I. CURRENT DEVELOPMENT TRENDS AND ISSUES

A. Recent Political, Economic and Social Developments[1]

1. The Philippines weathered recent external shocks such as the Bali bombing in October 2002, the global impact of the Iraq conflict in March 2003, and the severe acute respiratory syndrome epidemic relatively well. However, a series of negative domestic events in 2003 took a severe toll on the economy. The attempted coup d'etat in July 2003, threats of terrorism, two attempted impeachments of the Chief Justice, and uncertainties regarding political transition and the strategic agenda after the presidential, national, and local elections in May 2004, together have adversely impacted on investor confidence and may weaken ongoing and future development efforts.

2. The Philippines gross domestic product (GDP) is expected to grow by 4% in 2003, lower than the 4.4% recorded in 2002 which was the highest growth since 1997. However, high population growth erodes these modest gains on a per capita income basis. In the near term, the economy's resilience will continue to be tested: the global economic outlook remains subdued and, domestically, the fiscal deficit imposes sharp limits on spending, while the lead up to the elections in May 2004 is affecting the progress of economic reform, in particular administrative and legislative actions. Appendix 1, Tables A1.1 to A1.3 summarize the performance indicators.

3. Medium-term economic prospects depend largely on the Government's ability to consolidate its fiscal position, the pace of economic reform, no further domestic disruptions, and a supportive global economy. The Government has started to improve its fiscal position, but has extended the timetable for balancing the budget from 2006 to 2009. There is heightened concern at the size of the consolidated fiscal deficit, primarily due to the rapidly mounting liabilities of the power sector, which offsets the budget gains of the Government. It is imperative that measures are taken to allay fears of investors and to reinvigorate the investment climate for the private sector – the engine of wealth creation, employment, and productivity growth. The lagging pace of efforts to reform the Bureau of Internal Revenue, to index excise taxes to inflation, to rationalize public expenditure, and to restructure and privatize the power sector, must be accelerated.[2] High population growth places tremendous stress on the country's limited resources, social services delivery and infrastructure facilities, and complicates the task of reducing poverty and achieving targets stipulated by the Millennium Development Goals (MDGs). Recent joint reviews of the MDGs by the Government and the United Nations (UN)[3] indicate that while the Philippines is on track in some areas,[4] more effort is needed to address poverty reduction, malnutrition, gender equality in depressed areas, maternal mortality, health, and environment sustainability. A more balanced fiscal position, institutional strengthening, and policy reforms are fundamental to achieving the MDGs.

B. Implications for Country Strategy and Program

4. The Asian Development Bank's (ADB's) near-term challenge in shaping its country strategy and program is to be responsive to the current weak fiscal situation, to align new activities with the Government's absorptive capacity, unlock underutilized resources in the ongoing portfolio, and incorporate flexibility into the forward program. In this context, ADB continues to explore opportunities to support large financing requirements of the power sector through credit enhancement (as in 2002 with the partial credit guarantee [PCG]) and provide innovative support for

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[1] For further details, see: CER: PHI 2003-08. ADB. 2003. *Country Economic Review: Philippines*. August; and Board Information Paper. ADB. 2003. *25th Consultative Group Meeting for the Philippines*. November.

[2] These activities require legislation. See Board Information Paper for development partner concerns at the slow response of Congress to executive branch initiatives. ADB. 2003. *25th Consultative Group Meeting for the Philippines*. November.

[3] Government of the Philippines and the United Nations. 2003. *Philippines Progress Report on the Millennium Development Goals.* January; United Nations. 2002. *Philippines Country Study on Meeting the Millennium Development Goals*. March.

[4] Appendix 1, Table A1.4, indicates the Philippines' progress toward the MDGs and targets.

private sector development, including raising local currency debt in the domestic market to support private investments.[5] ADB has intensified its dialogue with the business sector.[6] The Country Strategy and Program Update (CSPU) aligns with the Country Operational Strategy (1998) and the Government's Medium Term Philippines Development Plan. To better understand issues, ADB has launched comprehensive assessments for poverty reduction, private sector development, governance, environment, gender, and the investment climate. These will provide inputs to the new country strategy and program (CSP) to be finalized in 2004. Thus, this CSPU serves as a guidepost to indicate some of the shifts in strategic direction and focus emerging from the CSP process. The new CSP will take into account (i) the new administration's priorities, (ii) emerging development issues, (iii) areas of revealed competitive advantage for ADB, and (iv) assistance from other development partners.

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[5] This is highlighted in ADB. 2001. *Private Sector Operations Strategic Direction and Review,* paras. 59-61. Manila.

[6] Besides other initiatives, ADB has opened a dialogue with the Joint Foreign Chambers of Commerce in the Philippines, with initial discussion focusing on the investment climate and the power sector.