impact. It addressed the issue of coordination among the multiplicity of government institutions involved in the sector. More recently, there has been a shift in emphasis toward the area of land under cultivation and employment as the population continues to rise.

### B. ADB Assistance

3. In support of the Government's newly promulgated market-oriented reform programs, the Asian Development Bank (ADB) aimed assistance for agriculture and rural development (ARD) at irrigation development, provision of rural infrastructure, improved research and extension services, forestry and fisheries resource management, crop diversification, microcredit, and agribusiness promotion. This was linked to the local government unit (LGU) capacity building to strengthen cooperation between LGUs and nongovernment organizations, rural transport and electrification investments, and community-based management of natural resources. With the 2001 Country Assistance Plan, ADB shifted its emphasis to institutional reform to enhance rural service delivery, including continued strengthening of LGUs and support for decentralization; capacity building for community development; reform of forestry and natural resource management; and support for coastal resource management. However, ADB support has not been as wide ranging as originally set out in country programs. Ongoing lending operations during the country assistance program evaluation period included the Grains Sector Development Program, Infrastructure for Rural Productivity Enhancement, Microfinance for Rural Development, Agrarian Reform Communities I, Fisheries Resource Management, Integrated Coastal Resource Management, and Southern Philippines Irrigation Sector projects.

4. From 2003 onward, greater focus on rural assistance was adopted, with a concentration on integrated coastal resource management, rural road development, and agrarian reform. Advisory technical assistance (TA) projects were linked to developing an irrigation service fee, analysis of grain market policy and institutional reforms, preparation of a policy for developing and maintaining rural

roads, a master plan for the Agusan River Basin, and a strategy for sustainable aquaculture development. Only one new investment project was approved during the country assistance program evaluation period indicating that ARD projects need a more realistic strategy. ADB assistance performance in ARD sector is assessed as “partly successful” based on the following criteria: relevance, effectiveness, efficiency, sustainability, and impact. ADB’s loan and TA projects to the sector are listed in Tables A11.1 and A11.2.

**Table A11.1: Project Support to the Agriculture Sector, 1992–2007**

Loan Number	Date Approved	Executing Agency	Project Title	ADB Finance (\$ million)	Cofinancing (\$'000)
1191(SF)	19-Nov-92	DENR	Forestry Sector	50.0	none
1192	19-Nov-92	DENR	Forestry Sector	50.0	none
1365	30-Aug-95	NIA under the DA	Second Irrigation Systems Improvement	15.0	none
1366(SF)	29-Aug-95	NIA under the DA	Second Irrigation Systems Improvement	15.0	none
1421	11-Jan-96	DA	Cordillera Highland Agricultural Resource Management	9.5	5,318
1422(SF)	11-Jan-96	DA	Cordillera Highland Agricultural Resource Management	9.5	none
1453(SF)	23-Jul-96	PGB	Bukidnon Integrated Area Development	20.0	none
1562(SF)	16-Oct-97	DA	Fisheries Resource Management	14.999	19,300 (expected)
1563	16-Oct-97	DA	Fisheries Resource Management	20.223	none
1667	18-Dec-98	DAR	Agrarian Reform Communities	93.162	none
1668	18-Dec-98	NIA/PGAN	Southern Philippines Irrigation Sector	60.0	none
1772	31-Oct-00	DA	Infrastructure for Rural Productivity Enhancement Sector	75.0	1,000
2311	23-Jan-07	DENR	Integrated Coastal Resources Management	33.8	9,000

DA = Department of Agriculture, DAR = Department of Agrarian Reform, DENR = Department of Environment and Natural Resources, NIA = National Irrigation Administration, PGAN = provincial government of Agusan del Norte, PGB = provincial government of Bukidnon.

Source: Asian Development Bank database.

**Table A11.2: Technical Assistance Support to the Agriculture Sector, 2000–2005**

TA Number	Date of Approval	Project Title	Amount (\$)
3393	21-Jan-00	Implementation of the Convention on Biological Diversity	120,000
3429	24-Apr-00	Grains Policy and Institutional Reforms	630,000
4552	23-Dec-04	Master Plan for the Agusan River Basin	970,000
4708	02-Dec-05	Strategy for Sustainable Aquaculture Development for Poverty Reduction	600,000

TA = technical assistance.

Source: Asian Development Bank database.

### C. Performance Assessment

5. **Relevance.** ADB interventions over the review period were designed to support Government policy and institutional reforms, in particular to decentralize implementation to local government units (LGUs). Several projects aimed to increase agricultural productivity, the key challenge facing the country’s agriculture sector. The Southern Philippines Irrigation Sector



Project (SPISP) and Second Irrigation Systems Improvement Project (ISIP II) were in line with government efforts to improve irrigation facilities. Recognizing ownership as a prerequisite for project success, ADB tried to involve different stakeholders (LGUs, nongovernment organizations [NGOs], and communities) in most of its projects (Forestry Sector Project [FSP], Fisheries Resource Management Project [FRMP], SPISP, ISIP II, Cordillera Highland Agricultural Resource Management [CHARM], Bukidnon Integrated Area Development Project, Agrarian Reform Community [ARC] Project, Infrastructure for Rural Productivity and Enhancement Sector [IRPES], and Integrated Coastal Resources Management [ICRM]). The FSP adopted a pioneering approach to involving NGOs, in addition to local communities, as partners of the government in forest management in the Philippines. Its success with community organization was a model for succeeding government projects in fisheries. Many projects took an integrated agricultural development approach to rural development in an attempt to achieve greater impact. However, a failure to provide an enabling environment for different institutions to cooperate and coordinate their roles at the design stage resulted in poor integration of project components. The assumption that interagency cooperation would continue after projects were complete was unrealistic.

6. Assistance for policy change—in the areas of grain marketing, forestry code, and rural road development—was necessary but ran ahead of the Government's ability to mount comprehensive policy change. The design of assistance suffered from a lack of geographic focus. Except for the CHARM Project, ISIP II, and the Bukidnon Integrated Area Development Project, all the other projects were implemented throughout the country. ADB's assistance to the sector also suffered from insufficient attention to the influence of political economy factors on decision-making, to LGU capacity to provide counterpart funds, to the high transaction costs of different proposed credit mechanisms, and to the sensitivity of assistance outcomes to volatile global market conditions. ADB's assistance to the sector was "relevant" since it generally reflected government's policy and institutional reforms.

7. **Effectiveness.** Some projects (e.g., forestry) have underperformed. The general lack of results-monitoring information makes drawing a definitive conclusion on the degree to which program objectives were met difficult. In terms of supporting sector policy change, agriculture assistance has had a mixed record. ADB assistance aimed at liberalizing the rice market and reforming the forestry code did not eventuate. However, despite delays and the cancellation of the GSDP, ADB made positive contributions through other projects. For example under the ARC project, more than 1,200 kilometers of rural access roads, and some 7,900 ha of irrigation systems have been developed. In the case of IRPES, more rural roads and irrigation are being completed. These irrigation projects have contributed to an increase in the number of cropping seasons and higher paddy production. Farm-to-market roads, bridges, and domestic water systems yielded both economic and social benefits. Extension support has contributed to the adoption of new production techniques, new livelihood activities, and more sustainable management of natural resources. Other projects, such as those involving LGUs in the southern Philippines, have had a positive demonstration impact on neighboring LGUs, increasing the spread of project benefits. Generally, ADB assistance has contributed to transparency and accountability in the LGUs through projects, while enhancing skills that will be useful in identifying, preparing, implementing, and monitoring projects. The CHARM Project was rated as successfully achieving its outputs. Although it is still too early to make a definitive conclusion, the ARC Project, and the ICRM appear to be on track in realizing planned outcomes. Operations completed during the CAPE period have resulted in substantial outputs and outcomes and were generally "effective."

8. **Efficiency.** Efficiency of ADB assistance was affected by severe delays in project implementation associated with insufficient or delayed LGU counterpart funds; LGU difficulties in complying with ADB requirements; insufficient technical feasibility of certain project components; tardy responses from ADB (e.g., it took 23 months to approve the land acquisition and resettlement plan in one of the SPISP subprojects); turnover of executing and implementing agency officers; and external factors such as El Niño for the Forestry Sector Project, which delayed the planting of trees; frequent rains, which delayed construction activities such as rural roads for the Infrastructure for Rural Productivity and Enhancement Sector project in Agusan del Sur and an irrigation project for ISIP II; and a deteriorating peace and order situation in the south. Despite delays, the projects have generally realized positive economic internal rates of return, and in some cases, the benefits realized from projects were greater than those foreseen at the design stage. Examples of the latter include the following:

- (i) Increased investments. For subprojects providing access to the communities, additional infrastructure development took place (such as power lines for rural electrification and cellular sites) after ADB-supported projects were completed. This encouraged private investment, increased the land value, and subsequently raised the value of property taxes collected by the municipalities.
- (ii) Diversification to high-value crops. For the Infrastructure for Rural Productivity and Enhancement Sector Project, the entry of banana investors encouraged farmers to convert paddy lands to bananas for export, especially in western Mindanao. The banana plantations provided additional employment to the local community.
- (iii) Social benefits. The construction of rural roads and bridges yielded economic and social benefits, as more children attending school had easier access to hospitals.
- (iv) Spillover benefits. In the Agrarian Reform Community and Cordillera Highland Agricultural Resource Management projects, the infrastructure and support services developed are used by both intended and nontarget beneficiaries. In the projects in the southern Philippines, approaches used in project implementation were applied by the beneficiary LGU in other projects. Successful projects were often visited by other LGUs and best practices were replicated.

Conversely, ADB assistance aimed at reforming the policy setting—e.g., in grain marketing, forestry policy, and rural transport policy—has not yet realized its objectives in a timely manner, lowering the returns on investment in the subsector enabling environment. As such, ADB operations were assessed “less efficient.”

9. **Sustainability.** The overall sustainability of interventions is mixed. Even though sustainability issues were not fully taken into account at the design and implementation stages, many projects had real and sustainable outcomes. A problem was that recurrent resources required to operate and maintain rural infrastructure investments were not consistently forthcoming due to LGU budget constraints. An example is that of farm-to-market roads, which are the responsibility of municipal LGUs. These roads in the Cordillera Autonomous Region were often constructed over difficult terrain and subject to landslides and flooding. However, the Rural Road Development Policy Framework, although not formally adopted as a policy as recommended by the Rural Development Policy Framework TA, was used to set up the Special Local Roads Fund, a facility funded from 5% of motor vehicle user charges and created by the Department of Public Works and Highways and Department of Interior and Local Government. The fund can be used by LGUs to finance the repair and maintenance of local roads. This provides a small, but for some LGUs the only source of finance for local road operation and maintenance (O&M).

10. Another problem was that institutional sustainability was undermined by reliance on project management offices to oversee project implementation. While this served to ensure coordination between different governments and NGOs during the implementation phase, once the project was completed, it was no longer clear who would play the coordination role or be responsible for ensuring that project benefits were sustained. In some instances, beneficiaries who were paid under a project have not replicated otherwise sound project practices as they await funding from the next project (grant dependency). Despite these weaknesses, some subprojects are being maintained and sustained by communities and/or LGUs:

- (i) Communities own the projects. Aside from community participation in all stages of the project cycle, community equity contributions (such as in the case of the implementing agency of the Kalayagon Community Irrigation Scheme) ensured that the community would continue to maintain project assets because they were co-investors in the project.
- (ii) Mechanisms were put in place to ensure O&M. These included formal agreements specifying LGU/beneficiary O&M responsibilities and penalizing LGUs/communities for noncompliance, community-agreed rules such as the “no water–no payment” policy of some implementing agencies, and user charges such as toll fees and irrigation service fees to finance O&M. The “conversion of the grant component into loan” mechanism was a strong motivation for the Agrarian Reform Community LGUs and beneficiaries to maintain that project.
- (iii) LGU support is continuous. In the case of Banay–Banay, Davao Oriental, the budget for the fisheries sector increased from ₱50,000 prior to the FRMP to ₱900,000 after completion of the FRMP. Allocating a significant portion of its budget for the fisheries sector facilitated continuation of FRMP-initiated activities in those municipalities.

11. However, in view of the uncertain financial institutional sustainability of project intervention, sustainability is a future risk. Hence, ADB assistance was assessed “less likely sustainable.”

12. **Impact.** In investment project sites, ADB assistance contributed to higher production and farm incomes, and opened new income-earning opportunities. LGUs and local communities have been empowered to participate in their own development, and communities residing nearby the project sites replicated best practices. In some instances, expected impacts are unlikely to occur. This is the case, for example, with ADB support for forest development, which covered substantially less area than anticipated in the design. Similarly, paying communities for their labor in certain projects, such as watershed protection, undermined the objective of communities safeguarding natural resources for their mutual benefit. However, in the policy arena, the expected impact of a more market-oriented agriculture policy has been undermined by inefficient government interventions in the sector resulting in costly subsidies to consumers and weak producer price incentives to raise grain production productivity. The continued priority accorded to developing the rice subsector, and the confusion in roles between local and central government agencies, continues to weaken the impact of ADB sector assistance. Thus, ADB assistance is rated as having “modest” impact.

13. Overall, ADB assistance to agriculture and rural development over the CAPE period is assessed “partly successful.”

14. **Key Lessons.** Agriculture and rural development have long been recognized as having potential to contribute to growth, inclusion, poverty reduction, and environmental management in the Philippines. However, finding suitable assistance instruments that can systematically and

effectively contribute to improvements in the agriculture policy setting or to actual field improvements has been difficult. Support to individual communities has in cases been successful because of local commitment and approach to subproject management. Agrarian reform communities may have been more effective because of the geographic focus. Support was provided for grain subsector reforms that were needed to address sectorwide inefficiencies and the fiscal burden of the National Food Authority. While the reform has so far failed to garner sufficient political support, its intentions are still relevant to ensuring that price signals sufficient to generate a productivity improvement response by farmers remains a key issue to addressing low rural incomes, and household and national food security. In retrospect, while ADB's grain subsector reforms were controversial, they are still relevant in terms of needed improvements to farmer incentives and removal of costly government intervention in grain marketing. If revived, support should be provided through a series of single-tranche loans, rather than loans that attempt to schedule difficult reforms. Similarly, ADB's investment project assistance to the sector was wide-ranging, even with only a few new lending operations during the country assistance program evaluation period.

15. While the assistance program was relevant to the range of development constraints and needs, the solutions have proved difficult in part because of uncertainties about the decentralization process; overlapping roles and responsibilities of many agencies involved in addressing the rural agenda; lack of access by LGUs to development finance; wide geographic dispersion and complex operational designs; and in some instances, insufficient follow-through in any one location. Careful consideration is needed of which institutions best support decentralized services for agriculture and rural development given the Government's as yet incomplete rationalization of these institutions.

## WATER SUPPLY, SANITATION, AND WASTE MANAGEMENT SECTOR

### A. Sector Challenges and Government Plans

1. **Sector Challenges.** The high population density in urban areas, coupled with high growth rates and relatively high incidence of poverty, leads to significant challenges to the provision of water supply and sanitation (WSS) services. Nearly one-fifth of the households in the Philippines did not have access to safe water and basic sanitation facilities in 2002.<sup>1</sup> The Asian Development Bank (ADB) WSS Sector Plan Study<sup>2</sup> conducted in 1999–2000 characterized the water supply subsector as having inadequate resource management, poor planning, and insufficient infrastructure provisions, all of which hinder the efficient and equitable distribution and use of a potentially abundant commodity. Efficient provision of clean WSS services is hampered by a number of problems, including inadequate financial resources; fragmented planning efforts; constraints to local government unit (LGU); and private sector participation, poor quality services, and resource degradation. More than 20 government agencies are involved in different aspects of the management of water resources and the provision of WSS services in the Philippines.<sup>3</sup> The two national institutions with a significant and specific policy mandate in the WSS sector are the Department of Interior and Local Government and the National Economic and Development Authority.

2. **Government Policies and Plans.** The overriding Government principle for the provision of local WSS services is the empowerment of LGUs. To implement this, national agencies have adopted the following policies and strategies:

- (i) Provide a favorable environment for LGU activity in the WSS sector through Government assistance and by encouraging private sector participation in the provision of WSS services;
- (ii) Privatize water supply facilities in urban areas whenever appropriate;
- (iii) Develop and provide incentives for contiguous water districts to amalgamate into single business entities to attract private sector investments in water supply development; and
- (iv) Adopt a holistic approach to water resources development through the inclusion of supply, distribution, treatment, and sanitation.

3. In the distribution of water supply and sewerage and treatment, the Government's policy has consistently been to encourage private sector participation. The process to allow for private sector participation in water supply distribution in Metro Manila culminated on 1 August 1997 when the operational and investment functions of the Metropolitan Waterworks and Sewerage System (MWSS) in water and sewerage services were transferred to Manila Water Company and Maynilad Water Services, Inc. under two separate concession agreements.

### B. ADB Assistance

4. Since 1974, ADB has provided loan financing for 18 WSS projects in the Philippines amounting to approximately \$731 million, and 27 technical assistance (TA) grants totaling \$12.4 million. Projects for improving WSS in Manila financed by ADB included nine loans to

<sup>1</sup> Of the 16 regions in the country, Central Luzon has the highest access to clean and safe water at 96% in 2002, an increase from 94% in 2000. The Autonomous Region of Muslim Mindanao is still the least served with clean and safe water supplied. In 2002 only 33% of the population had access to clean and safe water. This is a deterioration from 38% in 2000. In terms of sanitation facilities, the National Capital Region has the largest number of sanitation facilities covering 98% of the population in 2002, up from 97% in 2000. The Autonomous Region of Muslim Mindanao again has the least access to sanitation facilities covering only 44.7% of the population, an increase from 42.5% in 2000.

<sup>2</sup> ADB. 1997. *Technical Assistance to the Republic of the Philippines for Water Supply and Sanitation Sector Plan Study*. Manila.

<sup>3</sup> ADB. 2001. *Water Supply and Sanitation Sector Profile, Philippines*. Manila.

MWSS for water supply, one for sewerage, and a TA loan totaling \$468 million. During the country assistance program evaluation (CAPE) period, there were four projects aimed at improving water supply in Metro Manila and three ADB projects supporting the sector outside Metro Manila, all of which support ADB's WSS strategy. The projects to support Metro Manila water supply (the only one source of raw water) thus far were the Angat Water Supply Optimization Project (Loan 986-PHI), Manila South Water Distribution Project (Loan 1150-PHI), Umiray-Angat Transbasin Project (Loan 1379-PHI), and a TA loan to assist MWSS in designing new water source development (Loan 2012-PHI). To support water supply outside Metro Manila were the Municipal Water Supply Project (Loan 1269-PHI), Rural Water Supply and Sanitation Sector Project (Loan 1440-PHI), and Small Towns Water Supply Sector Project (Loan 1472-PHI). During the CAPE period, ADB's water sector, sanitation, and waste management sector strategy included support for public investment in infrastructure and sustainability of operations through adequate tariffs for financing of operation and maintenance (O&M) and depreciation, including (i) improving the LGUs' capabilities in administration, community management, and financial management; (ii) integrating water supply development with the improvement of sanitation facilities; (iii) facilitating community participation and adequate tariffs to achieve long-term service sustainability through proper O&M; and (iv) providing the poor with basic needs services such as WSS facilities to improve living conditions. The lists of loans and TA projects to support the sector during the CAPE period are in Tables A12.1 and A12.2.

**Table A12.1: Project Support to the Water Supply and Sanitation Sector**

Loan Number	Date Approved	Executing Agency	Project Title	ADB	
				Finance (\$ million)	Cofinancing (\$ million)
986	14 Nov 1989	MWSS	Angat Water Supply Optimization	130.000	120.000
1150	19 Dec 1991	MWSS	Manila South Water Distribution	31.400	20.100
1379	21 Sep 1995	MWSS	Umiray-Angat Transbasin	92.000	none
1269	25 Nov 1993	LWUA	Municipal Water Supply	43.200	none
1440	4 Jun 1996	DPWH	Rural Water Supply and Sanitation Sector	18.500	none
1441(SF)	4 Jun 1996	DPWH	Rural Water Supply and Sanitation Sector	18.500	none
1472	30 Sep 1996	LWUA	Small Towns Water Supply Sector	50.000	none
2012	14 Oct 2003	MWSS	MWSS New Water Source Development	3.260	none

ADB = Asian Development Bank, DPWH = Department of Public Works and Highways, LWUA = Local Water Utilities Administration, MWSS = Metropolitan Waterworks and Sewerage System, SF = special funds.  
Source: Asian Development Bank database.

**Table A12.2: Technical Assistance Support to the Water Supply and Sanitation Sector**

TA Number	Date Approved	Project Title	Amount
3703	8 Aug 2001	Capacity Building for the Regulatory Office of the Metropolitan Waterworks and Sewerage System	800,000
3848	18 Mar 2002	Metro Manila Solid Waste Management	1,250,000

TA = technical assistance.

Source: Asian Development Bank database.

5. The Angat Water Supply Optimization, Manila South Water Distribution, and Umiray-Angat Transbasin projects all aimed to support the expansion and improvement of the distribution of water in Metro Manila. The main objective of the Angat Water Supply Optimization and Umiray-Angat projects was to improve water supply services by increasing raw water production through the provision of new infrastructure and rehabilitation of existing infrastructure. The main objective of the Manila South Water Distribution Project was to improve the water distribution system to benefit southern Manila. The secondary objective of all three projects was to reduce nonrevenue water (NRW) in Metro Manila, which peaked at 64% in 1986 and was at 58% when the Angat Water Supply Optimization Project was approved in 1989.

6. The Municipal Water Project aimed to improve and expand water supply services in eight urban growth centers and to strengthen institutional and financial management capabilities of the Local Water Utilities Administration (LWUA) and the eight water districts in charge of supplying water in the respective cities.<sup>4</sup> The project's immediate objective was to increase the production capacity of the water districts to 229,235 cubic meters per day from 73,144 cubic meters per day. The increased capacity would be needed to meet the expansion in service connections to 159,598 from 53,088; the ultimate objective is to nearly triple the total served population to 1,026,216 from 376,130. The project also aimed to reduce water losses from leaks and illegal usage, i.e., NRW, to an average of 25% from 35%. The project's scope included rehabilitating and constructing water source intakes (where water is collected), pumping stations, treatment facilities, storage reservoirs, transmission and distribution pipelines, service connections, and other water supply facilities in the water districts. Parallel with the physical project implementation, an institutional strengthening program was developed. The first objective of the institutional strengthening program was to improve LWUA's organizational structure and strengthen its financial management, including its billing and collection systems. The second objective was to promote the self-reliance of each water district by strengthening its organizational structure; planning capability; financial management (such as accounting, billing, and collection systems); and operating efficiency by reducing NRW.

7. The objectives of the Small Towns Water Supply Sector Project were to (i) provide safe, adequate, and reliable piped water supply services to 80 small urban towns throughout the country with populations ranging from about 10,000 to 10,000; (ii) improve health and hygiene, education, and water quality testing to ensure the sustainability of project benefits; and (iii) improve the capacity of water districts through training in the planning, implementation, and O&M of water supply services. The project involved the improvement of water supply facilities and institutional development in the small towns through the construction and rehabilitation of piped water supply facilities serving approximately 1 million people, and aimed to increase the coverage of piped safe water supply in the project area from about 20% to 60% (an additional 30% of the population is estimated to have nonpiped supply installed by private sources) by 2001.

8. The objectives of the Rural Water Supply and Sanitation Sector Project were to (i) improve the capacity of sector agencies in enhancing the delivery of social services; (ii) provide safe, adequate, and reliable WSS services to selected low-income rural communities through community-based arrangements; and (iii) support health and hygiene education, water quality surveillance, and community management activities. The project aimed to (i) help develop the technical capacity of LGUs and communities in the planning, implementation, and O&M of basic rural WSS services; (ii) promote a sense of subproject ownership and enhance community management of rural WSS services; and (iii) improve health and hygiene education in the project areas to ensure the sustainability of project benefits. The project targeted about 3,000 rural communities (*barangays*) with populations ranging from 200 to 5,000. This represented about 50% of the total number of communities in the 20 poorest provinces spread throughout Luzon, Visayas, and Mindanao. Only about 40% of the rural population in these provinces had adequate access to safe and reliable WSS facilities compared with the nationwide average of 70% for rural areas. The project involved institutional development and improvement of WSS facilities in about 3,000 rural low-income communities serving nearly 2 million persons.

9. The three projects to improve water supply services in Metro Manila experienced major delays caused by legal disputes over the use of fiberglass pipes, approval of excavation permits in the case of the Manila South Distribution Project, and the effects of MWSS privatization (Box A12). The projects outside Metro Manila, namely Municipal Water Supply, Rural Water Supply

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<sup>4</sup> The eight urban growth centers are Calamba and Naga in Luzon; Iloilo, Dumaguete, and Calbayog in the Visayas; and General Santos, Cotabato, and Polomolok in Mindanao.

and Sanitation, and the Small Towns Water Supply, faced inadequate counterpart funds, which subsequently affected procurement and subproject preparation and implementation. On average, these three projects were delayed by at least 1 year, and project closing of the three was extended an average of 2 years. Subproject preparation took about 3 years before project implementation gained sufficient momentum.

### **Box A12: Privatization of Manila's Water Supply System**

Projects for improving water supply and sanitation (WSS) in Manila financed by the Asian Development Bank (ADB) include nine loans to the Metropolitan Waterworks and Sewerage System (MWSS) for water supply and one for sewerage totaling \$468 million. Privatization of the MWSS in 1997 has brought considerable benefits while raising numerous challenges.

In 1971, the National Waterworks and Sewerage Authority were dissolved and MWSS was formed. MWSS assumed responsibilities for the provision of water supply and sewerage services to the National Capital Region (NCR), the province of Rizal, and part of the province of Cavite. The water supply distribution and sewerage networks managed by MWSS were some of the oldest in Asia and were deteriorating rapidly. By the 1980s, MWSS found that the sustained population growth and increased urbanization of its service area was outstripping its ability to maintain and expand its WSS infrastructure. Significant upgrades were required to keep pace with rapidly rising demands.

By virtue of the Water Crisis Act of 1995, MWSS operations were to be privatized to attract international finance and expertise and to fund significant upgrades to the water supply and sewerage systems. In August 1997, following bidding by international consortia, the operations of MWSS were privatized through two concession contracts. The MWSS service area was divided into east and west zones. The East zone concession was awarded to the Manila Water Company (MWCI). The west zone concession was awarded to Maynilad Water Services, Inc. (MWSI). MWSS retained responsibility for provision of bulk water to the concessionaires, administrating and managing retained assets, and monitoring/enforcing the Concession Agreement.

Privatization has brought about rapid and significant improvements in the delivery of water supply services in Metro Manila. The serviced population increased from 7 million in 1997 to 10 million in 2003. Water service coverage increased from the preprivatization 67% of the service area population in 1997 to 87% in 2003. In the East zone, MWCI managed to reduce nonrevenue water (NRW) from the preprivatization 65% down to 37% in 2005.

Despite the successes, a number of setbacks and failures also occurred. First, despite implementing a number of NRW reduction programs, MWSI has not been successful in reducing NRW in the west zone, where it remains at about 67% and has had a significant impact on the ability of MWSI to improve water supply coverage. Second, the Asian financial crisis of 1997–1998 was a significant issue for both concessionaires. As part of the Concession Agreement, the debts of MWSS to international lending agencies such as ADB and the World Bank were passed on to the concessionaires. MWSI was required to take on 90% of the MWSS debt. The other 10% was passed on to MWCI. The devaluation of the Philippine peso by about 80% in the first few years of the concessions affected the servicing of foreign loans obtained for capital works, as well as the repayment of MWSS debts. While the Concession Agreement allowed for adjustments for foreign exchange fluctuations, recovery of foreign exchange losses was required to occur over the 25-year life of the concessions. This created cash-flow problems in the early years of the concessions. Third, the Philippines was subjected to lower than average rainfall during the early years of the concession due to the occurrence of the El Niño weather pattern. Water availability was reduced by about 30%, affecting the amount of water supplied to each concessionaire. Several key MWSS bulk water supply projects were either delayed or not implemented, affecting the supply of bulk water to the concessionaires. These projects included a 300 mega liters per day water supply project in Laguna de Bay, Angat Water Supply Optimization Project, Manila South Distribution Project, and Umiray-Angat Transbasin Tunnel Project.

To date, the East zone concession can be considered successful. MWCI has steadily increased profitability in recent years and delivered significant improvements to the East zone water supply system. The west zone concession cannot be considered successful. Apparently, MWSI incurred substantial



losses in all years of its operation. While a number of significant water supply improvement projects were commenced in the west zone, many were not completed due to the shortage of funds. By contrast, MWSI has failed to pay full concession fees since March 2001, resulting in an adverse impact on its finances. In 2005, an agreement on the restructuring of the MWSI concession was generally reached, including repayment of outstanding concession fees. As per agreement, MWSS can take over 84% of MWSI shares in a debt for equity swap partly reversing the private sector participation program. In December 2006, the west zone concession was successfully reawarded to another private sector. A consortium led by D.M. Consunji in partnership with Metro Pacific Investments won the bid for the Government's controlling stake in MWSI including MWSS' receivables and subscription right.

Source: Operations Evaluation Mission.

10. The actual cost of the three projects to support Metro Manila's water supply were all below appraisal estimates with cost savings coming from the devaluation of the peso and the cancellation of some components in the case of the Angat Water Supply Optimization Project. In the case of the Manila South Water Distribution Project, the lower actual project cost was due to the limited project outputs achieved during loan closing. The Manila South Water Distribution suffered from lack of water from the Angat reservoir aggravated by the El Niño.

11. The actual cost of the Municipal Water Project was \$40.3 million compared to a planned cost of \$72 million, of which ADB financed \$21.1 million; while still maintaining the original scope of work. The major reasons for the reduction of ADB-financed amount were (i) Naga funded its civil works from its own sources (\$3.5 million); (ii) the water districts used their own resources to procure water meters (\$3.9 million); (iii) the peso depreciated from ₱29.20 to the dollar at appraisal to around ₱50.00 when civil works started, which lowered the civil works' local currency costs (\$8.8 million equivalent); (iv) unused contingencies (\$9.3 million); and (v) a reduction in interest during construction due to these reductions (\$4.2 million). In the early stage of project implementation, disbursement was low because detailed engineering designs needed to be reviewed and revised due to changes in water sources among others. Disbursement accelerated from 1997 when civil works started and remained consistent with projections. The delays can be attributed to five causes:

- (i) At the beginning of project implementation, the consultant identified several design changes due to changes in water sources from groundwater to surface water and the location of well sites. New sites had to be secured and detailed engineering designs prepared.
- (ii) In two cases, the lowest evaluated bidders declined to enter into contracts because of the deteriorating security situation in the project areas, resulting in the contract approval process being repeated to award the work to the next lowest bidders. The approval of the Office of the President for awarding a contract of over ₱50 million also caused a delay of 2–3 months.
- (iii) During construction, various issues arose, such as rights-of-way with landowners and LGUs, contractors' slow implementation, unexpected geologic conditions, bad weather, and security issues in the project area.
- (iv) The Department of Public Works and Highways (DPWH) changed the regulation governing the use of existing bridges for laying pipes. DPWH, which was responsible for maintaining bridges, stopped allowing large water pipes to be laid on existing bridges. This unexpected change required LWUA, the consultants, and the water districts to spend substantial time designing and building independent bridges for water pipes to cross rivers.
- (v) LWUA took a long time to authorize several variation orders for construction contracts that arose from differences between the contracted specifications and actual site conditions.

12. The Small Towns Water Supply Sector Project also experienced delays in implementing subproject construction because of the Government's inability to release budgetary support for the project. LWUA resorted to local borrowing to replace the Government budgetary support. Actual implementation began about 2 years behind schedule. Major implementation delays were caused by:

- (i) a delay in loan effectiveness (including a 1-year national Government debt cap);
- (ii) a delay of at least 1 year in start-up activities and in identifying subprojects;
- (iii) a delay in the engagement of consultants;
- (iv) the need for more time to prepare and update feasibility studies and designs;
- (v) uncertainties on the release of Government counterpart funds; and
- (vi) until mid-2001, lack of coordination within LWUA, between LWUA and the water districts, and other local and national government agencies.

13. The Rural Water Supply and Sanitation Sector Project experienced considerable delays and cancellations of project components. As of 30 June 2004, the date of loan closure, 103 subprojects had signed subsidiary loan agreements with LWUA. Of these, 37 (36%) were complete and the remaining 66 were under construction. As of 31 March 2006, 90 subprojects (87%) were complete, while 13 were still under construction. Although the original target included 20 large or medium-sized subprojects, only five were constructed. The cancellation of the Bulacan bulk water supply scheme resulted in the withdrawal of eight large or medium-sized subprojects.

### C. Performance Assessment

14. ADB assistance performance in the WSS and waste management sector overall is rated "partly successful."

15. **Relevance.** All the WSS projects were integral to ADB country strategies, and they were closely aligned and supportive of Government strategies for developing the sector. The Metro Manila water projects were assessed to be "relevant" as they were consistent in terms of their goals, purposes, and outputs with key water supply-related issues in Metro Manila, Government strategy for development of the water sector, and ADB country assistance strategy.

16. The Municipal, Rural, and Small Towns Water Supply projects supported the devolution of water supply provision to local governments and provided assistance to strengthen sector institutions such as LWUA, water districts, LGUs, and community organizations. ADB's strategy reinforced the Government's water supply strategy and emphasized (i) the expansion of service areas, especially for the benefit of the poor; (ii) the availability of supply 24 hours a day; (iii) a reduction in NRW; (iv) an improvement in cost recovery, and (v) the financial sustainability of water supply services. The three projects were in line with ADB's own WSS strategy and were designed in a technically sound manner. They were also designed and implemented in a highly consultative manner. Through these projects, ADB promoted a shift away from the traditional "top-down" centralized planning approach and emphasized the concept of "bottom-up" planning with extensive local participation together with training and capacity building for the Department of Interior and Local Government and LGUs in project management, implementation, and community development. The three water supply projects benefited from the lessons from previous projects, including the importance of beneficiary participation, ensuring the financial viability of water districts to facilitate sustainable O&M, the need to improve water tariff revenue collection, and the importance of institutional development of water districts. ADB's assistance to the WSS sector is rated "relevant".

17. **Effectiveness.** Collectively, the assistance given to Metro Manila water supply is rated "less effective." ADB-financed projects for Manila water supply have contributed to the

construction of water supply infrastructure from the Angat reservoir and provided additional supply of treated water at a time when piped water was inaccessible to more than 50% of the population. The projects to supply water outside Metro Manila achieved targets and largely met program objectives. Most physical infrastructure were delivered, and capacity strengthening was well implemented. The projects, however, fell short in their objective of serving and benefiting the number of beneficiaries targeted due mainly to the high NRW. The projects were unable to reduce NRW and in some years NRW even increased. For the Angat Water Supply Optimization Project, there were substantial shortfalls in achieving connections and amount of water sold. The Manila South Water Distribution Project was ineffective in connecting households to the water supply and did not achieve its outcomes. The Umiray-Angat Transbasin Project augmented the treated water supply of MWSS, but the number of beneficiaries fell short of the target because the secondary objective of reducing NRW was not met.

18. ADB's assistance to WSS outside Metro Manila is assessed as "effective." Solid performance has been registered in terms of meeting program objectives. Both the Municipal Water Supply and the Small Towns Water Supply Sector projects have substantially achieved the targets set. However, the Rural Water Supply and Sanitation Project underperformed compared to its objectives. For the Municipal Water Supply Project, the physical infrastructure component was substantially completed as appraised, although the NRW reduction fell short of the target. Capacity strengthening was well implemented at LWUA, but some of the water districts needed more support to meet the demands of an expanded network. The production and distribution facilities were constructed as appraised or exceeded the appraised targets except for pump stations and service connections. In terms of the population served and service connections, Calamba, Dumaguete, and Naga exceeded the targets; while Cotabato substantially achieved the target. Calbayog, Iloilo, and Polomolok did not meet the targets. One reason was that a significant portion of the population in these cities already had access to some sort of water supply and, therefore, did not immediately connect to the new water supply service. The main target of the Small Towns Water Supply Sector Project was to serve an additional 700,000 people (60% them living below the poverty line) with piped water. By December 2005, the total population served was about 1,710,000 and an additional 440,000 were expected to be served by the subprojects still under construction. Although the outreach target for the Small Towns Water Supply Sector Project was met, actual ADB financing was 50% of the original loan amount and 30% of original project costs because of project delays, cancellation of various components, and uncertainties regarding the release of counterpart funds.

19. Institutional outcomes of the Municipal Water Supply and Small Towns Water Supply Sector projects were mixed. A main concern was that LWUA was unable to achieve capacity to internally generate funds that would allow a creation of "second-generation" funds or built-up reserves for future water projects. Thus, LWUA had to rely on external financing via counterpart funding on national government equity, subsidies, and international grants to achieve its role of providing funds for water district projects. For the water districts, inconsistencies in tariff setting mean that many of the water districts are not viable because tariffs are not adequate to cover O&M costs. Water districts that are relatively creditworthy could not access financing from government financial institutions or commercial banks because LWUA has to issue waivers and revise prepayment policies.

20. The Rural Water Supply and Sanitation Project was unable to meet its physical production targets, although the Government continued to invest and provide facilities as planned several years after the project was completed. During the loan period, the project completed 5,868 water supply facilities, representing 66% of the overall project target. DPWH constructed the balance of the water supply facilities using internal funds after the loan closing date. By the end of January

2004, 59 pilot water analysis laboratories (e.g., 91% of the target), 117 public toilets (93%), 242 school toilets (108%), and 60,817 household toilets (62%) were completed.

21. **Efficiency.** The financial internal rate of return (FIRR) of the Angat Water Optimization and the Umiray-Angat projects improved over the estimate at project completion and was higher than the weighted average cost of capital. This improvement was realized due to tariff increases and improvements in NRW reduction by the East zone concessionaire. The FIRR for Manila South Water Distribution was estimated at 0%, confirming the negative FIRR at project completion. The economic internal rates of return (EIRR) for the first two projects were reestimated at 15.3%, higher than the economic discount rate of 12% and implying that the projects can be efficient in resource use. The EIRR for Manila South Water Distribution was not reestimated because the expected benefits were not attained.

22. The other ADB-supported projects (Municipal, Rural, and Small Towns Water Supply) had FIRRs in excess of the cost of capital. EIRRs at project completion were estimated to be in excess of 12%, suggesting that projects were both financially and economically viable.<sup>5</sup> Financial viability hinges in the long run on the cost structure, tariff rates, and administration of agreed cost-recovery mechanisms. In the case of the Rural Water Supply and Sanitation Sector Project, this is a concern, with tariffs being collected from less than 50% of the water supply facilities constructed under the project. All three projects suffered from inadequate counterpart funds, which subsequently affected procurement, and subproject preparation and implementation. On average, the three projects were delayed by at least 1 year and project closing of the three projects was extended on average of 2 years. Subproject preparation took about 3 years before project implementation gained momentum. ADB's assistance to the sector as a whole is assessed "less efficient."

23. **Sustainability.** The sustainability of the Angat Water Supply Optimization Project is rated "less likely." Water from the Angat Reservoir is conveyed to the city by a system of tunnels and aqueducts, which show considerable leakage. The Manila South Water Distribution Project is rated as "unlikely" sustainable because of the very limited outputs of the project. The Umiray-Angat Transbasin Project is rated as "likely" sustainable. Socioeconomic benefits have accrued in terms of marked improvement in economic and social welfare as a result of water connections to households, but there remains much room for improvement and expansion. The Angat Water Optimization and Umiray-Angat Transbasin did increase the water supply in Metro Manila but not as much as expected. Number of households connected fell short of target, and targets to reduce NRW were not met. The Manila South Water Distribution did not achieve its objectives, and project outputs were limited. ADB's role in supporting Manila water supply services to involve the private sector was of limited effectiveness, and similarly the success of efforts to reduce the NRW in the first concessionaire in the West zone of Manila was limited. The East zone concessionaire has been successful in reducing NRW. The reawarding of the West zone concession to a new group of private sector participant offers renewed optimism that reduction in NRW will be at least as successful as that achieved in the East zone. The performance of the East zone concessionaire underscores the benefits that can be realized from private sector participation. Nevertheless, ADB's capacity building support to MWSS for regulation is considered useful, and experience was gained in supporting private sector participation in Metro Manila's water supply system as discussed in Box A12.

24. The infrastructure developed under ADB projects outside Metro Manila are being properly maintained, but sustainability is rated "less likely." The local institutions responsible for delivering water supply services have been strengthened under the projects. However, long-

<sup>5</sup> For the Municipal Water Supply Project, all reestimated FIRRs exceed the real weighted average cost of capital of 2.6%, but they were all lower than those estimated at appraisal except for Cotabato.

term sustainability depends to a large extent on the success of appropriate tariff policy and tariff revenue collection to cover O&M costs and new development to meet new demand. Tariffs in some of the water districts do not cover costs, raising concerns about the degree to which these systems can be properly operated and maintained. Moreover, for assets created under the Rural Water Supply and Sanitation schemes, sustainability is threatened by insufficient tariffs and inadequate government funding for O&M.

25. **Impact.** The overall impact of the Metro Manila projects is modest. Socioeconomic benefits have accrued in terms of marked improvement in economic and social welfare as a result of water connections to households, but significant improvements and expansion are still needed. The overall impact of the three projects outside Metro Manila is “substantial.” They have improved access to millions of beneficiaries to clean and safe drinking water, and in the case of the Rural Water Supply and Sanitation Sector Project, to sanitation facilities as well. ADB projects have introduced new concepts and approaches to managing the provision of WSS services. In the case of the Municipal Water Supply Project, the water production and distribution facilities planned for the eight water districts at appraisal were completed, which helped increase total water production capacity by almost four times and improve access for an additional 501,959 people, which is more than double that estimated at appraisal. The Small Towns Water Supply Sector Project brought safe and reliable WSS to 80 small towns. The target was to provide 1 million people, 60% of them living below the poverty line, with piped and safe water by 2001. By the end of 2005, 90 subprojects had been completed, covering about 2.1 million people. The Rural Water Supply and Sanitation Project provided nearly 6,000 water supply facilities (serving nearly 2 million people), established a network of water quality laboratories, and provided necessary sanitation facilities for schools and nearly 60,000 households in poor rural areas. Though only 66% of the target number of water facilities were constructed, local beneficiaries reported that the facilities provide adequate water supplies and convey substantial health benefits. Sanitation facilities completed are operating and widely popular among project beneficiaries.

26. **Key Lessons.** Lessons relate to systemic weaknesses in the sector, including the apparent inability of many water utilities to maintain existing water supply networks, lack of readiness for project implementation, and lack of transparency and accountability. Accurate demand forecasts are needed, along with more realistic assessments of the extent to which NRW can be reduced, and more active efforts to secure tariffs that cover O&M costs. Institutional capacity of the executing and implementing agencies, particularly LGUs; water districts; and communities is fundamental to the success of the project requiring strong management skills. Where new management structures are needed, such as new water districts, LGU-operated systems, or community associations, the time needed should be anticipated and sufficient resources allocated. Development plans need to match institutional capacity to prepare, implement, operate, and manage the projects; and be implemented in line with capacity. A continuing concern is the need to ensure that sufficient counterpart financing is available prior to launching new investment initiatives. Lessons based on the latest three ADB-financed Manila water supply projects implemented include the need for a thorough risk assessment, critical path monitoring, and risk management particularly for complex projects and those involving several funding sources to avoid implementation delays, more cautious projections of NRW reduction to avoid overestimating project benefits,<sup>6</sup> a holistic approach to reducing NRW; and appropriate treatment of both demand and supply side factors influencing water supply services.

<sup>6</sup> Based on project completion reports prepared for (i) ADB. 1989. *Angat Water Supply Optimization Project*. Manila (rated partly successful); (ii) ADB. 1991. *Manila South Water Distribution Project*. Manila (rated unsuccessful); and (iii) ADB. 1995. *Umiray-Angat Transbasin Project*. Manila (rated successful).

## **MANAGEMENT RESPONSE TO THE COUNTRY ASSISTANCE PROGRAM EVALUATION FOR THE PHILIPPINES: INCREASING STRATEGIC FOCUS FOR BETTER RESULTS**

On 24 July 2008, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

### **I. General Comments**

1. We appreciate OED's comprehensive and well-analyzed Country Assistance Program Evaluation (CAPE) for the Philippines. CAPE provides a good overview of the strategic shift in ADB approaches to the Philippines since 2005 with an overarching focus on selectivity and portfolio quality. This has proven to be an effective approach. The CAPE has appropriately summarized that the larger context for the next country strategy continues to be daunting. We agree with the CAPE findings that to address significant development challenges, the Philippines would need to (i) continue to exercise fiscal discipline; (ii) more widely institute good governance; (iii) increase spending for infrastructure, education, and social development; (iv) expand and diversify the economic base; and (v) make access to development opportunities more equitable.

2. Overall, the CAPE has rated ADB's assistance to the Philippines as "successful" with need for further improvement in several areas of the country partnership and strategy. We concur with this assessment and overall conclusions of the CAPE. CAPE findings would guide the next Country Partnership Strategy for the Philippines.

3. The CAPE has correctly identified significant challenges in project implementation and the risks to portfolio quality as ADB shifts from program lending focus back to an investment portfolio. These risks would be mitigated by adherence to readiness filters for improving the quality-at-entry of projects and programs, devoting ADB staff and financial resources for strengthening the project implementation capacity of executing agencies, and tackling systemic issues through country and sector portfolio review exercises.

### **II. Comments on Specific Recommendations**

#### **Recommendation 1. To Maintain the Strategic Focus on Improving National Public Finance Governance and Management**

4. We agree with CAPE recommendations 1 (i) and 1 (ii). These recommendations relate quite closely to the Development Policy Support Program (DPSP) of ADB and link up to specific paragraphs in the CAPE, which acknowledge the contribution that has been made by ADB to reforms in public finance governance and management. This strategic focus is especially relevant today given the emerging impacts on the Philippines' economy of the increased uncertainties in the global

economy (turbulent financial markets, surging oil and food prices, slowdown in the US economy).

### **Recommendation 2. To Deepen Support for Local Governance and Decentralized Service Delivery**

5. We agree with CAPE recommendations 2 (i)–2 (iii). In the medium term, ADB plans to intensify support for strengthening (i) intergovernmental fiscal relations; (ii) fiscal management, planning, and public expenditure management at the Local Government Unit (LGU) level; (iii) LGU performance measurement and service delivery; and (iv) improving LGU access to public and private sources of capital. ADB will work in close cooperation with the oversight agencies and the Philippine Development Forum (PDF) working group on decentralization and local governance.

### **Recommendation 3. To Continue to Support Private Sector Enabling Environment**

6. We agree with CAPE recommendations 3 (i)–3 (iv). We continue to build on microfinance reforms but staff resources constrain a major new effort. We believe that the credit information bureau bill should go a long way to widening SME access to formal finance. Our broader approach has a number of elements to supporting the enabling environment for the private sector. Specifically, our advisory TA work has focused on the following two elements. First, to build a stronger ability to evaluate the regulatory impediment prior to finalization of draft decrees and laws and to examine distribution networks and other aspects of the domestic economy from the perspective of competition policy; second, to strengthen backward linkages in agriculture with a view to eliminating existing distortions that impede agricultural trade and exports and to promoting off-farm rural employment. Both of these topics have been discussed with the National Economic and Development Authority (NEDA). The first has made some progress, while the second is still under preparation. We agree that ADB needs to systematically assess and identify where and how it can best contribute to infrastructure development. Last but not the least, we agree with the recommendation to support strengthening of the judiciary.

### **Recommendation 4. To Focus on Poor Provinces and Build on Synergies between Local Development and Regional Cooperation Initiatives, in particular BIMP-EAGA**

7. We concur with recommendations 4 (i)–4 (iii). The recommendation in 4 (iv) on pooled financing merit greater consideration. Recent experiments, such as the Multi-Donor Mindanao Trust Fund, have not been effective as envisioned. We do agree that engaging and supporting the Mindanao Economic Development Council (MEDCO) is crucial and must be maintained to provide strategic foothold on policies affecting the Autonomous Region in Muslim Mindanao (ARMM). We also agree that increased development partner coordination is needed, and that the primary mechanism for such engagement is through the PDF

Working Group for Mindanao, in which MEDCO and the national government agencies are represented.

#### **Recommendation 5. To Enhance Services to the Client**

8. We concur with recommendations 5 (i)–5 (v). Medium-term policy reform engagement and selectivity based on critical constraints have proven to be the correct strategic approach for ADB-Philippines partnership. This approach would continue to guide ADB engagement in the Philippines. ADB has been assisting the country-based development partner harmonization in key areas of procurement and financial management through the PDF working group on governance. This assistance would continue. We agree with the recommendation on upfront capacity development. This approach is being successfully implemented in the Mindanao Basic Urban Services Project. One issue that constrains wider application of this approach is the reluctance of executing agencies to borrow for capacity development. Application of Multi-Tranche Financing Facility (MFF) modality to the road and social housing sectors would help expand the programmatic approaches. The quality of the Philippines' portfolio has significantly improved, as noted in the CAPE. The CAPE has correctly highlighted the risks to portfolio quality with growing investment lending. Adequate resources would be provided for project implementation.

9. We do not agree with recommendation 5 (vi). The roles of the country office and sector divisions are quite clear and distinct. PHCO is responsible for standard RM functions including country programming, country economic work, overall policy dialogue, and portfolio management. By contrast, sector divisions are responsible for project design, project administration, and policy dialogue at the sector level. Organizational arrangements are broadly in line with other resident missions.



## DEVELOPMENT EFFECTIVENESS COMMITTEE (DEC)

### Chair's Summary of the Committee's Discussion on 6 August 2008

#### I. Philippines Country Assistance Program Evaluation: Increasing Strategic Focus for Better Results

##### Shift to Program Lending

1. **DEC** requested elaboration of ADB's shift from project lending to program lending in the Philippines. **Director, Operations Evaluation Division 1 (OED1)** explained that it had been necessary to address some policy and institutional issues before supporting large investments. **Deputy Director General, Southeast Asia Department (SERD)** said that after the first Philippines Country Assistance Program Evaluation (CAPE), which had been very critical of the ADB-Philippines partnership, ADB had radically changed the way it does business in the Philippines, including shifting from project lending to program lending. ADB had brought to the forefront key policy issues that needed to be addressed, becoming the partner of choice in many respects on policy advice. Although the shift to policy lending had been successful, **DEC** pointed out the need to maintain a balance between program lending and project lending, which is still badly needed.

##### Sector Performance

2. Noting that ADB's performance in the Philippines was rated partly successful in four out of nine sectors, **DEC** underlined the need to strengthen implementation in the weaker sectors, particularly those in which ADB has a competitive advantage, including infrastructure. On the energy sector, **DEC** inquired how the conclusion could be reached that ADB's support to the sector was a success when privatization was the only barometer. There would be a time lag before benefits are reaped, which could endanger the progress of reforms. **Staff, OED** responded that ADB's assistance had been provided at a critical time. Privatization had reduced the strain imposed on the budget by the energy sector and it would introduce competition and more efficient technology, eventually resulting in benefits.

3. **DEC** expressed concern at the perception among development partners, set out in Box 1 of the report, that ADB is seen as giving less attention to implementation support than the World Bank and requested further elaboration on this point. **Staff, OED** clarified that the issue had been discussed with the Deputy Director General, SERD and Country Director, Philippines Country Office (PHCO), and further information could be provided, but it was mainly a matter of managing perceptions. Director General, SERD, indicated that the basis of this perception was unclear given that (i) the Philippines portfolio was among the best performing in ADB, (ii) staff were reviewing projects frequently, often between 4-6 times a year, (iii) relationships between staff and executing agencies were uniformly good, and (iv) net resource transfers to the Philippines were on the increase over the last three years.

##### Selectivity

4. Referring to the list of key recommendations for Management's consideration on page vii, **DEC** observed that these did not appear to be selective, and greater focus would be desirable. **Director General, OED** responded that these recommendations were organized thematically rather than according to sectors, and they were not intended to be all-inclusive.

**Country Director, PhCO** said that the next country partnership strategy would provide an opportunity to address the matter of selectivity.

### **Role of the Philippines Country Office**

5. With respect to Management's disagreement with recommendation 5(vi) in the CAPE that the role and responsibilities of the Philippines Country Office (PhCO) should be clarified, **DEC** inquired why this conclusion had been reached. **OED staff** explained that this was primarily a logistics issue arising from the fact that PhCO is located in the ADB headquarters building. **Director General, SERD** responded that staff would clarify the respective roles and responsibilities of PhCO and headquarters staff. In response to a suggestion from some DEC members that ADB might consider relocating PhCO outside Manila to an area such as Mindanao, **Director General, SERD** explained that moving away from the capital city might create some difficulties for coordination with other development partners and for maintaining strong relations with other parts of the country.

### **Harmonization with Development Partners**

6. **DEC** emphasized the importance of ADB's working together with other development partners on policy advice, and inquired whether the need for development partners supporting the same major reforms to have a unified policy matrix was a significant concern for the Philippines, since it had been mentioned on several occasions. **Deputy Director General, SERD** emphasized that the country team works hard to ensure that all policy reforms supported by ADB are part of a government policy matrix, agreed between the government, ADB and other development partners rather than a separate ADB policy matrix.

### **Chair's Conclusion**

7. **DEC** noted with satisfaction the conclusion in the CAPE that ADB's assistance program for 2003-2007 had been successful. However, of the nine sectors, five were noted as successful and four as partly successful, so there is scope for further improvement. A DEC member encouraged ADB to do more in the country not only in financial assistance but also in promoting the exchange of development experiences between the Philippines and other DMCs in the region.

8. There was a shift from projects to policy loans, but many members felt that policy loans cannot supplant project loans, as these are critical for sector growth as well as promoting investment. Furthermore, policy loans may circumvent the problem of implementation, but implementation issues have to be faced squarely.

9. In the context of the energy sector, **DEC** endorsed OED's comment that "there is a risk that a lag between reform and benefits to consumers may result in political temptation to roll back market-oriented reforms to deliver short-term benefits, such as lower tariffs or subsidies, to consumers. Recent reemergence of political debate to amend provisions of the EPIRA would place reform progress at risk."

10. **DEC** underlined the need for selectivity in focusing ADB's assistance on strategic sectors in line with the resources available, as well as ADB's comparative strength.

## II. Special Evaluation Study - Effect of Microfinance Operations on Poor Rural Households and the Status of Women

### Targeting the Poorest of the Poor

11. **DEC** noted that the most important observation of the study was the regressive impact of the microfinance interventions on the households with lower incomes, and questioned whether ADB should target the poorest of the poor with such instruments. ADB should find other, more effective ways of helping the ultra poor. **Director General, OED** agreed with this assessment, pointing out that ADB should partner with other institutions such as NGOs or CSOs to reach the ultra poor effectively. **Practice Leader for Microfinance** said microfinance is one tool to lift people out of poverty, but livelihood promotion and protection must also be included in any intervention targeted to the ultra poor until they reach a level where they can benefit from mainstream microfinance activities. On the issue of targeting of the ultra poor, **Director, OED1** pointed out that some financial institutions did not want to lend to the ultra poor because of the high risk involved.

### Institutional Effectiveness

12. Referring to paragraph 136 of the report, **DEC** felt that an opportunity had been lost to assess the impact of different microfinance institutions included in the study (namely, NGOs, cooperatives, and banks) on the effectiveness of the microfinance projects. **Director General, OED** explained that the focus of the study was on poor rural households, and there was insufficient data to assess the impact of the institutions as well. However, this could be done in a subsequent study. **Practice Leader for Microfinance** added that the quality and sustainability of the services provided was more important to the success of the project than the type of institution used to deliver the microfinance.

### Impact on Employment

13. With reference to a point made in the Management's Response, a **DEC member** agreed that the study did not sufficiently analyze the impact of the microfinance projects on employment. **Practice Leader for Microfinance** concurred with this observation, adding that the poverty reduction impact on the poorest of the poor would be higher if the enterprises created employment for them, even if the projects did not directly target the ultra poor.

### Baseline Data

14. **DEC** regretted the lack of baseline data for assessing the impact of the microfinance projects, and one member suggested that collection of baseline data be incorporated into any such project design to allow the impact of the project to be measured. **Director General, OED** agreed that this would be desirable; however, it was costly and labor intensive to include such data collection in microfinance projects. Accordingly, data would be gathered from selected projects for rigorous assessments.

### Review of Microfinance Strategy

15. **DEC** inquired as to the nature of the review of the Microfinance Strategy referred to in paragraph 154. **Managing Director General** responded that the Microfinance Strategy would not be reviewed in isolation; rather, it would be considered as a part of ADB's financial sector strategy to ensure that it is consistent with the rest of the sector.

## Chair's Conclusion

16. **DEC** commended OED for a useful SES on the effects of microfinance operations on poor rural households and the status of women. The study establishes that promoting microfinance can be very effective instrument for helping poor rural households and improving the status of women. However, it simultaneously reveals a regressive tendency of the intervention, namely, microfinance institutions may not help in ameliorating the condition of the poorest of the poor without appropriate measures to promote and maintain livelihood in rural areas. More focused and deliberate approach in targeting is also important.

17. **DEC** opined that such an evaluation study in the future should assess the relative effectiveness of the different institutions in delivering microfinance, namely, NGOs, banks, and cooperative institutions.

18. **DEC** agreed with OED that in some microfinance projects it would be desirable to collect baseline data to assist in carrying out rigorous impact evaluations in the future.

19. Finally, **DEC** encouraged Management to review ADB's Microfinance Strategy, which was approved by the Board in 2000. The strategy should consider where to position microfinance vis-à-vis ADB's strategy for the financial sector as well as its strategy regarding rural development and agriculture.

Ashok K. Lahiri  
Chair, Development Effectiveness Committee