

IV. COUNTRY PERFORMANCE AND LENDING LEVELS

A. Lending Level Proposed

28. ADB operations need to keep in perspective the Government's institutional and budgetary absorptive capacity as reflected in the high attrition rate of about 60% of programmed versus processed loans in recent years. The program is a balance of poverty reduction projects, and other development interventions supporting human development and economic growth. Programming new investments is uncertain given the weak fiscal position, weak implementation capacity, and events such as the 2004 elections. Taking into account the Government's budget constraints, some loans will be coursed through off-budget agencies—government-owned and -controlled corporations and government financial institutions, although with an awareness of prudential limits for contingent liabilities and the consolidated fiscal deficit. Likewise, program lending will be explored where there is clear commitment to reform – particularly in the power sector, public expenditure and revenue management, decentralization, and capital markets. Taking into account the Government's prudent expenditure management and the challenges in project implementation, the more conservative lending pipeline for 2004-2006 will ensure a higher probability of successful processing of programmed activities. Some over-programming in 2004 will ensure preparation of a sufficiently robust pipeline to maintain an appropriate level of assistance. Projects are included in the pipeline only if they meet project readiness criteria, especially budget cover, capacity of the implementing agencies, advance action on preparatory activities (e.g., right-of-way and land acquisition, resettlement) and are fully supported by EAs, OAs, and ADB. To lessen pressure on the Government's budget for counterpart funds, the program applies the higher ADB project cost-sharing limit of 65%.²¹ Pilot testing the “two-step” loan for rural roads is an innovation designed to achieve better alignment between project design and lessons learned from actual implementation performance and disbursement profiles to minimize delays and commitment charges.

29. The 2004-2006 lending program targets the processing of 15 loans amounting to \$712 million (Appendix 1, Table A1.10). It is realistic to view this volume of assistance as indicating the possibility of delivery if the constraints outlined in para. 28 were overcome. In practical terms, an annual lending volume of \$100-150 million during 2004-2006 is indicated on the basis of recent experience. Apart from this level of about \$450 million over the 3 years, some additional program lending of about \$250 million could be processed (para 28). The priority projects are in the areas of health, education, water, microfinance, SME, irrigation, agrarian reform, energy, transport, environment, and governance. The program consists of one SDP loan, five project loans, and two TA loans. About 53% of national projects (60% of lending) have poverty reduction as the development objective (32% of lending will be core poverty operations and 27% of lending will be poverty interventions). During 2004–2006, one education project for \$50 million is solely for Mindanao, and over half of programmed assistance will have Mindanao as the geographical focus.

B. Nonlending Level Proposed

30. The nonlending program for 2004 amounts to \$3.7million and includes three advisory TAs and four project preparatory TAs (Appendix 1, Table A1.11). To allow more lead-time for firmer evaluation by the new government after mid-2004, the 2005 and 2006 nonlending program has been kept open and so far only includes two TAs totaling \$1.7 million. In addition, as a frequent participant in ADB regional technical assistance, the Philippines will benefit from continued knowledge transfer activities. Lastly, if a peace agreement is signed between the Government and the MILF, resources will be needed to support its rapid implementation. However, it is premature to estimate the level of ADB support for the “peace dividend”.

²¹ Effective from 1 January 2003.

C. Summary of Changes to Lending Program

31. The 2004-2006 pipeline reflects some changes compared with the CSPU 2003-2005 (Appendix 1, Table A1.12). More than half of the 15 loans included in the pipeline are newly proposed projects, reflecting ADB's flexibility to the changing priority needs of the Government. However, all the "new" loans are a product of continued dialogue, involvement, and economic and sector work, often supported under ongoing loans or TA, until the readiness criteria are sufficient to allow entry of the proposed project into the pipeline. In many cases, the 3-year horizon of a CSPU is simply not a long enough period to bridge the "absorbency gap" between sequential operations in one agency or sector. Specifically, the projects are: (i) *Rural Roads Development Project Readiness TA Loan*; (ii) *Judicial Reform TA Loan*; (iii) *Angat Water Utilization and Aqueduct Improvement Project*; (iv) *Energy Sector Development TA Loan*; (v) *Intermodal Transport Development Project*; (vi) *Agrarian Reform Communities II*; (vii) *Irrigation Sector II*, and (viii) *Southern Airports Development Project*.²² The *Microfinance for Rural Development Project* previously programmed for 2003, is now programmed for 2004²³ pending the results of the People's Credit and Finance Corporation's privatization study, and a detailed demand assessment. Processing of the proposed *SME Finance Acceleration Program* has been accelerated to 2004, while the proposed *Metro Manila Urban Services for the Poor Project*, and the *Mindanao Basic Education Project* are deferred from 2004 to 2005. As a result of the pilot 'two-step' loan in 2004, the main investment loan for the proposed *Rural Road Development Project* is now scheduled for 2006.

²² Involves the improvement of some of the five airports being canceled under the 3rd Airports Development Project, subject to full project reappraisal and confirmation of subproject priority and economic viability. Much of the technical assessment for the proposed project has been completed; however, several requirements need to be satisfied prior to submission of the Project for ADB Board consideration. These include: (i) land acquisition, (ii) relocation/compensation for affected parties, (iii) satisfactory progress in procurement of civil works; and (iv) agreement on an updated policy agenda for the civil aviation sector.

²³ The proposed *Enhancement of Rural Livelihood in Mindanao Uplands Project*, though not included in the pipeline, could be processed in 2004 as soon as it is cleared by Government's Investment Coordinating Council, and there is confirmation from Government that it is covered by the 2004 EA budget.