

I. BACKGROUND

A. The Bank's Operational Strategy for the Philippines

1. The Asian Development Bank's assistance for the socioeconomic development of the Philippines dates back to 1969. Since then, the Bank has provided loans amounting to over \$6 billion and technical assistance of about \$90 million for a range of development projects and programs in the country. In addition to this direct development assistance, the Bank has taken the lead in arranging cofinancing of about \$3 billion through 47 projects. The strategic thrust of the Bank's overall assistance program was adjusted from time to time to address the changing socioeconomic needs of the country. In recent years, the Bank's assistance program in the country was guided by the Country Operational Strategy (COS) approved in 1993. This COS was formulated at a time when the economy was in a recession. An economic recovery, which started in the mid-1980s, coinciding with the restoration of a democratic Government after two decades of an authoritarian regime, gave way to a recession by 1991, and there were no signs of a recovery by the time the COS was formulated.

2. During the recessionary years 1991-1993, the broad macroeconomic parameters signaled little economic promise (Table 1). Annual growth in gross national product (GNP) averaged a meager 1.4 percent, inflation was running high, the public sector resource balance was precariously placed, and above all, infrastructural constraints, especially electric power shortages, were holding back whatever little chance there was for an economic recovery.

3. The single most important concern for the Philippines in the early 1990s was low economic growth. Getting the economy out of the recession and on to a path of sustainable recovery was considered to be the necessary condition to combat the country's socioeconomic problems. It was against this background that the Medium-Term Philippine Development Plan (MTPDP) of the new Government attached great importance to reviving economic growth. The primary focus of the 1993 COS, therefore, was on assisting the country in its efforts to generate sustainable growth, with a special focus on infrastructure development. Since the Bank's Medium-Term Strategic Framework required Bank operations in the member countries to pay increasing attention to social and environmental concerns, the COS supplemented the growth-promoting efforts with targeted initiatives aimed at employment generation, poverty reduction, human development, and environmental protection.

B. Economic Changes Since 1993

4. Since 1992-1993, the Government embarked on a program of stabilization and structural adjustment. The program turned out to be more decisive and enduring than earlier attempts at economic reforms and enabled the country to (i) reduce the fiscal and public sector resource imbalances; (ii) reduce the size of the public sector, through the privatization of public assets and enterprises; (iii) foster a competitive business climate through the relaxation of entry barriers and other controls on domestic industries, and liberalization of the country's trade, investment, and the foreign exchange policy regimes; and (iv) improve physical infrastructure through greater private sector participation. Coupled with domestic political stability and considerable development assistance from external aid agencies, the economic reform program produced positive results. Economic growth resumed, investment and exports picked up, and the external debt-service ratio fell (Table 1).

Table 1: Selected Macroeconomic Indicators (percent)

Item	1986-1990	1991-1993	1994	1995	1996	First Nine Months 1997
Real Growth Rates						
Gross National Product (GNP)	5.2	1.4	5.2	5.0	6.9	6.0
Gross Domestic Product (GDP)	4.7	0.6	4.4	4.8	5.7	5.2
Agriculture	2.7	1.3	2.6	0.8	3.1	2.7
Industry	5.0	-0.5	5.8	7.0	6.3	5.6
Manufacturing	5.1	-0.5	5.0	6.8	5.6	4.1
Services	5.7	1.2	4.2	5.0	6.5	6.1
Gross National Saving/GNP	19.8	17.7	18.8	18.4	19.5	19.4 ^a
Gross Domestic Investment/GNP	19.9	21.6	23.5	21.6	23.3	24.0
Current Account Balance/GNP	-1.7	-3.0	-4.5	-4.3	-4.3	-4.9 ^b
Fiscal Balance/GNP	-3.3	-1.6	0.9	0.6	0.3	0.3 ^b
Public Sector Reserve Balance/GNP	-4.0	-1.9	-0.5	-0.2	0.3	-0.7 ^b
External Debt/GNP	77.7	61.7	56.4	49.6	48.1	n.a.
Debt-service Ratio	29.8	17.9	17.4	15.8	12.0	11.6 ^c
Inflation	7.6	11.7	9.0	8.1	8.4	5.0 ^d

Note: The current account balance is not equal to the difference between the gross national savings and gross domestic investment because of the statistical discrepancy in the national accounts.

Sources: National Statistical Coordination Board, National Accounts Statistics; Bangko Sentral ng Pilipinas, Selected Philippine Economic Indicators; Bureau of the Treasury.

^a First quarter, 1997.

^b First semester, 1997.

^c April, 1997.

^d January to November 1997.

5. During 1994-1996, the annual GNP growth averaged close to 6 percent, with value added from the industry sector growing at an average of 6 percent and dollar earnings from merchandise exports at about 22 percent. The improved economic situation attracted foreign investment, both direct and portfolio. The country also regained access to the international bond market, after more than a decade.

6. Driven by the deceleration in the industry sector, economic growth slowed somewhat in 1997. The year also witnessed the spillover effects of the regional currency crisis on the Philippines resulting in some outflow of foreign capital, a fall in the stock market, and episodes of speculative attacks on the exchange rate. In response, the Government took timely measures to avert a Thailand-like asset deflation that would cut short an otherwise promising economic recovery. The most recent of these measures is the flotation of the peso, effective 11 July 1997. Since the flotation, the peso depreciated by 35-40 percent against the dollar.

7. On balance, allowing greater flexibility in the exchange rate appears to be an appropriate policy response to the emerging economic scenario both within the country and in the Southeast Asian region as a whole. Between 1993 and June 1997, the Philippine real exchange rate appreciated by about 26 percent, putting pressure on the trade balance and leading to a slowdown in the manufacturing sector. Moreover, coupled with about a 6 percent difference between domestic and international interest rates, the tightly managed peso-dollar exchange rate also contributed to the rapid growth of bank credit based on the buildup of foreign currency liabilities by the banks. This had encouraged investors to underestimate the true cost of foreign currency loans and overinvest in sectors such as real estate. The flotation of the peso

should enable the Government to reverse some of these adverse economic trends. In particular, it should help contain the surging trade deficit, revive the manufacturing sector, and put brakes on the further buildup of excess supply in the real estate sector.

8. Over the long term, therefore, the Philippine economy should come out stronger from the ongoing currency adjustment. This could, however, involve some adjustment costs in the short term. In particular, the currency adjustment may lead to some asset price deflation, through softening of real estate prices; corporate distress; and financial sector correction. It may also involve higher debt-servicing costs on the Government's budget, which in turn could lead to cuts in public investment. All these could result in a slowdown in growth in the short term. However, these need not necessarily lead to prolonged economic recession or a systemic financial sector crisis. The key challenge for the Government is to ensure that the short-term adjustment costs of the currency depreciation are kept at manageable levels. This would require improved monitoring and supervision of the banking sector, continued consolidation of public sector finances while ensuring that public investment is not cut indiscreetly, and controlling the inflationary impact of the peso depreciation while at the same time stabilizing interest rates at more normal levels.¹ In recent months, the Government gave increased attention to some of these areas of macroeconomic management. These initiatives need to be intensified.

C. Development Constraints and Challenges

9. The country has now entered a critical phase in its development process. The key development goal for the country is to maintain the growth momentum of recent years, while at the same time ensure that the growth process is equitable and has a significant impact on poverty both in urban areas and the hinterlands. Maintaining the growth momentum and ensuring its sustainability will require an increase in the savings rate. Philippines has lower savings rates than most of its Southeast Asian neighbors. Improvement of savings performance will require attention to both public sector savings and private sector savings. The former will require better public sector management including that of government-owned corporations while the latter will be aided by efforts towards capital market development and improvement in efficiency of financial sector intermediation.

10. If the growth momentum is to be translated into growth in per capita terms, control of population growth is necessary. With an annual population growth rate of around 2.4 percent per annum, much of the gains in GDP growth rates are considerably reduced in per capita terms. The period 1991-1993 for instance witnessed negative growth rates in per capita terms, with positive per capita growth rates emerging only after 1994. A high population growth rate also has adverse implications for maternal health, on the delivery of health and educational services and on the rate of reduction of poverty.

11. Progress in reducing poverty was slow in the Philippines, until recently, especially compared to its Southeast Asian neighbors. This was partly because of lack of growth and partly because of the highly skewed income distribution (Table 2). During the two decades of the 1970s and 1980s, the incidence of poverty in the Philippines declined by about 0.7 percentage points annually, whereas during roughly the same period, it declined by about 2 percentage points in Indonesia, and about 1.5 percentage points in Thailand and Malaysia.² Since 1991, the annual decline in the incidence of poverty has been more than 1 percentage point per year.

¹ See ADB. 1997. Philippines: Country Economic Review, November.

² See World Bank, 1997. "Philippines: Promoting Equitable Rural Growth" (draft). Country Department 1, East Asia and Pacific Region.

Despite this recent improvement, about 35 percent of the Philippine households and about 40 percent of the population still live below the poverty line (Table 3). The incidence of poverty in the rural areas is much higher than in urban areas.

12. Until recently, the overall development strategy and the policy regime neglected the agriculture sector and the rural economy, and encouraged capital-intensity of the industry sector. As a result, the country simply did not experience the typical transformation in the employment structure associated with the development process. Typically, economic development is accompanied by a decline in the share of agricultural employment and an increase in the share of more productive wage employment in the nonagriculture sectors. Within the agriculture sector itself, the declining share of the sector in employment is accompanied by more productive agricultural employment. Neither of these transformations has fully taken place in the Philippines.

Table 2: Income Distribution in the Philippines and Selected Asian Countries

Country	Year	GINI Coefficient	Ratio of Income Shares of Top 20 Percent to Bottom 20 Percent
Philippines	1985	0.447	10.0
	1988	0.445	10.0
	1991	0.468	11.5
	1994	0.451	10.6
Bangladesh	1992	0.283	4.0
India	1992	0.338	5.0
Pakistan	1991	0.312	4.7
Sri Lanka	1990	0.301	4.4
Indonesia	1993	0.317	4.7
Viet Nam	1993	0.357	5.6
China, People's Republic of	1992	0.376	7.1
Thailand	1992	0.462	9.4
Malaysia	1993	0.459	n.a.

Note: For the countries other than the Philippines, data refer to expenditure shares by fractiles of persons.

Sources: World Bank. 1996. *World Development Report*. Washington D.C. Government of Malaysia, Mid-term Review of the Sixth Malaysian Plan, 1991-1995.

Table 3: Poverty in the Philippines

Population	1985	1988	1991	1994
Total				
Annual per capita poverty threshold (in pesos)	3744	4777	7302	8885
Population below the poverty line (percent)	49.3	49.5	45.3	40.6
Families below the poverty line (percent)	44.2	40.2	39.9	35.5
Rural				
Annual per capita poverty threshold (in pesos)	3353	4094	6276	7946
Population below the poverty line (percent)	56.4	52.3	55.1	53.1
Families below the poverty line (percent)	50.7	46.3	48.6	47.0
Urban				
Annual per capita poverty threshold (in pesos)	4365	5893	8327	9831
Population below the poverty line (percent)	37.9	34.3	35.6	28.0
Families below the poverty line (percent)	33.6	30.1	31.1	24.0

Source: National Statistical Coordination Board.

13. In the past two and half decades, the share of agricultural employment declined only marginally, the share of industrial employment remained more or less unchanged, and that of services, acting as the residual employer, increased somewhat (Table 4). The slow progress in the generation of productive employment is also evident from the very high share of self-employed and unpaid family labor in total employment. The share of such employment, which was about 58 percent in 1970, declined only marginally to about 55 percent in 1994. By its very nature, therefore, the development strategy contributed to the persistence of poverty, as it did not create enough employment opportunities for the rapidly growing population. Therefore, even when the economy grew at a brisk pace in the 1960s and 1970s, progress in reducing poverty was negligible.

Table 4: Composition of Employment (percent)

	1970	1980 ^a	1990	1996 ^b
By Sector:				
Total Employment	100.0	100.0	100.0	100.0
of which:				
Agriculture	53.8	51.4	45.3	42.8
Industry	16.5	15.5	15.2	16.3
Services	29.7	33.1	39.5	40.9
By Type of Employment:				
Total Employment	100.0	100.0	100.0	100.0
of which:				
Wage and Salaried Employed	41.7	42.4	46.1	45.2
Own Account	38.2	36.9	38.9	39.0
Unpaid Family	20.1	20.7	15.0	15.8

Notes: ^a 1980 figures come from the *1984 Yearbook of Labor Statistics*.

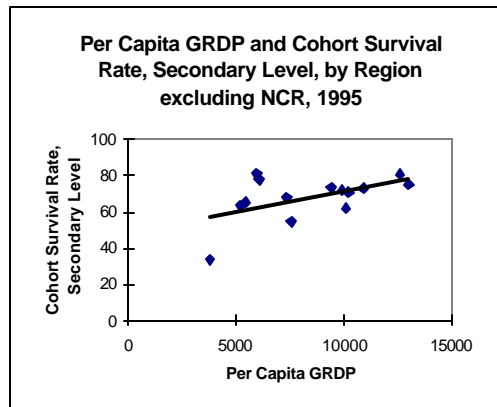
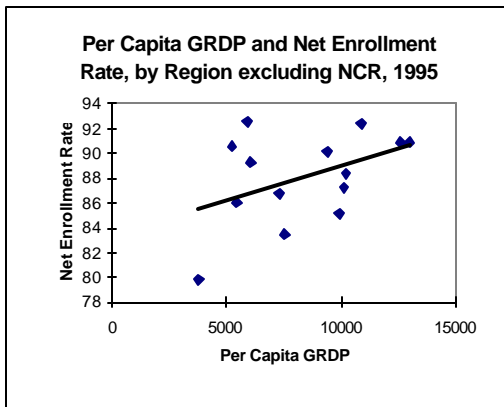
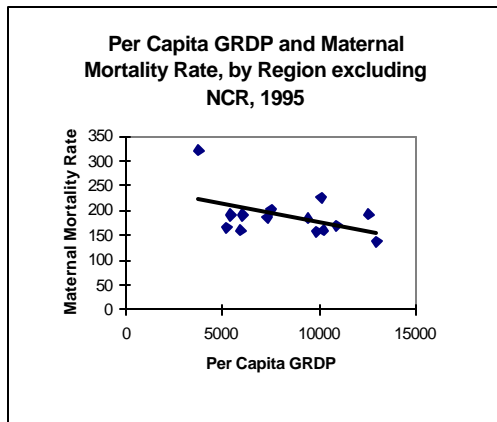
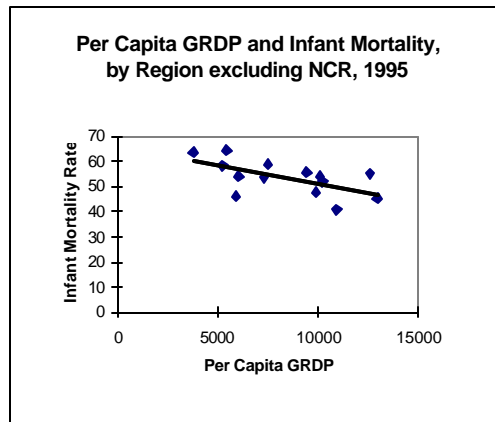
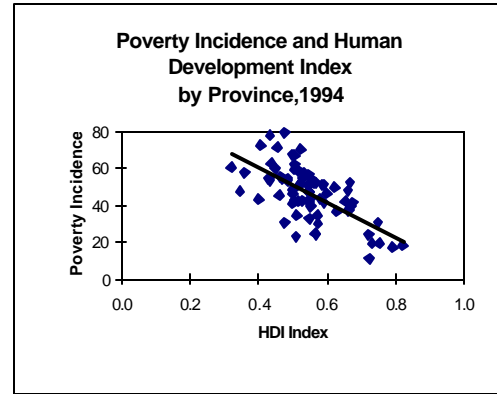
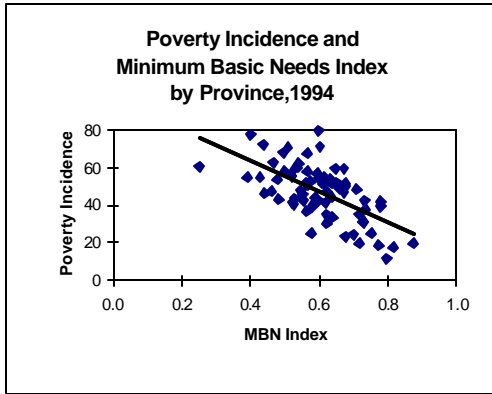
^b Data on the type of employment refer to 1994.

Sources: World Bank. 1993. Philippines. *An Opening for Sustained Growth*, April; Government of the Philippines. 1980. *Yearbook of Labor Statistics*, Department of Labor and Employment.

14. For most of the 1980s, the country experienced a stagnation or even a deterioration in infrastructure and the provision of basic public services such as primary health care, basic education, drinking water, and sanitation. The access to infrastructure and basic public services by the poor suffered as a result. Over time, therefore, the problem of poverty has become intertwined with a lack of productive employment, and a growing gap between the basic minimum needs of the poor and what the system as a whole offered to them. Poverty in the country is now part of a larger and more general problem of socioeconomic inequity. As a result, regions within the country that have low incomes and high poverty also tend to be lagging behind in the indicators of overall social development and basic needs fulfillment (Figure 1 and Appendix 1). Therefore, while sustained high growth is a necessary condition for the country to make a significant dent in poverty, faster progress in poverty reduction will also require promotion of a more labor-intensive growth process, and improvements in the provision of basic public services, especially to the poor. In other words, the overarching challenge for the country is to sustain a growth process that promotes equity and social development. To effectively meet this challenge, development policy and economic management will need to give increased attention to five key areas: (i) upgrading the country's infrastructure, (ii) rural development, (iii) human resource development with a special focus on improving the access to basic education and

primary health care facilities by the poor; (iv) promoting a more regionally balanced development, and (v) environmental management.

Figure 1: Income, Poverty, and Social Indicators



1. Upgrading Infrastructure

15. During the decade following the debt crisis of the early 1980s, the country lagged behind its Southeast Asian neighbors in building infrastructure for development (Table 5). This was partly because of cuts in Government infrastructure spending and partly because of the overall stagnation of the economy. Public investment in infrastructure fell from about 5 percent of GNP between 1979 and 1983 to less than 2 percent during the remainder of the 1980s. Between 1980 and 1990, the electricity-generating capacity of the Philippines increased by less than 50 percent, compared to a six-fold increase in Indonesia, and more than a two-fold increase in the People's Republic of China, Malaysia, and Thailand. Similarly, the Philippines lagged behind its Southeast Asian neighbors in terms of expanding telephone facilities. The performance of the Philippines was particularly poor in the case of road construction and maintenance, one of the major modes of transportation in the country. Between 1980 and 1990, the total length of paved roads in fact declined, whereas it more than doubled in Indonesia, and increased by about 70 percent in Thailand and by about 35 percent in Malaysia.

16. The status of infrastructure has improved during the last few years. The widespread electric power shortage in the early 1990s, which brought growth to a grinding halt in 1992/93, forced the Government to take innovative policy initiatives that enabled significant private sector participation in power generation. The power situation has since improved, with the power-generating capacity of the country increasing by about 40 percent between 1990 and 1995. The deregulation of the telecommunications sector attracted substantial private sector participation. As a result, the telecommunications facilities have improved, with the number of telephone connections more than tripling between 1990 and 1995, and the cost of overseas telecommunications in the country is comparable to many of its neighbors. In the transport sector, the length of paved roads has increased by about 16 percent between 1990 and 1995.

Table 5: the Status of Physical Infrastructure

Country	Electricity generating capacity ('000 kw)			Paved roads (km)			Telephone Mainlines (number of connections)		
	1970	1980	1990	1970	1980	1990	1975	1980	1990
China, People's Republic of	24,183	67,000	137,891	-	-	-	3,262,000	4,186,000	6,850,300
Indonesia	907	2,786	11,480	21,073	56,600	116,460	219,400	375,800	1,069,015
Korea, Rep. of	2,764	10,272	24,056	3,618	15,587	34,248	-	3,325,000	13,276,449
Malaysia	936	2,430	5,037	15,351	20,461	27,720	194,000	396,000	1,585,744
Philippines	2,176	4,632	6,869	15,523	27,719	23,110	304,000	420,000	610,032
Thailand	1,336	4,010	9,722	9,656	23,613	39,910	237,000	366,000	1,324,522

Notes: In the Philippines, by 1995, the length of paved roads had increased to 26,850 kilometers (16 percent increase); electricity generation capacity to 9,696 thousand kilowatts (41 percent increase); and the number of telephone connections to 1,877,072 (308 percent increase).

Sources: World Bank. 1994. *World Development Report*; National Statistical Coordination Board. *The Philippine Statistical Yearbook 1996*.

17. Despite recent improvements, the country's infrastructure needs substantial upgrading both in quantity and quality. This is particularly so in the transport sector. Despite

recent improvements, the length of paved roads in 1995 was below the 1980 level. The cost of transportation in the Philippines, especially intracountry transportation cost, is considered to be a constraint for the relocation of industrial production into the Philippines from the more developed countries in Asia. Although electric power generation increased in the last two years, at about \$0.01/kilowatt-hour (kWh), the cost of electricity for industrial clients is higher than in countries like Indonesia and Thailand (\$0.06); the Republic of Korea and Taipei, China (\$0.07), and Malaysia (\$0.09). Overall, given the past underinvestment, the capital requirements of the infrastructure sectors are indeed large.

18. Official estimates of the required annual investment in the power sector over the period from 1995-2005 works out to about \$25 billion, or about \$2.5 billion per year. For telecommunications, the official estimate for the period 1992-2010 works out to about \$27 billion, or about 1.5 billion per year. A Philippine Transport Strategy Study, financed by a technical assistance from the Bank, estimates that the investment requirements of the transport sector (covering roads, rail, maritime, and aviation) for the period 1999-2004 would be close to \$12 billion, or about \$2.4 billion per year. Over the next decade, the investment requirements of these three infrastructure sectors (power, transportation, and telecommunications) alone would work out to upwards of \$6 billion per year. Some estimates put the investment requirements for water and sanitation in the range of about \$2 billion per year. Over the next decade, the investment requirements of infrastructure sectors would, therefore, be about \$8 billion per year. During the last two years, the Government's public investment program provided an annual infrastructure investment budget of about P75 billion, or about \$3 billion. A large resource gap for the infrastructure sector over the next decade, of, say, about \$ 5 billion per year appears imminent. Given the resource constraint of the public sector, the Government's strategy is to rely increasingly on the private sector to fill the resource gap.

19. The key challenges for the Government in infrastructure development are (i) to create an enabling environment for greater private sector participation; and (ii) where private sector's role is inherently limited, to ensure that public provision is forthcoming in adequate quantity and quality.

2. Rural Development

20. About half of the Philippine population lives in rural areas, and more than half of the rural population is poor, with rural poverty accounting for nearly two thirds of the country's 27 million poor. During the last decade, there was hardly any noticeable reduction in the incidence of rural poverty. In 1985, the percentage of rural families below the poverty threshold was about 51 percent and the percentage of rural population below the poverty threshold was about 56 percent. By 1994, these measures of poverty incidence decreased only marginally to about 47 percent and 53 percent. Most of the rural poor are engaged in agriculture, with rice, corn, and coconut farmers, along with fisherfolk, comprising the majority. Rural poverty is particularly common among upland farmers working on steeply sloped land, lowland landless agricultural workers, tenants and leaseholders, and artisan fisherfolk. Any strategy of growth with equity, therefore, needs to aim at a significant reduction in rural poverty over the next decade. The slow progress in rural poverty reduction in the past was due to a number of factors¹. The most important of these were: (i) slow growth of agricultural production; (ii) lack of rural infrastructure and basic social services; and (iii) inequality in the distribution of land, the key economic asset for the rural population.

¹ For a detailed discussion of issues in poverty in the Philippines, See World Bank. 1996. Philippines: A Strategy to Fight Poverty, March; and World Bank. 1997. Philippines: Promoting Equitable Rural Growth (draft), May.

21. The gross domestic product (GDP) from agriculture grew at an annual rate of close to 6 percent in the 1970s, but at a little more than 2 percent after 1980. The slow pace of agricultural growth in the last decade limited the capacity of the agriculture sector to absorb labor, a key channel through which agricultural growth made a significant dent in rural poverty in other East Asian economies. With the Green Revolution petering out in the 1980s, most crop yields leveled off. The technology-driven increases in yield and production were, therefore, simply absent in the last decade and a half. Growth in agricultural production could have come from additional irrigation and better rural infrastructure but this was constrained by the lack of public spending on agriculture and rural infrastructure. With weather patterns experiencing considerable variability (such as the current El Niño phenomenon) greater efforts to more efficiently utilize available water resources, such as through greater coverage of arable land by irrigation, are necessary. The share of public spending on agriculture-related activities, however, declined from about 10-12 percent of the total public spending in the late 1970s to about 6 percent in the 1990s.

22. The lack of rural infrastructure facilities and support services reduced the profitability of agricultural activities. Irrigation and the density of rural roads have a substantial impact on the use of inputs, such as fertilizers and tractors by farmers, and hence on farm output. Electricity and communications services also help generate rural nonfarm employment. About half of the barangays (villages) in the country lack all-weather roads, and about half of the existing rural roads are in such poor condition that they cannot be maintained any longer. Similarly, only about 50 percent of the rural households have electricity connections. The status of other rural infrastructure such as agricultural extension services, storage, and marketing facilities also suffered mainly because of the lack of public funding. Coupled with poor agricultural growth, inadequate rural infrastructure has limited the growth of productive non-farm activities in rural areas, thus further limiting the opportunity for the poor to find productive employment in rural areas. It also hindered the rural poor from gaining access to primary health care and basic education, two key public services that enable them to benefit from growth.

23. Evidence worldwide shows that a more egalitarian distribution of rural landholdings promotes more equitable rural growth, and hence makes a significant dent on poverty. If anything, land distribution in the Philippines has become more unequal over time. The Gini coefficient for landholding remained at about 0.54 from 1960 to 1980, but increased slightly to 0.57 by 1990. About 86 percent of all Philippine landowners owned farms of 7 or fewer hectares, accounting for about one fourth of the agricultural land, while less than 2 percent of landholders had farms exceeding 24 hectares, but controlled 36 percent of all the farmland. Because of the shortage of land in the lowland areas, about a quarter of the rural population live in upland areas, and more than half of these farm on forestland, often with techniques that contribute to very high rates of soil erosion. The inequity in land distribution, therefore, not only limits progress in rural poverty reduction, but also leads to the degradation and depletion of natural resources. A comprehensive program of rural development over the next decade appears crucial if the country is to make a significant dent on poverty and stop natural resource depletion and environmental damages.

3. Human Capital Development: Basic Education and Primary Health Care

24. The Philippines continues to be endowed with good human capital. With an adult literacy rate of about 94 percent and a functional literacy rate of about 84 percent, the country has a highly literate population. About 36 percent of the population (15 years and older) have elementary education, about 38 percent secondary education, and another 20 percent college education. The proficiency of the population in the English language is an added asset. The

widespread literacy and educational attainments should generally help to make the growth process more equitable by enabling a greater trickle-down of the benefits of growth.

25. Despite these positive indicators of educational attainments of the population, a number of concerns are emerging in the country's education system. The cohort survival rates in the elementary and secondary cycles are declining, the dropout rates are increasing, and the quality of education is deteriorating. Overall, student enrollment at the elementary level is lagging behind the rate of population growth. Also, at about 2.4 percent of GNP, public expenditure on education in the Philippines is lower than in many countries in Asia: Malaysia (5.3 percent); Republic of Korea (4.5 percent); Thailand, and India (3.8 percent); Sri Lanka (3.2 percent); and the People's Republic of China (2.6 percent). As a result, the country relies significantly on the private sector for financing education.

26. Equally important, the provision of basic education appears to be becoming inequitable over time¹. In the mid-1980s, about 80 percent of the cost of elementary education and about 66 percent of secondary education was borne by the Government, and the remaining by the households. By the mid-1990s, the Government's share has declined to about 69 percent for elementary education and about 57 percent for secondary education. During the same period, the Government's share of the cost of tertiary education increased from 74 to 78 percent. Education financing has, therefore, become increasingly inequitable as the Government's share in the cost of the provision of education with greater externalities (elementary and secondary) is declining, whereas that in education with lower externalities (tertiary) is increasing.

27. Like basic education, the provision of primary health care needs improvement. In terms of key health indicators, such as life expectancy, child malnutrition, and maternal mortality rate, the Philippines fares better than only Indonesia in the region. Equally important, in the area of the management of communicable diseases, there is scope for considerable improvement. For example, the per capita annual incidence of tuberculosis in the Philippines is the highest in the region, and is even higher than in poorer countries such as India. Moreover, infectious and preventable diseases still constitute the leading causes of death in the Philippines.

28. Part of the health sector problems in the country stem from the poor health infrastructure. Indicators of health infrastructure such as the ratio of health expenditure to GNP, and per capita availability of hospital beds and doctors compare less favorably with the neighboring countries. At less than 1 percent of GNP, public health expenditure in the Philippines is on the low side compared with the India, Malaysia, People's Republic of China, Sri Lanka, and Thailand. Among the neighboring countries, it is higher than only Indonesia. Under the fiscal decentralization program implemented since 1991, the provision of primary health care was devolved to local Governments. Although fiscal devolution should ultimately result in better accountability and improvements in the health services, over the medium term institutional and other weaknesses, including lack of coordination between local Governments and the National Government, may lead to deterioration in the provision of health care.² Equally important, there is a need to step up public spending on preventive health care facilities along with improvements in service delivery.

¹ See World Bank. 1996. Philippines: Education Financing and Social Equity: A Reform Agenda. Country Department 1, East Asia and Pacific Region, June.

² See World Bank. 1994. Philippines: Devolution and Health Services: Managing Risks and Opportunities. Country Department 1, East Asia and Pacific Region, May.

4. Balanced Regional Development: Need for a Special Focus On Mindanao

29. Promoting more regionally balanced socioeconomic development will have to be a crucial element in a strategy to promote more equitable growth. In the past, due to several factors, growth was uneven. Some amount of interregional disparities cannot be avoided in any development process. For example, it was natural for the National Capital Region (NCR) to develop faster than the rest of the country. There was, however, a second level of interregional disparity that accompanied the development process between the northern (excluding the NCR) and the southern Philippines, which, if not corrected by affirmative Government action, could derail the hard-earned economic recovery.

30. In almost every indicator of socioeconomic progress, Mindanao lags behind the other two island categories of Luzon and the Visayas (Table 6). Mindanao accounts for about 20 percent of the country's population, but accounts for about 30 percent of the country's poor, whereas poverty shares of Luzon and the Visayas are roughly equal to their population shares. Mindanao's education, health, and infrastructure indicators also compare poorly with those of Luzon and the Visayas. Within Mindanao, one can distinctly observe significant dualism between the 13 provinces included in the recently created Special Zone Of Peace and Development (SZOPAD), and the rest of Mindanao. The SZOPAD lags behind the rest of Mindanao and the country in almost all aspects of socioeconomic development. More regionally balanced growth in the country with a special focus on promoting development in Mindanao is, therefore, one of the key challenges for the Government over the next decade. A development process that accords priority to Mindanao's progress is also an essential element of a strategy of growth with equity and social development, as a significant portion of the country's poor and socially disadvantaged population live in Mindanao.

5. Environmental Management

31. Environmental deterioration is another major concern. In the past, the natural resource base of the country was increasingly depleted. Forest cover declined, soil erosion accelerated, fishery stock declined, and coral reefs degraded. Moreover, air and water pollution increased. In many respects, therefore, environmental management is an issue that cuts across sectors ranging from fisheries through farming to urban development. Besides being an issue in its own right, environmental deterioration, by causing health problems, contributes to the erosion of the human resource base of the country. By its very nature, it also appears to especially affect the living conditions of the poorer sections of society. Hence, cleaning up the environment and the prevention of its further deterioration are among the best measures that can be initiated to improve the living conditions of the poor.

D. The Government's Development Strategy

32. Against the background of the emerging socioeconomic scenario, and development constraints and challenges in the country, the Philippine Government updated its Medium-Term Philippine Development Plan, originally formulated in 1993. The updated Plan provides a guide to economic and social policy reforms for the medium term, within the overall objectives of economic, social, political, and cultural transformation of the country envisaged in "Philippines 2000" – a vision of development articulated by President Ramos.¹ The updated Plan is supplemented by regional development plans, focusing on regional priorities. Three of these regional plans, one each focusing on Northern Luzon, the Visayas, and Mindanao, have already

¹ See Government of the Philippines. 1996. Updated Medium-Term Philippine Development Plan: 1996-1998, National Economic and Development Authority, May.

been drawn up and presented to the aid community for consultation and assistance. There are also sectoral development plans, such as the Medium-Term Agricultural Development Plan, which define sectoral objectives, programs, and priorities for the sector concerned.¹

Table 6: Interregional Differences in Socioeconomic Development

Indicators/Region	Year	Philippines	NCR	Luzon	Visayas	Mindanao
Income and Poverty:						
Average family income (pesos)	1994	83,161	173,600	78,433	58,325	60,308
Average per capita family income (pesos)	1994	15,802	33,000	14,949	11,312	11,167
Percentage of population below poverty line	1994	40.60	10.5	42.0	44.5	52.8
Percentage of families below poverty line	1994	35.50	8.0	36.7	38.2	47.6
Unemployment rate (Third Quarter)	1996	7.40	11.6	6.8	7.9	5.7
Underemployment rate (Third Quarter)	1996	19.80	18.7	19.4	17.1	34.0
Health:						
Life expectancy at birth	1995	68.10	69.3	68.9	67.5	65.0
Infant mortality rate	1995	49.80	32.2	47.3	53.5	54.0
Maternal morbidity rate	1995					
Education:						
Adult literacy rate	1994	93.90	98.8	95.4	92.1	90.0
Functional literacy rate	1994	85.90	93.0	87.6	83.9	80.1
Net enrollment rate (elementary)	1995-1996	89.20	91.6	91.2	87.5	85.9
Net enrollment rate (secondary)	1995-1996	62.30	93.8	68.2	55.5	46.1
Dropout rate (elementary)	1992-1993	7.10	3.3	4.0	6.5	8.9
Infrastructure:						
Paved road density	1996	0.10	0.4	0.1	0.2	0.1
Unpaved road density	1996	0.1	0.0	0.1	0.1	0.1
Percentage of households with access to electricity	1994	66.0	98.4	71.8	51.1	40.4
Percentage of households with faucet and community water systems	1994	43.2	81.2	35.5	38.7	33.2

33. Following the Peace Agreement between the National Government and the Moro National Liberation Front (MNLF) in September 1996, the Government and the regional authorities attach high priority to the promotion of peace and development as a prerequisite for poverty reduction and socioeconomic growth in Mindanao. For this, the Government has designated 13 provinces in Mindanao and the province of Palawan to form the SZOPAD, and appointed a special council, called the Southern Philippines Council for Peace and Development (SPCPD), with the responsibilities of coordinating peace and development efforts for the part of Mindanao with a substantial Muslim population. The SPCPD has a tenure of three years effective from September 1996, after which a plebiscite will determine the continuation of the Council. The SPCPD recently developed a regional development framework for the SZOPAD, and the

¹ See Government of the Philippines. 1993. Medium-Term Agricultural Development Plan: 1993-1998, Department of Agriculture.

Government is committed to significantly augmenting resource allocation and investments to Mindanao to reverse the past inadequacy of resource flow to the region.

34. Decentralization and privatization are two key elements of the Government's development strategy. Following the implementation of the Local Government Code (LGC) in 1991, fiscal responsibilities for the provision of such public goods/services as health care and rural infrastructure, including agricultural extension, were devolved from the National Government to the local Government units (LGUs). To enable the LGUs to discharge these additional fiscal responsibilities, resource transfers from the National Government to the LGUs was increased. The Government's development strategy also gives an increased role to the private sector in economic growth both by privatizing many of the public enterprises and by encouraging private sector participation even in areas such as infrastructure provision. For this, the Government has put in place a system of build-operate-transfer (BOT) and other forms of franchising schemes.

35. The Social Reform Agenda of the Government, which coordinates all the projects, programs, and policies of the Government into a consolidated program for poverty reduction and social development is expected to enable the country to achieve many of these objectives (Appendix 1). As the Reform Agenda observes: "The war against poverty has four foundations: social equity, economic prosperity, sound ecological balance, and meaningful participation of key stakeholders in all stages of development and decision making"¹. The Government has been in close consultation with the aid community on the various aspects of its development strategy. The Consultative Group Meeting for the Philippines (where the Philippine Government and the aid agencies discuss the country's development strategy and agree on the level of aid assistance), held in December 1995, devoted a session to the discussion of a strategy study on poverty done by the World Bank. The 1996 Consultative Group Meeting in December had a similar session on a strategy to promote growth with equity, with special attention to rural development and the Government's agrarian reform program, and another session on promoting socioeconomic development in Mindanao.

36. Taken together, the key objectives of the Government's development strategy that are articulated in the various medium-term documents – national, regional, and sectoral –are reduction in poverty, improvements in health and education, and protection of the environment. While the strategy recognizes the need for sustained high growth as a necessary condition for poverty reduction, it also stresses the need for better access by the poor to (i) publicly provided services/facilities such as primary health care, basic education, and sanitation; (ii) infrastructure facilities such as electricity, roads, and water; and (iii) economic assets like land. The key rationale behind the development strategy is to enhance the conventional trickle-down effect of growth on the poor by measures to buildup their capabilities in terms of access to health care, basic education, and infrastructure.

E. Need for the Reformulation of the Bank's COS

37. On balance, the emerging socioeconomic scenario is quite different from the one prevailing in the early 1990s when the Bank's last COS was formulated. A strengthened economic structure, with significantly reduced economic distortions, rising private sector investments and exports, and an improving external debt situation have enhanced the economy's capabilities to adjust to shocks, both internal and external. Despite the slowdown of the economy in the aftermath of the regional economic turmoil in recent months, the economy

¹ See Government of the Philippines. 1996. Major Policy Directives in the Implementation of the Social Reform Agenda, Manila.

possesses the potential to maintain an annual growth of about 6 percent over the medium term. From the perspective of the Bank, therefore, the time has come to focus more sharply on promoting equity in socioeconomic development, while at the same time enabling the economy to sustain the growth momentum of recent years. The Government's own development strategy is moving in this direction as well.

38. The next chapter (Chapter II) deals with the country's challenge in infrastructure provision. Chapter III takes up the challenge of promoting equitable rural development. Chapter IV examines the need for increased attention to social development. Chapter V concentrates on the need for a more regionally balanced development process with special emphasis on Mindanao's development. Chapter VI pulls together key elements of the reformulated Bank strategy and discusses issues that are relevant for its implementation. The various appendixes deal in more detail with some of the specialized topics.

II. INFRASTRUCTURE DEVELOPMENT

A Past Experience and Implications for the Future

39. In recent years, the Government accorded increasing importance to the development of the country's infrastructure and devoted large resources for investments in the sector. In the current 1994-1998 Medium-Term Public Investment Program, for example, 71 percent of public investment is devoted to infrastructure development. Earlier Investment Programs also placed an emphasis on infrastructure. Despite these large outlays, the stock of existing infrastructure is still quite inadequate. The Government's two basic goals for the sector are improving access of the population to infrastructure services, such as electricity, water and transportation, and providing adequate facilities to support production needs of the economy to enable the adequate production for domestic markets and exports. Neither goal is being fully met at present owing to the outstripping of the supply of infrastructure services by the growing demand arising from the expansion of the economy and rapid urbanization. Speedy infrastructure development is also crucial for improving the country's competitiveness. Lack of adequate farm to market roads, for example, have been inhibiting agro-industrial exports. High power tariffs and bottlenecks in transportation, including marine transportation are also frequently cited causes inhibiting exports.

Table 7: Selected Infrastructure Indicators

Year	<u>Electricity</u>			<u>Roads</u>				<u>Water</u>	
	Per capita Electricity Generation (kwh per capita)	Electricity Intensity in GDP (kwh/peso of GDP)	Electricity Intensity in Ind'l. Prod'n. (IP) (kwh consumed /peso of IP)	(meters all roads per capita)	(Meters of asphalt concrete roads per capita)	(meters per vehicles registered)	(meters of asphalt-conc. per vehicle)	(% of pop. with access)	(% of urban pop. with access)
1985	471	0.039	0.113	2.96	0.39	0.13 ^a	0.02	61	64 ^b
1990	406	0.034	0.099	2.59	0.37	0.1	0.01	65	51 ^c
1995	475	0.033	0.094	2.29	0.38	0.06	0.01	68	63

^a 1986

^b 1987

^c 1992

Source: Philippine Statistical Yearbook and other Government sources.

40. The inadequacy of infrastructure services can be gauged from Table 7.¹ Per capita generation of electricity rose appreciably after 1985, but electricity intensity in GDP (measured by electricity generated per peso of real GDP) remained stagnant. Electricity intensity in industrial production (electricity consumed per peso of real industrial production) markedly declined in the period. Although these intensity indicators can be used as indicators of efficiency,

¹ See also Table 5.

at the present stage of development of the country these possibly indicate an inadequate increase in power generation and consumption commensurate with the needs of a growing economy.

41. In the case of roads, the kilometers of roads per capita and per registered vehicle declined, the latter dramatically so. When paved roads are considered (asphalt and concrete) the situation is equally unsatisfactory. In the case of water supply, the situation appears to have improved, although not as significantly as would be desirable with more than 30 percent of the population still without access to safe drinking water. In the case of urban water supply, the situation is far less satisfactory, with more than a third of the urban population remaining without adequate access.

42. The Government is aware of the inadequacies in infrastructure provision and has drawn up plans for large expansions in all infrastructure subsectors. In electricity, against the current generation of around 35,000 GWh, of which private sector generation is only 21 percent, generation is projected to be in excess of 90,000 GWh by 2005; this represents a growth rate of about 12 percent per annum against the roughly 7 percent achieved in the period 1991-1996. This will involve more than doubling the installed generating capacity by 2005. The entire addition to power generation is targeted from the private sector. This will also require a large expansion of transmission lines from around 17,000 km to 27,000 km (about a 60 percent increase). At present, the transmission of electricity is planned to remain in the public sector, although future privatization is possible. Nevertheless, a large-scale transformation of the sector is necessary if it is to attract private investments on the scale envisaged. The necessary legislation in the shape of the Omnibus Electric Power Industry Bill was drafted and is presently under examination by the Congress.

43. In the water supply sector, the updated MTPDP aims to increase the proportion of the population served with potable water to 76.4 percent nationwide by 1998, against 68 percent in 1995. In urban areas, the corresponding target is 72 percent against 63 percent in 1995. These are very ambitious targets and will rely on more efficient service delivery by private concessionaires in Metro Manila and substantial additional private initiative in other areas if the targets are to be achieved. The National Water Crisis Act (1995) expressly provides for encouragement to private sponsors of BOT projects.

44. In the transport sector, plans for large capacity expansions have been made. In roads, where traffic is anticipated to double in the next ten years, the basic thrust is on upgrading roads rather than building new ones as the total road length is considered satisfactory. The physical targets for the current Medium-Term Public Investment Program (MTPIP) includes rehabilitating or upgrading 12,200 km out of the total of 26,600 km of national roads (46 percent) within the plan period (i.e., by 1998), which will convert all national arterial roads and 74 percent of the national secondary roads to all-weather status. For local roads, 90 percent of barangay roads are to be brought up to all-weather status by 1998 from 62 percent in 1992. The development of national roads and local roads is to be shouldered by the public sector, although private investments are anticipated for developing high-capacity transport corridors adjacent to Metro Manila and other urban centers of which 170 km has been planned for development by 1998. The rail transport targets are construction of LRT lines in Metro Manila and operationalizing 550 km of the Philippine National Railways (PNR) network including the PNR Mainline South by 1998. In air transport, it is proposed to develop both Clark Airport and NAIA with the former to become the premier international airport in the country. In addition, several regional airports are to be upgraded to international standards, while others are to be modernized and upgraded. In water transport, general upgrading of national, local and fishing ports is envisaged with special emphasis on provision of roll-on-roll-off facilities. In the development of all transport

infrastructure, private investment is encouraged and there are possibilities of such investments in all transport projects where revenues can be generated to offset investment costs. As of now, however, other than projects in Metro Manila, there has been little success in generating private investments in the transport sector.

45. The Bank recently assisted the Government in preparing a long-term transport strategy study and intends to discuss the major policy recommendations of the study in future policy dialogue with the Government. The study supports the Government's emphasis on roads as the prime mode of transportation and the continued need for a significant public sector presence in the sector. It differs from the Government's plans for limited expansion of the rail network on the grounds of unviability. It supports the need for an alternative airport to that of Ninoy Aquino International Airport but does not confirm the choice of Clark. It calls for policy and institutional changes in all sectors. The study recognizes that it is not feasible for the public sector on its own to generate the level of investment flow necessary to overcome the transport inadequacies in the medium term or even to meet the Government's own planned transport infrastructure expansion for the economy. But to attract private investments in any significant way, major policy reforms and changes in Government procedures, including major institutional changes, are necessary. This conclusion for the transport sector also applies in general to all infrastructure subsectors.

46. The focus of any strategy for rapid expansion of infrastructure provision, which seems essential in view of current inadequacies, is therefore twofold: to improve the efficiency of public sector investments, which are bound to remain important in the medium term; and to lay the groundwork through policy and institutional reform in the real and financial sectors to enable private sector participation in infrastructure investments in the economy.

B. Improving Efficiency of Public Sector Investments

47. Public investments are going to remain important in the medium term in key infrastructure areas such as roads, air transport, power transmission, and water supply. As indicated earlier, other than power generation, the celebrated privatization of the Metropolitan Waterworks and Sewerage System (MWSS) and some transport projects in the Metro Manila area, there is no significant indication of private sector activity as yet. The role of the public sector will thus still remain crucial in the medium term. A key strategic objective for infrastructure sectors, therefore, is to ensure improvements in the efficiency of public sector investments and the maintenance of assets created.

48. In the roads sector, for instance, which is representative in some ways of the transport sector in general, investment efficiency is eroded by a number of factors such as extraeconomic factors influencing project selection, lack of systematic network-based highway planning, improper engineering designs resulting from staff capacity constraints, continued weaknesses in construction capability due to poor supervision and the inexperience of contractors, and lengthy and avoidable delays in administrative and legal processes. In addition, inadequate maintenance is a crucial sector issue, caused by such factors as inefficient use of maintenance funds, insufficient use of private contractors for routine maintenance works, and insufficient local level supervision. These concerns are heightened in the case of LGU-level roads, especially in the light of insufficient LGU capacity. In the water sector also, some of these factors play a role in lowering the productivity of public investments, including inadequate maintenance. A high level of nonrevenue water is an important cause for financial weakness of water districts. In the power sector, proper maintenance of plant and equipment, and improved functioning of generating stations and the transmission system are important goals. The financial health of the National Power Corporation (NPC) and the postprivatization transmission entity also

need to be ensured if large public investments made in the sector are to be utilized effectively. On the whole, these point to a general need for capacity building efforts to improve public sector efficiency.

49. It has been suggested that where privatization is not feasible and public delivery of services is necessary, institutional changes in the public sector may enable superior delivery of infrastructure services. Corporatization of agencies where possible, for instance, may yield better accountability of costs and revenues, therefore cost recovery for services and efficiency of operations. The corporatization of the Air Transport Office (ATO) under the Department of Transportation and Communications (DOTC) as well as the Bureau of Equipment under Department of Public Works and Highways (DPWH) is being pursued by the Bank. The transport strategy study recommended that a national highway authority be created with substantial managerial and financial autonomy for developing and maintaining the national highway network.

50. Another important reform necessary is the separation of regulatory and operational activities, and the creation of independent regulators to enable impartial arbitration between consumers and public suppliers of services. As private entities begin entering the market, the independent regulatory function will become more crucial to create a level playing field between public and private providers of services. These need to be created where nonexistent, and strengthened where adequate capacities do not exist. Except for energy, independent regulation is not yet in existence in most infrastructure sectors, and even the Energy Regulatory Board (ERB) will need substantial strengthening with the impending privatization of NPC and the proposal to introduce competitive electricity pricing. There is also a strong case for independent technical regulators, especially in sectors such as air and marine transportation, where safety considerations are important to ensure such standards are set and strictly observed.

51. Tariff reform is another area common to the infrastructure sector that needs greater attention to improve the overall financial viability of service providers and to ensure the provision of quality services and proper maintenance of assets. This involves attempting to introduce user cost charges where they do not exist such as roads, and charging appropriate tariffs to recover economic costs where these are being levied but not appropriately, e.g., the air and marine subsectors. Consumer interest may also need to be reflected in the determination of fair tariffs at the other end of the spectrum, e.g., electricity pricing, where above-regional tariffs have emerged.

52. Finally, the option of privatization must be examined and pursued in sectors where this is feasible. The efforts of the Government in privatizing NPC, the largest Government corporation in the country, for example, need to be assisted. This is a major task involving grouping generating stations into viable units for their sale, formation of a transmission company to continue transmission responsibilities and establishing a grid code. Proceeds from NPC's privatization will be used to retire loan obligations, make employee separation payments, and fund a portion of the transmission expansion program. An item of major importance is the integration of NPC's existing private power contracts into the emerging competitive environment. In other sectors, such as transportation, privatization of commercial operations need to be pursued. In the water sector, the MWSS example (or other appropriate model) could be used to attempt privatization in other large water districts. Commercialization of Local Water Utilities Administration (LWUA) is also necessary.

C. Facilitating Private Sector Participation in Infrastructure Investments

53. That private participation has so far been somewhat inadequate, except for the power sector, indicates that much remains to be accomplished if significant volumes of private investments are to be attracted to the infrastructure sector. There has been considerable analyses and discussion on this issue between the Government, major market participants, and the multilateral banks on what has come to be known as the Private Sector Infrastructure Initiative. It is now well recognized that initiatives are required in the following areas: (i) key policy reforms in each of the infrastructure sectors; (ii) project promotion and facilitation; (iii) adequate risk mitigation; (iv) special attention to financing needs of projects at the local government level; (v) creation of special infrastructure facilitation vehicles; and (vi) capital market development.

1. Sector Reforms

54. General reforms toward the privatization of infrastructure provision, corporatization where privatization is not feasible, enunciation of clear policies for private sector participation, establishment of independent regulation, and development of appropriate tariffs are essential measures. In addition sector-specific policy reforms are needed. Considerable reforms were undertaken in the power sector that enabled a rapid private sector response to ameliorate the power crisis in the early 1990s. Because similar urgency was absent in other sectors, inadequate progress in policy reforms has resulted.

55. Further progress is necessary even in the power sector. An important requirement is ensuring smooth access to the transmission network by all participants; this will necessitate establishing an independent transmission company and a transparent grid code. Allowing all private generating companies free access to fuels and nondiscriminating excise taxes is necessary to create a level playing field. The consolidation of small and weak distribution utilities into viable entities will help strengthen the distribution market for participants, as will the allowing of distribution companies the right to contract for the purchase of power directly from generating companies. Developing gas utilization from the Malampaya gas field will provide readily available fuel for supporting another 3,000 megawatts generation and provide strong incentives to private entry.

56. In the transport sector, an important issue is the Government's decision requiring the factoring in of the costs of relocation within the project's total cost rather than the Government shouldering such costs. This may result in unacceptable tariffs and may need further analysis. In the roads sector, the issue of the franchise of the Philippine National Construction Company (PNCC) over toll-road projects may need examination to determine if it impedes private sector participation. Allowing the levy of appropriate tolls, enabling periodic toll revisions in line with costs, and establishing a mechanism to insure minimum toll revenues are crucial policy measures necessary in the sector. In marine transport, policies to ease constraints in interisland shipping appear necessary. In seaports, a problem that is emerging in the Greater Capital Region (GCR)¹ is the lack of National Government planning and prioritization of ports for development leading to some uncertainty about future traffic volumes. Depending on this, development of supporting infrastructure will be required. A similar airport strategy for the GCR is also urgently necessary. Permitting greater competition in domestic and international routes will facilitate the optimum use of airport infrastructure and improve airport revenues.

57. In the water supply sector, apart from attempting the privatization of water districts according to the most appropriate model (converting large water districts into

¹ Defined currently as the region comprising NCR and the provinces of Batangas, Pagbilao, Quezon and Subic.

independent joint stock companies or entering into joint ventures with strategic private partners), private sector participation will require the amalgamation of smaller water districts into viable units and specifying effective local and national regulators for them. Other important requirements are setting up adequate environmental protection of raw water resources and ensuring creditworthiness of the LGUs. Apart from its commercialization, the LWUA needs to concentrate more on financial intermediation and less on technical and procurement matters. In addition, profitable water districts should be encouraged to access commercial sources of funds, while LWUA assists the weaker ones. Legal and other policy issues critical to the sector are being examined by a Presidential task force whose recommendations will have an important bearing on future private sector participation.

2. Project Promotion and Facilitation

58. Two main areas where attention needs to be focused on are improving the BOT bidding procedure and laws, and developing the project pipeline. In the first case, the overriding concern is for greater transparency and competitiveness, in particular, the acceptance of unsolicited bids needs to be minimized. Further simplification of bidding documents, and greater availability of information about the projects, and about existing and proposed sector policies need to be effected. Some concern was expressed about the appropriateness of the discount rate used for evaluating BOT projects; this may also need examination.

59. A major problem encountered by interested private sector participants in the infrastructure sector is the lack of a significant ready-to-finance pipeline of projects except in the power sector. This is especially acute in the case of projects outside the GCR and for smaller projects at the LGU level. The lack of feasibility studies and political commitment to private participation in infrastructure development at the LGU level are major impediments to converting available infrastructure projects into effective demand for private investment. Because the potential demand is vast, the task of preparing projects for private sector participation needs to be taken up urgently. In the water sector, for example, rapid urbanization led to shortages of water in practically every major urban center; yet there are few viability studies on possible BOT-type water projects. A part of the problem is the lack of funds and capability of staff with the LGUs and Government agencies for conducting such studies. The BOT Center may also need additional budget and capacity building to undertake this task speedily.

3. Adequate Risk Mitigation

60. The role of the Government in risk mitigation for early projects is crucial. The Government must, however, judge carefully where its development function should cease, where market mechanisms and institutions can take on the usual risks of projects, and where continued support for encouraging project development is still warranted. Sponsors and creditors would obviously desire maximum Government support even when this is not strictly necessary. In the power sector, for example, where there is considerable experience now with private participation, risk mitigation by the Government could arguably be less necessary than for toll roads or the water sector. Separating and pricing specific risk categories appropriately, such as political or sovereign risks, e.g., expropriation or changes in taxes and tariffs; foreign exchange convertibility risk; market risk; and credit risk, is an important task that may help in risk mitigation but may require appropriate skill enhancement of Government staff for its proper application. At the LGU level, political risk is often cited as a major constraint by private sponsors because of frequent changes in administrations and lack of continuity of commitments. Some of the LGUs noted this concern and are attempting solutions such as through tighter legal documentation. Other credible ways of overcoming this problem will have to be found.

61. As more experience is gained by project sponsors, the role of the State in risk mitigation may be reduced; moreover, it may not be in the best interests of projects if excessive risk mitigation is sought as the climate of complacency it generates may lead to project failure. The experience of International Finance Corporation suggests that capital supplied without risk has not had a good record of success.

4. Private Infrastructure Financing at the LGU Level

62. A large share of the Philippine infrastructure requirements falls within the domain of provincial and local governments. Apart from the general problem of the absence of long-term fixed-rate peso financing, which affects all potential infrastructure projects, a special set of problems arise at the LGU level owing to (i) the often weak financial state of provincial/local governments and therefore their inability to provide effective guarantees or assurances for performance undertakings entered into by provincial or local public utilities or to issue credible debt instruments; (ii) the National Government's inability to provide a counter-guarantee for projects under the jurisdiction of local governments, owing to legal restrictions to provide such guarantees; (iii) the inability of local governments to provide certain required assurances that are plainly national in character such as convertibility and availability of foreign exchange; (iv) the uncertainties and risks associated with the remoteness or distance from national financial centers, and the possibility that Philippine country credit ratings may not bear any relationship to the risks inherent in investing in the local area; (v) problems associated with the capacity of local governments to operate effectively in screening, identifying, and selecting sponsors and projects, and generally in facilitating their implementation; and (vi) political risk at the LGU level alluded to previously.

63. Private financing of infrastructure at the LGU level therefore remains a major challenge. The Government attempted a categorization of the LGUs according to their potential ability to borrow commercially and is trying to wean away the financially stronger ones from dependence on concessional funds, such as the Municipal Development Fund (MDF), and to move them to commercial sources of finance for infrastructure creation. A system of credit rating for the LGUs is being attempted. The concept of an LGU credit guarantee corporation is being examined. Attempts to obtain aid support to develop a pipeline of BOT- type projects is being attempted. However, policy and other reforms are still necessary in areas such as enabling LGU bond flotation, a fairer system of Internal Revenue Allotment (IRA) allocation, powers of taxation by the LGUs, and allowing the LGUs to keep deposits with nongovernment commercial banks and to enable such banks also to avail of the IRA intercept. These are necessary to encourage greater commercial bank lending to the LGUs.

5. Special Infrastructure Finance Facilitation Vehicles

64. While many of the necessary reforms may take time to bear results, infrastructure investments could be facilitated meanwhile by special infrastructure finance facilitation vehicles. The basic principle behind such facilitation, however, is intervention by the Government to offset market failure. Such facilities would thus need special Government support directly, such as by bearing the exchange risk, or through development institutions such as Development Bank of the Philippines or Landbank. The requirement for such facilitation appears especially necessary in the case of LGU-level infrastructure and generally for infrastructure requiring the provision of long-term fixed-rate peso resources.

D. Capital Market Development

65. The development of the capital market is essential for private sector financing of infrastructure projects, as it will enable access to steady and reliable sources of funds at reasonable costs. It is also crucial for improving the overall savings rate of the economy. The banking sector has historically been the main intermediary between suppliers and users of funds, with the capital market still relatively undeveloped compared to some countries in the region. Table 8 illustrates the low market capitalization, insufficiency of trading in issued stocks, and virtual nonexistence of a domestic debt market.

66. Banking sector reform, which began in the mid-1980s heralded the beginnings of the reform of the financial sector as a whole. The reforms were necessitated by the banking crisis following the severe external shocks to the economy in the post 1979 period which led to growth deceleration, balance of payments difficulties and large debt accumulation. Debt service burden remained high despite debt reschedulings including those with the Paris Club. Three commercial banks closed down and several others needed Government support to survive, including the Government owned Philippine National Bank (PNB) and Development Bank of the Philippines (DBP). A large number of small thrift and rural banks also failed. Government undertook major reform of the financial sector with the assistance of the IMF and the World Bank principally in the following areas:

- (i) *Reform of Government Financial Institutions(1986-87):* The main task was rehabilitation of the PNB and DBP rendered insolvent as a result of interference in lending decisions, undertaking of unremunerative government credit programs and poor management practices. Major reforms of the Social Security System (SSS), the Government Services Insurance System (GSIS), Philguarantee and Land Bank of the Philippines (LBP) were also undertaken.
- (ii) *Financial Sector Restructuring(1989-90):* The main elements of reform were: (a) improvement of commercial banks supervision and establishment of new prudential regulations; (b) improving depositor protection by strengthening the Philippine Deposit Insurance Corporation (PDIC); (c) reduction of high intermediation costs by promotion of more effective competition, elimination of some taxes on financial intermediation, and improvement of laws regarding debt recovery; and (d) converting DBP into an effective wholesaler of long term funds and elimination of the Central Bank's role in credit allocation.
- (iii) *Restructuring of the Central Bank (1993):* Restructuring was necessitated by the financial distress the Central Bank was facing due to losses incurred during 1986-90 as a result of currency devaluations; swap, forward cover and open market operations; and granting of emergency loans to failing financial institutions. Restructuring included transfer of foreign liabilities to the national government, capital increase and improvement of the effectiveness of its monetary policy instruments. Following restructuring, it was renamed the Bangko Sentral ng Pilipinas (BSP).
- (iv) *Other Recent Reforms:* The banking sector was opened to foreign competition in 1994. State-owned commercial banks are being gradually privatized. The BSP raised the minimum capital requirements for licensed banks in 1995. Further, to safeguard the health of the banking system, BSP has decided, in principle, to adopt the internationally accepted Basle Committee norms on capital adequacy and income recognition. These will be gradually enforced within the banking system. Following the currency instability

further reform measures are contemplated in areas of banking supervision, further capacity building of PDIC and reduction in intermediation costs of the banking sector.

67. Far reaching capital market reforms were also introduced. In line with the understanding with the Government and the World Bank, the lead in capital market development was assumed by the Bank. In 1995, the Bank approved the Capital Market Development Program Loan which was designed to improve the functioning of the stock market, prevent insider trading, introduce transparency and investor protection measures, improve supervisory and regulatory practices and generally raise Philippine Stock Exchange functioning to international standards. The reforms under this program are ongoing. Most administrative measures necessary under the reform program have been implemented. The required legislative measures which had been included under the Securities Regulation and Enforcement Act, could not, however, be passed by Congress before the elections in May 1998.

68. Mutual fund development to make these funds more effective in the secondary market is also proposed. The reforms should aid greater demand and supply of equities, and encourage greater reliance on the capital market for the mobilization of funds. Although there was some increase in new stock issues annually in the post-1990 period (from less than \$400 million in 1990 to \$2.5 billion in 1994) it will be necessary to carefully monitor whether these reforms which have focused mainly on the equities side of the capital market actually lead to significant increases in the issue of and trading in securities, and whether further measures are necessary.

Table 8: Capital Market Indicators for Selected DMCs for 1994

Country	Bank Assets		Stock Market Capitalization (SMC)		No. Of Listed Companies (number)	Value Traded/ SMC (%)	Bond Market		Share of Public Debt in Total (%)	Net Inflows from Cum. Int'l. Bond Issues, 1990-94 \$(billion)
	\$ (billion)	% of GDP	\$ (billion)	% of GDP			\$ billion	% of GDP		
Philippines	34	54	56	87	187	13.5	25	39	97	2.1
Indonesia	90	57	47	30	198	19.0	9	6	92	1.0
Malaysia	70	100	199	283	431	31.6	40	56	74	0.6
Thailand	153	110	132	94	361	37.3	14	10	74	5.9

Sources: World Bank: Emerging Asia Bond Markets, 1995.

World Bank: World Debt Tables, 1996.

International Securities Institute: Asian Stock Market Factbook, 1994/1995.

69. More attention is, however, necessary for the development of the debt market, particularly the domestic bond market. Access to the international bond market improved steadily after the reentry in 1993 of the Philippines to this market. International issuances, including a recent europeso issue, exceeded \$6.5 billion in 1996 representing about a third of the total Philippine debt. The process was aided by Bangko Sentral ng Pilipinas launch of 30- and 100-year Yankee bonds that provided the needed benchmarking to enable longer-term international private sector bond issues.

70. The domestic bond market is dominated by Treasuries with practically no corporate issues. Treasuries accounted for 88 percent of the total domestic debt of \$14.5 billion.

The corporate debt market is confined to issues of mainly short-term commercial paper. BOT projects in the Philippines have generally relied on external sources to long-term capital needs, including for local currency costs, and only limited use of domestic peso funds were made, mainly to meet working capital requirements. This was due to the lack of an affordable long-term debt market. Many factors have discouraged domestic financial institutions from intermediating in long term debt instruments and the main suppliers of such long term funds (pension funds and insurance companies) from holding them. Two such factors, the absence of listing facilities for corporate bonds in the stock exchange and the lack of risk-free treasury benchmarks were overcome. Listing facilities are now available and recent issues of 10- and 20-year fixed-rate Treasury notes have established a long yield curve on the basis of which corporate issues can be priced.

71. Other inhibiting factors remain, however. These include (i) the categorization of bonds as deposits and therefore subject to nonearning cash reserve requirements penalizing issues by financial institutions; (ii) the 20 percent withholding tax on bonds, thus discouraging holding; (iii) the 0.75 percent documentary stamp tax on bonds inhibiting trading; (iv) the tendency of pension funds and insurance companies to avoid holding nongovernment instruments, as they are prohibited from holding more than a fixed percentage of risky assets, (such assets may need credit enhancement from banks with investment grade ratings to be held thus increasing costs); (v) the absence of a municipal bond market owing to the perceived financial weaknesses of the LGUs and political risk factors; (vi) the lack of a reliable credit-rating system; and (vii) the lack of a secondary market rendering bonds highly illiquid.

72. While a number of remedial measures to improve the environment for establishing a bond market are within the realms of fiscal and administrative policy reform, others will require sustained capacity building and developmental efforts. Improving the credit-rating system falls in this category, especially with respect to its ability to rate bonds and LGU instruments. Special efforts to develop LGU bonds may be necessary by measures that include offsetting some of the perceived LGU infirmities through tax incentives. Such incentives should, however, be considered as part of an overall tax reform package for the financial sector. Developing the secondary market for securities will require attention to the development of secondary market institutions such as mutual funds, and advice on asset restructuring of pension funds and insurance companies that can provide large volumes of long-term funds but are inhibited from doing so.

III. PROMOTING EQUITABLE RURAL DEVELOPMENT

73. About one third of the country's GDP comes from rural areas, of which about two thirds is accounted for by agriculture, including fisheries and forestry, and the remaining by rural industries and services.¹ Within the agriculture sector, about 55 percent of the production is accounted for by crops and the remaining by livestock, fisheries and forestry. About half of the Philippine population, or about 35 million people, live in rural areas, with about three fourths of these living in lowlands and the rest in uplands. The lowland rural population is mainly engaged in farming, livestock, fisheries, and to a limited extent in rural industries and services, whereas the upland population is mainly engaged in forestry and to a limited extent in rainfed farming of rice, corn, fruits, and vegetables. The combined incidence of rural unemployment and underemployment is about 30 percent, more or less the same as in the urban areas, but about 54 percent of the rural population live below the poverty threshold as compared to about 28 percent in urban areas. It indicates that a significant proportion of the population that is employed in rural areas earn less than the poverty threshold. The incidence of poverty is generally higher in the uplands, with more than 60 percent of the upland population being poor, as compared to a poverty incidence of about 50 percent in the lowlands.

74. The rural Philippines poses both a challenge and an opportunity for promoting growth with equity. Since about two thirds of the country's poor live in rural areas, it poses the biggest challenge in promoting equitable growth. But the abundance of rural resources, both natural and human, also offers the biggest opportunity to promote a sound labor-intensive, pro-poor development strategy for the country. As President Ramos aptly remarked, "And so today, the need is more and more apparent to develop the countryside. The countryside is where the willing hands are and where the bountiful seeds of development may be found."²

75. Equitable rural development will require policies and programs to enable faster growth of agricultural production and nonfarm rural employment opportunities and specific policy interventions to channel the benefits of rural growth toward the rural poor. Effecting this two-fold transformation of the rural economy would require concerted efforts on several fronts: (i) expansion of irrigation; (ii) improving agricultural extension services; (iii) expeditious completion of the agrarian reform program; (iv) developing rural infrastructure; (v) improving upland agriculture and natural resource management; (vi) strengthening the institutional capacity of the LGUs; and (vii) improving the provision of rural credit and availability of microfinance.³

A Expansion of Irrigation

76. Crop production, which accounts for about 55 percent of the country's agricultural production, including fisheries and forestry, and about one third of the rural economy, comes mainly from lowland agriculture. Improving irrigation is one of the key measures required to

¹ The share of the rural sector in GDP is not readily available. The estimate given here is based on the family income and household survey of 1994. In the survey, the aggregate family incomes of the rural and the urban sectors was distributed in the ratio of 1:2, implying that the rural sector's contribution to total family income in the country is about one third. This is the estimate used here.

² Speech in Malacañang, December 1993, quoted in World Bank. 1996. Philippines: A Strategy to Fight Poverty, Country Department 1, East Asia and Pacific Region.

³ For a detailed discussion of many of these issues, see World Bank, 1997. Philippines, Promoting Equitable Rural Growth, (draft), Country Department 1, East Asia and Pacific region; (ii) Asian Development Bank. 1991. Agriculture Sector Profile of the Philippines, Agriculture Department, December; and (iii) Asian Development Bank. 1994. Irrigation Sector Study of the Philippines, Agriculture Department, December.

stimulate crop production. This is especially necessary in view of the frequent variability in weather patterns being experienced due to the El Niño phenomenon. In 1997-98, for example, significantly less than normal rainfall has been experienced so far in the Philippines. Analysis of seasonal rainfall covering the period October 1997 to January 20, 1998 showed that an estimated 90 percent of the whole country received rainfall amounts of less than 50 percent of normal values. El Niño type drought conditions have also been experienced in the past, such as in 1969, 1973, 1983, 1992 and 1993. The frequent recurrence of this phenomenon underscores the need to extend and improve irrigation facilities and watershed management.

77. Irrigation systems now serve an area of about 1.3 million hectares, constituting about 42 percent of the irrigable area. About 42 percent of this is accounted for by the national irrigation system, about 48 percent by communal irrigation system, and the remaining 10 percent by private irrigation. Due to cuts in public investment in irrigation, the area brought under irrigation declined from an average of 25,000 hectares per year in the early 1980s to about 10,000 hectares per year in recent years. As a result, the irrigation ratio, the ratio of irrigated to irrigable land, has increased only marginally since the early 1980s.

78. Irrigation is generally associated with paddy. About two thirds of the country's paddy production comes from irrigated land, and about 45 percent of the land under paddy cultivation is irrigated. At about 3.3 metric tons per hectare, the average yield of irrigated paddy is comparable to that of other countries with similar soil conditions. In the long term, there is scope for increasing agricultural productivity by the application of some of the technological breakthroughs currently being achieved in high-yielding rice, with potential yields of up to 10-12 tons per hectare. However, over the medium term of about three to five years, the application of these new technologies is limited by familiar problems of seed multiplication and marketing. As a result, technology-driven yield increases in agriculture are likely to be somewhat limited over the next few years. However, since the paddy yield from irrigated land is more than one and a half times that from rainfed paddy cultivation, there is scope for improving the yield and production of paddy by the rehabilitation and improvement of existing irrigation facilities as well as by developing additional irrigation facilities.¹

79. A number of existing irrigation systems, covering about 40 percent of the irrigation service area, need rehabilitation and improvement.² The unit cost of rehabilitation and improvement projects is typically half of the unit cost of new irrigation projects, and hence rehabilitation projects have higher returns. Rehabilitation and improvement of the existing irrigation systems should, therefore, be given top priority in the medium term.

80. In 1992, the Government legislated an accelerated irrigation development program that envisages the development of about 1.5 million hectares of new irrigation facilities over ten years. However, even though the current ratio of irrigated to irrigable land is only about 42 percent, economically viable projects for such an ambitious program of new irrigation appears doubtful. Moreover, the funding requirement of such a program would exceed all current projections of resource availability. It may be more realistic to aim, as does the Medium-Term Agricultural Development Program, for an annual addition of irrigated area of about 25,000 hectares, roughly the annual average levels achieved in the early 1980s. Such a more realistic irrigation development program would also be feasible to finance, given the annual allocation of about ₱4 billion for irrigation under the MTPIP. Although some conventional large irrigation projects were successful in the past, these projects are often beset with long gestation periods and other implementation problems. It would, therefore, be advisable to give priority to developing

¹ See Asian Development Bank. 1991. Irrigation Sector Study of the Philippines, Agriculture Department, December.

² Ibid.

small- and medium-sized communal irrigation projects. Communal irrigation development is now devolved to the LGUs under the LGC, and their involvement will be crucial for the success of such an irrigation development strategy.

B. Improving Agricultural Extension Services

81. Strengthened agricultural extension services are important for enhancing the effect of irrigation on agricultural productivity. With information dissemination and demonstration, a set of dedicated agricultural extension workers can also aid in crop diversification. Prior to the LGC of 1991, agricultural extension was the responsibility of the Department of Agriculture (DA). With the implementation of the LGC, agricultural extension was devolved to the LGUs. Devolution involved the transfer of about 17,000 staff of DA, or about 220 staff per province, to the existing provincial and municipal extension services.

82. Devolution essentially created 75 provincial and more than 1,350 municipal extension services, from one national extension service. The decentralization of agricultural extension services was expected to encourage greater participation of farmers in decision making, policy formulation, and planning of local agricultural development. Many of the LGUs were not prepared for the structural change brought about by the devolution. Moreover, following devolution, the National Government gave very little assistance to the provinces and municipalities to develop strong and purposeful extension services. As a result, the provision of agricultural extension services appears to have suffered.

83. The devolution of extension services created a void in responsibility for matters such as planning strategies for extension, developing extension methodologies, implementing training programs, and coordinating the activities of the numerous extension service units. Devolution also weakened the linkages between agricultural research and extension, with the responsibility for the former resting with DA and that for the latter with the LGUs. These constraints need to be addressed urgently.

C. Completion of the Agrarian Reform Program

84. Experience worldwide shows that a more egalitarian distribution of rural landholdings promotes more equitable rural growth and makes a significant dent in rural poverty.¹ Recognizing this, the Government implemented a program of land reforms as a part of its Comprehensive Agrarian Reform Program (CARP) launched in 1987. While earlier programs of land reform mainly attempted to improve the status of the existing tenants, the CARP outlined a far-reaching program. Originally planned to be implemented over a ten-year period from 1988 to 1998, the program estimated that 10.3 million hectares of land would be redistributed to benefit about 3.7 million small farmers and landless families. In addition, the program aims to replace share tenancy with leasehold. The land reform planned under the CARP constitute one of the most progressive socioeconomic development initiatives taken by the Government. If expeditiously completed, it has significant potential to redress socioeconomic inequity in the rural areas.

85. Due to a number of constraints such as inadequate funding, resistance from landowners, and administrative and legal problems, the progress in implementing the agrarian

¹ See (i) World Bank. 1990. *World Development Report: Poverty*; (ii) Bruno, Michael; Martin Ravallion; and Lyn Squire. 1996. *Equity and Growth in Developing Countries: Old and New Perspectives on the Policy Issues*. World Bank, Policy Research Working Paper, January; and (iii) Ahuja, Vinod; Benu Bidani; Francisco Ferreira; and Michael Walton. 1997. *Everyone's Miracle? Revisiting Poverty and Inequality in East Asia*, World Bank, May, (draft).

reforms has been slow. By December 1996, only 4.3 million hectares of land, accounting for about 42 percent of the original target, was transferred to the beneficiaries. What is equally important, most of the land that was transferred is public land, which has some form of Government ownership or control, and most of the private land identified for distribution remains to be acquired and distributed. As a result, the CARP made the least progress in regions with the highest inequality in landholdings, such as the Western Visayas and Bicol. The slow progress of land redistribution resulted in the Government revising the program. The Government now plans to complete land redistribution under the CARP by 2004, and the target for redistribution is revised downward from the original 10.3 million hectares to 8.2 million hectares.

86. The slow progress of land reforms under the CARP appears to have distorted the rural land market, eroded the collateral value of land, and contributed to a decline in farm investments – all of which hamper rural growth.¹ An expeditious completion of land redistribution is crucial to reverse these trends. Besides the larger allocation of budgetary funds for land acquisition and redistribution, this may also require redesign of the program to ease landowners' resistance and ensure its enforceability. It is estimated that over the period, 1998-2004, budgetary allocations of about ₱55 billion will be required for the completion of the program, although the ultimate financial requirement may turn out to be much larger. It is important that the Government allocates sufficient funds for the CARP. It may also be worthwhile to redesign the program in such a way that the compensation paid to the landowners is somewhat comparable to the market prices of land, with the cost of land transfer shared between the Government and the ultimate beneficiary. This would ease landowners' resistance to the program, while at the same time limiting demands on scarce budgetary funds.

87. The reform program should not end with merely a transfer of land but should also involve assistance for enabling viable rural income generating activities. A program of infrastructure development in such transferred land is crucial and Government has embarked on such a program through the Agrarian Reform Communities Development Program involving implementation of agro-industrial projects, plantation/estate development, development of settlement sites and institutional enhancement program for CARP beneficiaries. However, the program so far has been beset with funding problems.

D. Developing Rural Infrastructure

88. Building rural infrastructure by investing in rural roads, water, storage facilities, electricity, ports, and communications will have to form a key element of an equitable rural development strategy. A better rural infrastructure, besides improving agricultural productivity, could also facilitate a wide variety of rural nonfarm economic activities.² Diversification of rural economic activities is essential to enhance rural employment opportunities and to make a significant dent in rural poverty. Improved rural infrastructure also raises the quality of life by providing cleaner water, land, and air, which contribute to the improved health status of the population, and by providing services valued in their own right such as transport and communication.

89. There is substantial scope for improvements in rural infrastructure in the Philippines. About half of the barangays in the country lack all-weather roads, and half of the existing rural roads are in such poor condition that these cannot any longer be maintained. Less

¹ For a detailed discussion of these effects see World Bank. 1997. Philippines: Promoting Equitable Rural Growth , May. (draft).

² For estimates of these effects, see Clarete, R. 1995. Improving the Rural infrastructure System in the Philippines: Its Potential for Rural Poverty Alleviation. World Bank, Country Department 1, East Asia and Pacific Region, May.

than 50 percent of the rural households have electricity connections, with this percentage as low as about 30 percent in certain southeast regions of the country and only about 18 percent in the Autonomous Region for Muslim Mindanao (ARMM). Only about 30 percent of the rural population has access to faucet and community water systems, and another about 40 percent depend on water from tubed or piped wells. The remaining 30 percent of the rural population have no access to potable water, and hence depend on unsafe sources such as open wells, rivers, and streams for drinking water. Most rural areas also lack safe sanitary excreta disposal facilities. Only about 47 percent of the rural population have water-sealed toilet facilities. About 36 percent of the rural population depend on poorly designed pit latrines, and the remaining 17 percent have no toilet facilities at all. These poor sanitary facilities further contaminate rural water. As a result, sanitation-related diseases like diarrhea, tuberculosis, intestinal parasitism, schistosomiasis, malaria, and hepatitis afflict large numbers of the rural population.

90. Lack of public investment in infrastructure is the key factor behind the poor state of rural infrastructure. It is difficult to apportion public infrastructure investment to rural and urban. Yet, indirect evidence suggests that the public infrastructure investment has a distinct urban bias. For example, about 50 percent of the public sector infrastructure budget is spent on the NCR. Of the remaining public sector infrastructure budget, about 40 percent is spent in Northern Luzon and Southern Tagalog – the two regions with the lowest rural-urban population ratios. The rest of the country, which accounts for about 72 percent of the country's total population, and about 80 percent of the country's rural population, thus received only about 30 percent of the public sector infrastructure budget. A similar picture emerges if, instead of the public sector budget, the National Government budget is considered. About 60 percent of the National Government infrastructure budget is spent on the NCR, and of the remaining budget about 40 percent went to the two regions of Northern Luzon and Southern Tagalog. If anything, the urban bias is even more pronounced in the capital budget of DPWH, which accounts for about 70 percent of the National Government infrastructure budget. About two thirds of the capital spending by DPWH goes to the NCR, and about half of the remaining capital budget is spent on Northern Luzon and Southern Tagalog.

91. Over the next decade, not only is there a need for stepping up public investment in infrastructure but also is there a need for changing its composition in favor of the rural sector. Since the responsibility of providing many of the rural infrastructure facilities was devolved to the LGUs, the local governments have a major role in stepping up public spending on rural infrastructure. This is especially true for rural roads, rural water supply, sanitation, public markets, and agricultural storage facilities. The improvements in rural infrastructure would, therefore, depend very much upon the ability of the LGUs to raise resources for infrastructure development, design projects, and implement them effectively.

E. Upland Agriculture and Natural Resource Management

92. The high incidence of poverty in the uplands, besides being a problem in its own right, also poses an environmental threat. In the absence of an alternative livelihood, the upland poor are generally engaged in economic activities that lead to natural resource depletion and environmental degradation. Coupled with illegal logging and poor management of forest resources by the Government, this has resulted in the rapid decline of the country's forest cover. Old growth forests were reduced from about 10 million hectares in 1950 to less than 1 million hectares today. Another 3 million hectares of scattered residual secondary forest remain in varying conditions, and deforestation continues at about 10,000 hectares per year. Upland farming also resulted in significant soil erosion over the years. Tackling the poverty problem in uplands is, therefore, important from both socioeconomic and environmental angles.

93. While rural growth-enhancing policies and programs, such as the expansion of irrigation facilities, overall improvements in rural infrastructure, and agrarian reforms, coupled with strong labor-intensive growth in the industry sector, should make a significant dent in lowland poverty, upland poverty will be somewhat less responsive to overall growth. First, the upland population are less educated than the lowland population, and would, therefore, be less likely to benefit from any expansion of employment opportunities associated with economic growth. Second, most of the upland population consist of tribal and indigenous people, who strongly resist migrating to towns and cities. Third, by the mountainous nature, uplands are less amenable to infrastructure development. All these factors make the task of poverty reduction in the uplands more challenging than that in the lowlands.

94. Agricultural intensification targeted at increasing family incomes is perhaps the most appropriate strategy for tackling the poverty and environmental problems in the uplands. Such a strategy would require (i) adoption of farming systems with improved crop rotation, and better integration of crops, livestock, and soil conservation; and (ii) a program of forest management. A comprehensive program of forest management with a special emphasis on reforestation and a stricter enforcement of existing laws and regulations on forest protection needs to be implemented. A closer involvement of local communities in managing forest resources will be crucial for the success of such a program of natural resource management.

95. The strategy of upland agriculture should promote livelihood activities using environmentally sustainable techniques that are not only productive but also maximize the retention of soil and water. Recently, the Government took several initiatives to improve forest resource management. The rapid expansion of the multisectoral forest protection committees is one such important initiative. Experience shows that the committees, in which the local leaders and communities participate in natural resource management, are effective instruments to address the forest management issue. Experience with some of the existing programs of reforestation reveal that more secure tenure arrangements than the existing 25- year lease in the uplands are required for their success.

F. Strengthening the Institutional Capacity of the LGUs

96. Under the LGC, the major responsibilities for rural development were transferred from the National Government to the local governments. As a result, many of the functions of the National Government agencies responsible for rural development before the devolution, such as Departments of Agriculture (DA), Environment and Natural Resources (DENR), Agrarian Reform (DAR), Public Works and Highways (DPWH), Science and Technology (DOST), and Health (DOH) are now transferred to the LGUs. Although fiscal devolution should ultimately lead to greater people's participation and improved public service delivery in rural areas, over the medium term, it has given rise to two sets of problems: (i) lack of coordination between the National Government agencies and the LGUs; and (ii) inadequate institutional capacity of the LGUs to undertake the devolved activities.

97. Following devolution, most of the staff and related facilities were transferred from the concerned National Government agencies to the LGUs. Yet, there is a lack of coordination between the two layers of government. As a result, in many areas of rural development, there is a fragmentation of responsibilities and underinvestment by the LGUs. In many instances, the National Government departments transferred their responsibilities, but funding for programs and activities are inadequate at the local level. For example, although the responsibility for communal irrigation systems was devolved, there has been virtually no investment in communal irrigation by the LGUs since 1992. Similarly, for the uplands, the responsibility for the Integrated Social Forestry Program was devolved, but there has been virtually no investment in this program by

the LGUs since 1992. There is, therefore, an urgent need for better coordination of rural development programs between the National Government agencies and the LGUs. This would require considerable efforts to restructure and streamline various institutions involved in rural development.

98. At present, the institutional capabilities of the LGUs vary a great deal, with many having inadequate experience in designing and implementing development programs and projects. Most LGUs also have limited knowledge and understanding of how to access the various sources of finance for development projects. There is, therefore, considerable scope for improving their institutional capabilities in planning, designing, implementing, and monitoring development projects and programs. At present, there are a number of capacity-building programs for the LGUs run jointly by the Department of Interior and Local Government and the Local Government Academy (LGA). Many aid agencies are also funding programs for local capacity building. However, many of these concentrate on imparting theoretical training on development administration. To maximize the impact of these capacity building programs, there is a need for concentrating on imparting on-the-job, project-specific training rather than on general courses on development administration. External funders can promote such capacity building programs by incorporating capacity building components in traditional development projects.

G. Rural Credit and Microfinance

99. Inadequate rural credit is one of the major obstacles to rural employment and income generation. It has been estimated that the formal credit system composed of a variety of banks and savings and loans associations, a large number of which are of unsound financial health, provide only about 30 percent of the total rural credit while the rest is provided by the informal financial system of money lenders and others who generally charge very high rates of interest, in some cases exceeding 200 percent per annum. The formal system generally caters to the large and medium scale enterprises. Though micro and cottage enterprises are considered by the Government as having the highest potential for generating output and employment and alleviating poverty, they are largely unserved by the formal financial system.

100. The Government's response to this problem has been threefold: (i) expand rural coverage by the formal credit system; (ii) to introduce directed credit regulations to allocate greater credit to the rural sector; and (iii) assist informal providers such as the NGOs in their efforts to provide rural credit. Expansion of the formal credit system has not been substantial. Directed credit regulations for enhancing rural credit have not achieved their objectives in the Philippines. The use of the alternative providers such as NGOs has had some limited success through sector programs as the Tulong sa Tao Self Employment Loan Assistance Program and the Development Assistance Program for Cooperatives and People's Organizations (DAPCOPO). Government has also attempted to use the Grameen Bank Approach to reach the ultra poor through such initiatives as the Bank-assisted Rural Microenterprise Finance Project. The Government also recently established the People's Development Trust Fund and the People's Credit and Finance Corporation for capacity building for microfinance, livelihood and enterprise projects and savings mobilization. The new microfinance strategy is to graduate from directed credit to the poor through line agencies to market oriented microfinance.

101. Policies to strengthen rural credit provision should focus on (i) improving the financial health of the formal credit system operating in rural areas; (ii) reduction in the overall costs of intermediation of the banking system as whole; (iii) liberalization of the entry of banks and other financial institutions especially in the countryside; (iv) removal of subsidies in credit in

view of their distortion of actual cost of credit and as the basic problem is not cost but availability;
(v) recognition of the alternative institutions such as NGOS as essential vehicles for credit provision and strengthening them to play their role more effectively.

WWIV. CHALLENGES IN SOCIAL DEVELOPMENT

102. Despite recent improvements in the provision of education and health services, a number of problems are emerging that need to be addressed expeditiously. The level of overall public expenditure on human resources development is low compared to other countries in Asia. While private sector and LGU participation in the delivery of these social services has been generally welcome in augmenting their overall availability, considerations of equity and efficiency have emerged. Social indicators also show significant regional disparities in both health and educational services.

103. In education, although achievements in literacy and participation rates are better than in many Asian countries, services provided still do not prepare children and youth adequately with qualitative training relevant for the labor market of an emerging industrializing economy. There are also problems of access and equity. In health, comparative Asian performance reveals an unsatisfactory picture. The decentralization of health services has introduced several new concerns. Only with major investments can adequate access to social services and improvements in their quality be ensured. Equitable financing methods have to be devised for the purpose. Major policy and institutional reforms at the national and local levels are necessary to properly harness the human resource potential of the economy.

104. Apart from education and health, challenges in social development in the Philippines also concern issues related to urban development and social insurance. The former set of issues is demanding increasing attention of policy makers in view of the rapid rate of urbanization in the Philippines and the lack of adequate infrastructure in urban areas. The latter concerns issues relating to particularly disadvantaged sections of the population towards whom greater attention is necessary.

A Challenges in Education

1. Current Status

105. Although the literacy rate (at 94.5 in 1995) and participation rates achieved in the Philippines are better than those achieved in most Asian countries, there is evidence of stagnation especially in the critical elementary level. In addition, there are questions about quality and equity. The fast-growing population has placed great strains on the public delivery of educational services. Merely providing basic educational services to the newly arriving cohorts of school-age children has been difficult with attempts to improve quality appearing to take lesser priority. Attempting to involve the private sector in cost sharing was a solution but has led to issues of equity. The choice between basic and higher education in the allocation of resources appears to have been resolved somewhat inequitably in favor of the latter. An equity issue also arose in the regional disparity of access and quality of education at all levels.

2. Access

106. Among countries in Asia, the Philippines has achieved comparative success in expanding primary, secondary, and tertiary education. The gross primary school enrollment ratio for males and females exceeded 100 percent by 1985. The 1994 gross secondary school enrollment ratio of 75 for females and 71 for males is generally well above all ASEAN countries. In tertiary education, enrollment is also high with about 25 percent of the age cohort currently

attending tertiary institutions. Behind these seemingly impressive enrollment figures, however, lurk a number of problems.

107. There is a possibility, for instance, of inaccuracies in enrollment figures. Department of Education, Culture and Sports (DECS) estimated that the actual primary participation rate in 1992 was around 83 percent compared with the 98 percent that was being claimed at the time.¹ The updated Medium-Term Philippine Development Plan places the participation rate at 91 percent in 1995. Also, current student enrollment rates at the elementary level are lagging behind the growth rates of the population. In addition, the growth of public school enrollment at the elementary level is lower than private, indicating an increasing inability of the public sector to cope with the needed demand for schooling. The regional variation in participation rates is also considerable and is posing an equity problem. Lack of access and noncompletion have left a large body of the population illiterate. The Functional Literacy, Education, and Mass Media Survey conducted in 1989 found 27 percent of the population above ten years of age to be functionally illiterate.

3. Quality

108. That the struggle to improve quality in basic education is not entirely successful can be seen from some simple indicators. Cohort survival rates, which are to a great extent an indication of quality, are virtually stagnant or slightly declining at the elementary level (from 69.7 percent in 1990/91 to 68.6 percent in 1996/97) and have dropped quite significantly at the secondary level (76.4 percent to 71.9 percent in the same period). Teacher to student ratios in Government schools have also deteriorated since the early 1990s but especially so when compared to the early 1980s. For elementary education, there were 35 students per teacher in Government schools in 1995/96 compared to 33 in 1990/91 and 31 in 1980/81. In the case of secondary education, the situation is one of stagnation in the 1990s, considerably worse than in the 1980s: 34 in 1995/96 compared with 33 in 1991/92, and 17 in 1980/81. Teaching aids are insufficient especially for the sciences, and teaching methods are old fashioned and inappropriate. The number of qualified teachers is continuously declining; in 1992, only 20.5 percent of high school mathematics and 6.6 percent of science teachers were suited to instruct their subjects, and less than 20 percent of the teachers passed their professional board exams in 1995. The 1994 National Elementary Achievement Test showed a national achievement level of only 43.6 percent for primary and 38.9 percent for secondary education against the targeted 75 percent. Low academic performance is particularly true for science and mathematics. An important factor impeding quality is the short ten-year basic education cycle (elementary and secondary), which is one of the shortest in Asia.

109. According to statistics of the International Labor Organization, less than 6 percent of the labor force have appropriate technical skills, compared to 25 percent in Taipei, China and Singapore, or 8 to 9 percent in Hong Kong, China and Malaysia. In 1991, more than half of the employed poor had only received primary education and 15 percent had not completed their schooling. This calls for much greater attention to vocational and technical education. In 1981, the Bank's sole project in this area found generally adequate facilities in both public and private institutions, and an insufficient funding, inequitable distribution of institutions across the country, and an insufficient nexus with industry in curriculum development, practical exposure of teaching, and general industry needs. High economic growth since the mid-1990s will lead to

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¹ Quoted in the Bank's RRP for the Non-formal Education Project (1993). In preparing this section on education, data has also been obtained from the Bank's other project RRP's such as the Technical and Vocational Education Project (1981) and the Secondary Education Development sector Project (1988). Use has also been made of the World Bank study, Philippines: Education Financing and Social Equity (1996) and Government publications.

greater industry demands for skilled human resources. A response in the form of the creation in 1995 of the Technical Education and Skills Development Authority (TESDA) to oversee all technical and vocational education appears to be in the right direction but an examination of its functioning and successes achieved is necessary.

110. Private schools contribute significantly to basic education with 16 percent of all schools at the basic education level being private. The enrollment of students in private schools is more important at the secondary level, with 33 percent of all student enrolled accounted for by them, than at the elementary level, which accounts for only around 4 percent. The quality of education in private schools is better than in public schools in terms of repetition rates, dropout rates, completion rates, and final examination scores. Although private schools provide basic education at a somewhat higher cost, with increasing financial constraints and difficulties in raising tuition fees in economically depressed areas, they are also facing difficulties in improving quality. Considering their important overall contribution to basic education, particularly secondary education, the attempt to improve quality in basic education will therefore, need to target private schools in a significant way.

111. In higher education, where private education plays a dominant role with about 80 percent enrollment, quality disparity between institutions and disciplines is acute. This is revealed, for example, through performance in licensure examinations. In 1993, medicine recorded an 83 percent passing rate, but in the case of accountancy, teacher education, civil engineering, and law passing rates were low. Many institutions do not meet the minimum curriculum and other standards.

4. Equity

112. There are strong inequities in the provision of education in the Philippines. An important inequity arises from the heavy burden of households in sharing the cost of basic education. Private schooling is more expensive at both the elementary and secondary levels. While private school enrollment at the primary level is still small, that growth of enrollment in private schooling is higher than in public shows the increasing burden on households. At the secondary level, a large body of students is enrolled in private schools despite their higher costs. Cost recovery is also being made highly inequitable. The share of households in the total cost of education in the elementary level was about 30 percent in 1994 compared to only 11 percent in 1986. In the same period, the household share in secondary education increased from 34 to 43 percent. This seems to be especially iniquitous considering increasing subsidization of higher education with the household share falling from 26 percent to 18 percent in tertiary education.

113. There is also considerable regional variation in the provision of education. In poorer areas, enrollment rates and completion rates are much lower for both the elementary and secondary levels. Poverty plays an important role in influencing the completion of schooling. The quality of education as evidenced by student achievement scores is also generally much lower in poorer areas, which receive lower quality teaching and school management inputs. Regional inequity is also reinforced by the differential resource allocation by the LGUs, some of the more affluent ones are able to provide additional resources to supplement National Government provisions. Inequity also arises as the poor generally flock to cheaper public schools where quality is generally lower.

5. Government Policies and Plans

114. The Government's highest priority, in terms of the policy announced in the updated MTPDP 1996/98 is to improve the quality of basic education through the concerted efforts of the formal and nonformal sectors. The basic literacy rate is targeted to increase from

95.8 percent to 98 percent in 1998; participation rates in elementary and secondary schools to 95.8 and 65.8 percent respectively; and cohort survival rates at these levels to 75.1 and 81.2 percent. Quality improvements will be attempted in basic education by upgrading the instructional material, providing laboratories, upgrading teacher skills, and providing special emphasis on the teaching of science, math, and English. A greater decentralization of the decision-making authority will be attempted. The decision to make DECS solely responsible for basic education (by creating TESDA for vocational and Commission on Higher Education (CHED) for higher education) is to be further strengthened by reorganizing DECS into the Department of Basic Education. Vocational education and skills formation are emphasized with the increase in the number certified between 1995 to 1988 expected to be about 60 percent. This ambitious target is based on an expected capacity improvement of TESDA through upgrading; devolving greater responsibilities in this sector to the LGUs, industry groups, and NGOs; and introducing a system of stricter accreditation of institutions. The regional equity issue, which was addressed to some extent by the Presidential Task Force for the Fight against Poverty with its basic education emphasis in the priority provinces, will be further addressed through a special emphasis on basic education in the Visayas and Mindanao.

115. In higher education an enrollment increase of about 18 percent is expected from 1995 to 1998. A major restructuring of the higher education sector, with presumably greater attempts to improve cost recovery, is planned with centers of excellence for priority disciplines set up. Academic freedom, fiscal autonomy, and greater accountability will be stressed.

6. Priorities for Development of Education

116. While the Government plans reveal a responsiveness to the major issues relating to access, quality, and equity, a more comprehensive coverage of the issues appears necessary. The actualization of the Government's commendable program of universal free access to basic education will call for a significant increase in public sector outlays for education. The overall spending on education from the Government, the LGUs and private sources amounted to 6 percent of GNP in 1994, and therefore can be considered satisfactory. However a change in the composition of this expenditure appears necessary with much greater public spending needed in basic education. The problem of inadequacy of access in elementary education indicates that the need for devoting increased public resources toward this sector where there are few private schools should not be lost sight of. Besides, more public resources will be necessary to address the equity issue of relieving the burden of households that cannot afford the high cost of basic education. There are a number of ways the resources problem can be tackled: persuading the LGUs to take a greater share of the costs of basic education, reducing subsidies to higher education, and increasing cost effectiveness in public spending. Apart from expanding the formal sector, the need to address the problem of functional illiterates, including educating illiterate parents, through nonformal education is an important priority for the medium term. The participation of the NGOs, which play an important role in this sector, needs to be further encouraged.

117. Quality improvements will be required at all levels of education and should not be confined to the public sector. An active policy of quality improvements in the private sector, both basic and tertiary, is necessary. Maintenance and operating expenditures need to be given as much attention as capital expenditures, to bring this about. Particular attention needs to be paid to teacher development and effectiveness, school management, and improvement of the quality and provision of textbooks and physical facilities. A greater degree of decentralization is necessary in the planning and delivery of educational services. Increasing the secondary cycle from four to five years may also be necessary to address the goal of better quality.

118. On the equity issue, reducing regional inequities will require better targeting of public expenditure. At present, DECS does not appear to be able to take an independent, objective, and a political view of resource allocations for this to be realized. Institutional reform is necessary, after examining the functioning of key agencies such as DECS and their technical and managerial capability, and their ability to decentralize operations and to act independently. Addressing governance issues in the sensitive area of resource allocations across regions in an objective manner is also called for. Apart from better regional equity, the issue of the iniquitous burden on households for basic education will need addressing through greater public spending in basic education with additional resources being raised through effective savings being generated from reducing the subsidies on higher education.

B. Challenges in Health

1. Current Health Status and Priorities

119. All major health indicators in the Philippines compare somewhat unfavorably with neighboring countries except Indonesia. Some indicators, such as persons per doctor and calorie intake, even show the Philippines at the bottom when compared with all Asian countries. As far as performance over time is concerned, rates of improvement do not match those experienced by all the three main ASEAN comparators.¹ For example, life expectancy which was 67 in 1994, improved 27 percent for the Philippines from 1960, but the improvements were 54 percent for Indonesia, 33 percent for Thailand, and 32 percent for Malaysia for the same period. The same is true for improvements in such indicators as fertility, infant mortality, and incidence of underweight children. This relatively unfavorable performance of the Philippines in the health sector is to a large extent due to inadequate spending on health. Public expenditure on health at just 1 percent of GDP in 1997 is among the lowest of the developing countries.

120. Addressing the issue of population growth is an important health sector priority. The improvement of maternal and child health and the overall nutritional standards of the population, areas in which Philippines is lagging, should be given priority. The major causes of morbidity are communicable and preventable diseases such as pneumonia and tuberculosis, which require continued attention. New morbidity patterns are, however, emerging with noncommunicable diseases such as cancer and heart disease taking a prominent place in adult morbidity. These are also more expensive to treat. The incidence of malaria and schistosomiasis is high in certain regions and needs to be controlled. The needed overall thrust in health policy appears, therefore, to be on fertility decline and control of preventable diseases with attention new morbidity patterns. The emphasis in Government health programs, however, is on curative rather than preventive health care with less than a quarter of the amount spent on curative care in 1990 being devoted to preventive care. Also, attention to fertility decline seems to be inadequate with the contraceptive prevalence rate of women being among the lowest in Asia. Major issues regarding access, equity, and capacity building need to be addressed also.

2. Access and Equity Before and After Devolution

121. Access to health services is still inadequate. The number of physicians per population is one of the lowest in Asia (barring Bhutan and Nepal). Around half the births are unattended by trained health personnel. Health services in the country are shared roughly equally

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¹ Data and conclusions in this section have relied on the Bank's RRP on the Integrated Community Health Services Project (1995), the World Bank Report, Devolution and Health Services (1994), the Bank's Key Indicators, and various Government documents.

between public and private providers in terms of expenditure incurred and hospital beds available. However, private health care services were concentrated in the NCR region indicating a thinner distribution in outlying areas. The public health network prior to devolution was composed of a network of regional DOH offices, provincial and district hospitals, rural health units and barangay health stations. However, the coverage of the population through this network is inadequate and the quality of services provided needs improvement. DOH has had difficulties in attracting doctors to the remote areas.

122. With devolution, the expectation is that the efficiency of the public provision of health services will improve with greater attention to local requirements and easier cost recovery, especially for curative services. However, the overall access of the population may not improve in the medium term given the general financial weakness of the LGUs, the possibility of duplication, and the likely overspending on curative health care. A World Bank study on the devolution of health services reached the conclusion that with the IRA allocations, 13 of 73 provinces, 109 of 1,533 municipalities, and no cities would face a deficit in their postdevolution budgets. A previous Government assessment (conducted by Department of Budget and Management) reached a more pessimistic conclusion. Both these assessments, however, consider only the provision of the existing inadequate level of services. Unless a substantial increase in resource allocation by the LGUs is brought about, there is not much likelihood of improved overall access to health services.

123. Although there are some regional variations in the provision of health services, prior to devolution, DOH attempted and succeeded in generally spreading available facilities evenly throughout the country. Rural health centers were, however, unevenly distributed with relatively better-off provinces having a larger share of these centers. Although cost recovery for public health services has been minimal, households contributed about 42 percent to total health spending in 1988, mainly on private services. The richer sections of the population generally used private facilities more and the poorer, public. Public facilities have not been known to be poorer in quality than their private counterparts. Unlike in the case of education, there does not appear to be regressive cost sharing for health services. However, with devolution, equity concerns have arisen. These relate to the fact that devolution created winners and losers in the availability of IRA allocations. Regional variations in access may thus worsen. In addition, the fact that the LGUs, predevolution, showed a pattern of increasing per capita expenditure on health when the LGU was prosperous implies that populations in poorer LGUs are likely to be worse off in the provision of health services unless there are strong remedial interventions by the National Government.

3. Government Policies and Plans

124. For the medium term, the Government expects an improvement in the life expectancy to 69.7 years by 1998. Infant mortality rates are expected to decline from 49 per 1,000 births in 1995 to 44 in 1998. A considerable emphasis is being placed on population control with a planned decline in the fertility rate from 3.8 to 3.5 and in the population growth rate from 2.4 to 2.2 percent in the same period. Targets are also set for improvements in calorie intake levels, nutrition standards, and incidence of underweight children.

125. On the policy side, it is proposed to integrate health, nutrition, and population concerns at the regional level. The family planning program will be integrated with women's health, safe motherhood, and child survival programs. An emphasis on nutritional improvement, especially in the 20 priority provinces, will be pursued. All these programs will be strengthened at the local level with the LGUs expected to play a significant role. A specific budget for the health, nutrition, and population subsectors will be provided and sourced from the IRA allocations for the

LGUs. The long-term 1994-2004 agenda includes an additional emphasis on the control of prevalent diseases (tuberculosis, malaria, and schistosomiasis) and the reduction of the incidence of heart disease and cancer. A universal decentralized and community-based national health insurance scheme is proposed.

4. Prerequisites for Sustainable Postdevolution Health Provision

126. A number of measures appear to be necessary so that the provision of health services, now mainly the responsibility of the LGUs, can be placed on a sound and sustainable basis. First, it must be recognized that the predevolution status of health care was deficient in several respects: it is not mere maintenance at these levels that is necessary but rather substantial improvement even in the medium term. The financial wherewithal of the LGUs must be ensured. Much greater cost-recovery efforts for the provision of public services is therefore essential. Prior to devolution the National Government generally kept away from any significant cost-recovery measures, and while this may have strained national resources, it enabled a generally equitable access to health services. Cost recovery by the LGUs will have to be therefore carefully administered to not burden the poorer segments of the population. Expanding health insurance is a long-term measure that should also be pursued along with measures to encourage private sector participation where the population can afford such services.

127. The LGUs have been given responsibility in many areas of health care for which they have insufficient capacity to administer the programs. The weakest in the LGU structure are the municipalities that do not have sufficient expertise in planning, and program and personnel management in general, and have not handled disease control in particular, earlier. Coordination, which is crucial in disease control programs may also suffer unless strong national or at the least provincial-level coordinating mechanisms are set up. The role of the provinces, which will be crucial in the decentralized structure, needs to be better defined, such as in the assumption of a crucial intermediary role in key public health programs and maintenance of the information system, and their capacities ensured. Mechanisms to ensure uniformity and the improvement of technical standards are also necessary.

128. The new role for DOH has to be clearly defined. It will shift from the direct provision of health care services to setting overall health policy in general and continued responsibility for ensuring successful implementation of national health programs, particularly the control of communicable and preventable health diseases. Such responsibility is not stipulated in the Local Government Code but must be assumed and effected through the devising of innovative instruments of monitoring and control. Capacity may need to be developed at the national level for this new role.

C. Challenges of Rapid Urbanization

129. The Philippines is witnessing a rapid growth of urbanization with the urban population growing at about 5 percent per annum. With about 55 percent of the population currently residing in urban areas, the Philippines has now the highest urbanization level among Southeast Asian countries, barring Singapore. Metro Manila and its environs alone account for over 60 percent of the urban population in the country. The high poverty incidence and lack of employment opportunities in the countryside mainly explains the continuous migration of population to the urban areas. The rapid growth of urban population and industrial agglomeration are however placing increasing pressures on municipal services and infrastructure, causing a deterioration in the urban environment and air quality, and leading to the emergence of social problems. With devolution, the enormous responsibility for urban services has shifted to the LGUs.

130. City and municipal governments need assistance to cope with the pressures of urbanization. Primary among the rapidly growing demands for municipal services is water supply and sanitation, which includes sewerage and solid waste management. Other pressing needs are housing, transportation, roads, and other municipal level infrastructure.¹ A major constraint faced by cities and municipalities, particularly the smaller ones, is finance for capital expenditure and maintenance. Although the Local Government Code of 1991 consolidated and devolved powers of some categories of local taxation to the LGUs and formalized the IRA, most of the LGUs have not been able to substantially improve their revenues. With the general withdrawal of the National Government from local level infrastructure provision and growing needs posed by rapid urbanization, a major gap in infrastructure financing at the LGU level is emerging. In the medium term, most of the LGUs will be unable, given the state of their finances and present capacities, to tap commercial sources of funds for infrastructure development. It is necessary therefore that interventions in capacity building be made, especially for the weaker LGUs, in areas of resource mobilization and enhancement of local revenues through various measures such as tax reforms and budget management.

131. The unplanned development of some cities and towns is one of the characteristics of the present urbanization process in the Philippines. There is a need for urban planning especially in the earlier stages of urban development. Apart from planning for the provision of urban infrastructure, land use planning is also critical to prevent congestion, enable the most efficient use of land for commercial and housing purposes, and also provide sufficient space for public amenities such as parks and playgrounds.

132. Large urban agglomerates such as Metro Manila are beginning to experience severe environmental problems, particularly regarding air and water quality. Vehicular emissions and industrial pollution are the main causes of air pollution, while household wastes and industrial effluents contribute to the deteriorating water quality. A comprehensive and coordinated approach toward environmental management is needed covering areas such as legislation and law enforcement, developing a system of fiscal and financial incentives and disincentives for reducing pollution, and an effective organizational structure to coordinate and implement an environment plan. In view of the significant externalities and the nature of the environment problem, its alleviation is not feasible through action at the LGU level alone but will need concerted intervention at the level of the National Government.

133. Although the incidence of urban poverty in the Philippines is considered to be lower than rural poverty, the harsher conditions of urban existence for the poor require special measures for improving their well being. Housing for the urban poor living in squalid conditions is an urgent requirement. The National Government's ongoing National Shelter Program, which targets the low- and middle-income households, intends to provide 1.2 million units of housing in the 1993-1998 period. The updated MTPDP 1996-1998 calls for the formulation of a comprehensive housing finance program targeted at the lowest 30 percent of the population. The task of providing decent and adequate shelter to the urban poor population is arduous and will require significant mobilization of resources and innovative approaches to financing.

D. Sustaining Social Protection

134. In addition to the protection provided under the traditional extended family system, safety nets in the Philippines comprise a variety of public social protection programs (mainly food subsidies and livelihood projects), the social welfare system (under the Department of

106.

¹ The policy issues concerning urban infrastructure at the LGU level, including policies to enable private sector participation in LGU level infrastructure were discussed in Chapter II on Infrastructure.

Social Welfare and Development and the LGUs), and social insurance for the formal sector and Government employees. Public social protection programs in the Philippines have, however, generally not been very effective and not contributed much to poverty reduction. Thus only 2 percent of the country's 10 million households have benefited so far from the Government's food subsidies and the 58 livelihood programs show little sustainable impact. Employment programs have not met their objectives of benefiting the poor, serving as employment of last resort, addressing seasonal underemployment and creating assets benefiting the poor. There is scope for public work projects to be more effective as instruments of employment generation for the needy, and better integrated into national and local government infrastructure programs.

135. Special social assistance programs have been created to protect and integrate socially disadvantaged people such as out of school youth, persons with disabilities, senior citizens, women and children in difficult circumstances, and people affected by disasters. An important target group are neglected children. In 1995 the Government estimated that 2.9 million children need special protection, being victims of sexual, physical and drug abuse, child prostitution and child labor. Before 1992 about 5.8 million people received assistance from the Government, but transfer payments were very low at only \$2 per year and beneficiary. Though with devolution the national Government's role as deliverer of social welfare programs has been transferred to LGUs, it is currently formulating a national policy and regulatory institution for safety nets. The Comprehensive and Integrated Delivery of Social Services program under the Social Reform Agenda is currently the national Government's major effort to provide beneficiary oriented social development services in an integrated manner.

136. There is a great need to establish social security for the informal sector. In agriculture, these comprise about 3.5 million small farmers, 2 million municipal and coastal fisherfolk, 1 million forest dwellers and 0.5 million livestock raisers. The industry sector has about 0.8 million small entrepreneurs and 2 million small miners and construction workers. The service sector contributes to about 48 percent of total informal sector workers. The majority of informal sector workers belong to the low income group. Studies show, however, that informal sector workers can afford and are interested in formal social insurance schemes. However, the current formal insurance system (GSIS and SSS) covers only 27 percent of the formal sector workers and 60 percent of all government employees. It is not designed for people working in the informal sector. Major reforms are therefore due to improve the service orientation of these institutions to enlarge their coverage.

V. BALANCED REGIONAL DEVELOPMENT: A FOCUS ON MINDANAO

A Regional Disparities in Socioeconomic Development

137. In the past, the development process in the Philippines was uneven across the regions, resulting in substantial interregional disparities. Some degree of interregional disparities cannot be avoided in the development process. For example, it was natural for NCR to develop faster than the rest of the country. There has, however, been a second level of interregional disparity that has accompanied the development process between the northern (even excluding NCR) and the southern Philippines, which, if not corrected by affirmative action, could derail the development process. In almost every indicator of socioeconomic progress, Mindanao lags behind the other two island categories of Luzon and the Visayas (Table 9). In addition, within Mindanao, there are two distinct parts: (i) the less developed and politically more unstable Regions IX, XII, and ARMM, which are now part of the recently created SZOPAD; and (ii) the progressive regions of the Cagayan Corridor (the newly formed CARAGA Region including parts of Regions X and XI) and the Davao Gulf cluster (Table 10).

Table 9: Regional Differences in Social and Economic Infrastructure

Service	Year	Mindanao	Visayas	Luzon	NCR	Philippines
Water and Sanitation						
Irrigation rate (irrigated to cultivated land, percent)	1995	28.2	43.7	48.6	0	41.8
Access to community water systems and faucets (percent of households)	1994	32.1	38.7	35.5	81.2	43.2
Access to water-sealed toilets (percent of households)	1994	44.9	46.2	64.7	91.4	61.8
Health						
Municipal health units per population	1995	1:33,722	1:32,664	1:29,021	1:24,913	1:30,094
Hospital-bed ratio (population per hospital bed)	1995	1:1,037	1:1,208	1:1,133	1:347	1:870
Physician per population ratio (Government hospitals)	1995	1:56,814	1:34,550	1:28,822	1:37,992	1:34,632
Nurses per population ratio (Government services only)	1995	1:33,859	1:22,260	1:37,678	1:36,678	1:26,084

Sources: Department of Education, Culture and Sports, Department of Health, National Statistics Office, Family Income and Expenditure Survey.

138. Many factors have contributed to the interregional disparities between Mindanao and the rest of the country, and, to a large extent, the same factors have led to the intraregional disparities within Mindanao. Two of these factors deserve special mention: (i) the Muslim separatist movement and the armed conflict that ensued between the Muslim rebels and the Government; and (ii) the inadequate development of infrastructure in Mindanao, both physical and social, compared to the rest of the country. Both these factors have reinforced each other to retard the island's socioeconomic progress.

139. Since the beginning of the Muslim Independence Movement in 1968 and the formation of the MNLF in 1971, Mindanao has almost continuously witnessed civil strife and armed conflict between the members of the MNLF and the Government. The Muslim separatist

movement often caused serious law and order problems in the region hampering economic progress. The lack of economic progress, in turn, has intensified the separatist movement. As a result, Mindanao is caught in a vicious circle of underdevelopment and civil strife. Data on the interregional allocation of Government expenditures are not available. Yet, the relatively poor socioeconomic infrastructure facilities in Mindanao, such as the irrigation rate, paved road density, access to water and sanitation, and education and health infrastructure indicate that Mindanao has generally got less than its due share of public funds. The law and order problem of the island has also discouraged the flow of private sector funds to the island, thus aggravating the problem of insufficient public funding. Moreover, whatever resources, public or private, flowed to the island was concentrated in the relatively peaceful provinces of Davao, Misamis Oriental, and Zamboanga, thus causing substantial interregional disparities within Mindanao.

Table 10: Intraregional Disparities in Mindanao

Item	Year	Total Mindanao	Disadvantaged region	Region IX (Western Mind.)	Region XII (Central Mind.)	ARMM	Progressive regions	Region X (Northern Mind.)	Region XI (Southern Mind.)
Population ('000)	1996	17,201	7,562	2,968	2,451	2,143	9,639	4,220	5,419
Economy									
GRDP (Pmillion, current)	1996	401,375	143,560	59,522.4	63,157.4	20,880.4	257,815	111,218.0	146,596.7
gross value added in agriculture (Pbillion, 1985 prices)	1992-1996 average per year	57.4	24.0	10.7	8.6	4.7	35.2	14.5	20.7
Per capita GRDP (current)	1996	17,224	18,984	20,055	25,768	9,744	26,747	26,355	27,052
Growth (average annual, 1994/95)		4.1	4.6						
Per capita family income	1996	2,640.2	1,946.1	2,059.6	2,644.8	994.8	2,747.7	2,705.4	2,780.7
Equity									
Poverty (percent, household)	1994	47.6	53.1	44.7	54.7	60.0	44.8	49.2	40.3
Magnitude (million persons)	1994	8.1	3.8	1.3	1.3	1.2	4.3	2.1	2.2
Ultra Poor (percent of poor people)	1994	59.3	57.1	60.4	65.2	45.7	60.4	65.6	55.2
MBN Index	1995	0.5251							
Compiled un- and underemployment (percent)	1995	33.4	35.7	27.4	44.0	20.1	42.2	39.8	44.6
Social Services									
Education									
Elementary school dropout rate	1992-93	8.9	14.3	12.0	9.2	21.6	9.0	9.4	8.5
Functional literacy rate	1994	77.3	71.3	75.4	77.4	61.2	81.4	83.4	79.4
Secondary school enrollment rate	1994-95	47.9	41.3	47.0	55.3	21.6	53.0	54.3	51.7
Vocational training skills (persons above 15 years, percent)	1994	5.9	3.9	3.6	6.8	1.3	7.4	7.2	7.6
Expenditures (budgeted, Pmillion)	1997	14,055.6	6,180.9	3,030.5	3,069.6	80.8	7,874.7	3,854.2	4,020.5
Public education expenditures of the NGA per person per year	1997	817.1	817.4	1,021.1	1,252.4	37.7	817.0	913.3	741.9
Health									
Infant mortality rate	1995	54.0	58.5	58.6	53.5	63.4	52.8	53.7	51.88
Prevalence of anemia (percent)	1993	28.4	31.9	24.4	37.0	34.3	25.8	23.7	28.0
Population per barangay health station ratio (persons)	1994	5,216	4,991	4,561	4,577	5,835	5,529	4,821	6,237
Population per hospital ratio (private and public, persons)	1994	38,234		40,200	29,063	73,357		53,413	29,466
Population per hospital bed ratio (persons)	1995	1,037		1,091	1,036	1,687		1,023	887

Notes: The following abbreviations have been used: ARMM: Autonomous Region for Muslim Mindanao; GRDP: Gross Regional Domestic Product; MBN: Minimum Basic Needs; NGA: National Government Agency.

B. Recent Initiatives in Mindanao's Development

1. Peace and Development

140. In 1993, the Government started a process of peace talks with the representatives of the MNLF headed by Nur Misuari and the New Peoples' Army led by Jose Maria Sison. In September 1996, a peace agreement was signed between the Government of the Philippines and the MNLF (Appendix 4). The peace accord paved the way for the establishment of the Southern Philippines Council for Peace and Development (SPCPD), the SZOPAD, and a Consultative Assembly for Muslim Mindanao. The SZOPAD is a temporary administrative union comprising 14 provinces and 9 cities in regions IX, XI, and XII of Mindanao, and the province of Palawan in Region IV of Luzon. The SPCPD is an interim body created to (i) manage the transition of the MNLF in a postconflict environment; (ii) lay the foundations for lasting peace through sustained development in the SZOPAD; and (iii) oversee the preparations for a plebiscite that will eventually create a new autonomous government and replace the ARMM in 1996. It is chaired by Nur Misuari, who is also the governor of the ARMM at present. The Consultative Assembly for the SPCPD consists of 81 public and private sector representatives from the SZOPAD area, and serves as the advisory body for the SPCPD.

2. Institutional Framework

141. To promote Mindanao's development, the National Government also created special institutions. In 1992, the Mindanao Economic Development Council (MEDCO) was established as planning agency for the whole island in coordination with the Office of the Presidential Assistant for Mindanao. In 1996, the territory was administratively reorganized with the SPCPD as the new agency to guide the development of the SZOPAD. Other institutional arrangements to promote the development of Mindanao comprise the Mindanao Legislators' Association, the Mindanao League of Governors and Mayors, the Mindanao Business Council, the Mindanao Agriculture and Fisheries Council, and multisectoral political movements such as the *Kusog Mindanaw*. In addition, geoeconomic clusters were created through local initiatives, the most successful being SOCSKSARGEN,¹ CARAGA, and the Cagayan-Iligan Corridor. The geographic coverage encompasses adjoining provinces and/or municipalities with joint socioeconomic ties. The economic clusters have been promoted by multisectoral organizations comprised of representatives from the LGUs, local NGOs, private sector, and civil society. These institutions follow an integrated area development approach.

142. Many of these institutions and administrative bodies have overlapping functions and jurisdictions. As a result coordination problems emerge, mainly between (i) MEDCO, SZOPAD, and ARMM; (ii) SZOPAD/SPCPD and the LGUs; (iii) the new administrative clusters and the provinces and regions; (iv) the Government and the private sector, in the context of East Asian Growth Area between Brunei, Indonesia, Malaysia and the Philippines (BIMP-EAGA); and between (v) SPCPD/ARMM and the supporter of those groups in Mindanao who are not participating in the gains of the peace process. Apart from the urgency to rationalize the complex and conflicting institutional setting in Mindanao, the absorptive capacity of the various levels of Governments, the private sector, and the NGOs in services delivery and planning for the SZOPAD area needs to be substantially enhanced.

¹ The SOCSKSARGEN cluster is composed of South Cotabato, Sultan Kudarat, Sarangani, and the city of General Santos (in Regions X and XI).

3. Government's Program for Mindanao

143. Besides achieving the peace accord on Mindanao, the Philippine Government is paying increasing attention to the development of Mindanao. Investments in irrigation were intensified with two large projects comprising 11,500 hectares in Maguindanao and 10,800 hectares in North Cotabato. As part of the safety net measure for small-scale farmers, a General Agreement on Tariff and Trade (GATT) adjustment fund was created to ensure additional funds for the construction of irrigation, postharvest facilities, and farm-to-market roads. Between 1992 and 1996, 753 km of arterial roads were built; 501 megawatts were added to the island's power grid capacity; 200,963 more telephone lines were installed; several sea and airports were rehabilitated; and two international airports were opened. Because of the deregulation of air and sea routes, four more airlines are now servicing Mindanao and four are for international destinations. One of the airlines provides interregional flight services, the first ever for the island. Sea-route services are also expanded with fast-ferry services plying the busy Cagayan de Oro and Cebu route.

144. In 1994 Brunei Darussalam, Indonesia, Malaysia and the Philippines founded the BIMP-EAGA. Within the Philippines BIMP-EAGA participation concentrates on Mindanao and Palawan. BIMP-EAGA was set to enhance regional cooperation by making use of (i) cross-border complementarities and economies of scale in production, (ii) joint infrastructure provision, and (iii) closer cooperation in trade in finance. Mindanao's numerous small- and medium-scale entrepreneurs are provided new opportunities for international trading through BIMP-EAGA. However, the physical infrastructure in the region is still largely inadequate, major investments in EAGA – apart from tourism – are yet to come, economic complementarities are actually constrained, and capacities to enhance regional economic cooperation between the member countries are still weak.

145. It is too early to make an assessment of the economic impact of the BIMP-EAGA initiative. It has aroused considerable interest among investors, including foreign investors, though actual investment flows have not been very significant so far, basically due to inadequate progress in infrastructure development. Plans to improve transport infrastructure linkages, particularly air and shipping, are now under implementation. The Bank is assisting the Government in development of roads and airports and in capacity building for establishment of a Coordinating Council for the BIMP-EAGA.

146. The Government, through a joint effort of SPCPD, National Economic and Development Authority (NEDA), and the ARMM Planning and Development Office, recently formulated a Priority Investment Program for SZOPAD. The suggestions were consolidated through a consultative process with the LGUs, the National Government, NGOs, the private sector, and representatives of the MNLF. In addition, the regional units of line governments reexamined their national programs to find activities to be fast-tracked for implementation in the SZOPAD for the next 2-3 years.

147. Conceptually, the Government places special importance on rural integration through improved transport facilities. For industrial development, the integrated growth center approach is proposed to be applied. In education, in addition to school building and curriculum development with a special focus on peace education, the Madrasah system is proposed to be strengthened. Ecosystem-based development is suggested through the CARP approach. The Government also recognizes the strong need for capacity building in the areas of project identification, development, design, evaluation, and monitoring.

148. The Public Investment Program for SZOPAD (1997-2000) comprises 85 projects amounting ₱30.8 billion in the priority areas of transport, rural social infrastructure and health

services, agro-industry, agriculture and environmental management, and education, as well as capacity building (Table 11). Roads, bridges, and ports require by far the largest investment (42.3 percent); followed by ecosystem-based development (31.2 percent), and rural infrastructure and social services (18.6 percent). The Public Investment Program also lists eight joint venture and BOT-type projects worth P3.6 billion. Funding requirements are estimated at \$1.7 million in 1997, \$411 million in 1998, and \$612 million from 1999 onward. The Government assumes that official external development assistance will be 75 percent of this. As the 1997 budget has already been programmed and the proposed 1998 budget lined up, actual funding will be processed only during the 1999 budget exercise. Notwithstanding additional budget allocations for the SZOPAD, the urgent development objectives can only be pursued to accommodate the new priorities for Mindanao development. These are (i) realignment of agency budgets and funds of ongoing projects for other regions; (ii) refocusing of new projects already identified by national agencies; (iii) the use of pole-vaulting budget; (iv) a one-time new special budget allocation for the SZOPAD; (v) the use of the proceeds of Government-owned and -controlled corporations and financial institutions; and (vi) tapping private sector resources.

Table 11: The Public Investment Program (1997-2000) for SZOPAD

Item	Costs (Pmillion)	Physical Targets	Implementation (number of Projects and Agencies)		Proposed Sources of Aid
			National Government	LGUs	
Total	30,825				75 percent of total costs
Transport	13,024				
Roads	9,575	1,466 km	16, DPWH	14	ADB, OECF, Kuwait
Bridges	655	1470 lineal meters	1 DPWH	1	
Ports	2,794		7; PPA, DOTC	2	
Rural infrastructure and social services	5,740				ADB, JICA, OECF, World Bank
Irrigation and flood control	1,632		3, NIA	2	
Water supply	70			2	
Health	4,038		1, DOH	3	
Regional agro- industrial growth centers	1,631	3 growth centers	1 DTI	2	OECF, ADB, World Bank, CIDA, EC, European bilateral aid agencies
Ecosystem-based development	9,622				OECF, ADB, World Bank, EC, European bilateral aid
Agriculture	8,990		1 DA	5	
Environment	632		1 DENR	2	
Education	158	elementary school building, vocational training	3 DECS, 2 TESDA	2	OECF, JICA, AusAID, ADB, New Zealand
Planning and capacity building	649				CIDA, USAID, UNDP, ADB

Note: The following abbreviations have been used: ADB: Asian Development Bank; OECF: Overseas Economic Cooperation Fund; JICA: Japan International Cooperation Agency; CIDA: Canadian International Development Agency; AusAID: Australian Agency for International Development; UNDP: United Nations Development Programme.

C. Challenges Ahead

149. Designing and implementing macroeconomic and islandwide policies to ensure balanced regional development is a major challenge for the Philippines in the years to come. The new policy calls for an area-oriented investment approach targeted mainly at the less-developed regions and derived from sector-integrating bottom-up planning for the needs of the poor and the ex-combatants of the MNLF. Under this approach, Regions IX and XII in Mindanao, and the provinces of Bicol, Eastern Visayas, Palawan, ARMM, and Cordillera Autonomous Region are perceived to be the key investment areas to reduce regional disparities. To achieve sustainable growth with equity, sectoral policies should focus on the following: (i) the poor's increased access to infrastructure in rural areas; (ii) promotion of agrarian reforms and rural growth; (iii) improvement of human capital, particularly through investments in qualitative education for a better-equipped labor force; (iv) support of peace-related initiatives in Mindanao; and (v) enhancement of institutional and planning capacities to harness partnership between the LGUs, National Government Agencies (NGA), private sector, and NGOs.

1. Investing in Rural Infrastructure

150. Infrastructure, a precondition for growth, is especially lacking in Mindanao. Since private sector involvement in infrastructure provision is low, enhanced Government support is inevitably needed. With the peace process underway and the BIMP-EAGA efforts gaining momentum, new investments are expected to flow to Mindanao. By early 1997, ₱2.87 billion had been invested in Mindanao, most of which are tourism investments. Apart from this, progress has been made in the reduction of telecommunications toll rates, and there has been increased trade in the less developed Regions 9 and 12. If the BIMP-EAGA Growth Fund materializes, the island may have access to about \$300 million for infrastructure development.

2. Promoting Mindanao's Agriculture

151. Of the three major island groups, Mindanao has a comparative advantage in agriculture. Its topography and typhoon-free climate can support the cultivation of a variety of grains, and commercial and perennial crops. It can draw on numerous entrepreneurial small- and medium-scale agriculture producers and agrobased cooperatives that have established good production and marketing ties with agribusiness; for example, 20 percent of Japan's asparagus imports are supplied by Mindanao. It has been progressive in fixing land and labor relations with local and foreign agribusiness groups in the context of the CARP. Investments in agriculture will surely have a direct positive impact on reducing poverty in Mindanao.

3. Upgrading the Human Capital: Focus on Education

152. Mindanao is especially disadvantaged in terms of the provision, access, and availability of relevant educational facilities and services. In 1997, only 16.4 percent of the total public education expenditures were allocated to Mindanao. This is a low share considering that of the country's total student population, 26 percent of the elementary, 13 percent of the secondary, and 14 percent of the tertiary level students, are from Mindanao. As a result, education achievements are also lower in Mindanao. The cohort survival rate is only 40 percent, and the functional literacy rate is below 50 percent. In all regions, except the NCR and Regions 1, 3, and 4, the cohort survival rate for elementary education had fallen below the national average in the mid-1990s. The dropout rate in Government elementary schools was 7.1 percent in 1992/93 for the Philippines, but at 8.9 and 21.6 percent, respectively, for Mindanao and ARMM. As a result, students from the rural and southern part of the Philippines are generally less

educated than those from the NCR. For example, in 1996 only 20 percent of the ARMM students applying for undergraduate science and technology scholarships passed the test. Given the regional disadvantage of the island group; the critical role of education and training for economic growth; the importance of education for sustaining peace and orienting the children and youth, and the need to respond to the cultural diversity in Mindanao, investments in education are a strategic thrust for Mindanao's development.

4. Continued Adjustment Toward Peace and Development

153. Achieving broad-based equitable growth in the SZOPAD is the key to guaranteeing a lasting peace in Mindanao and the south of the Philippines. In addition, efforts need to be made to also include the Moro Islamic Liberation Front and the group around Abu Sayyaf in the peace agreement. Immediate action showing constructive and measurable results is required to link peace with development. The projects need to be designed with a strong participatory approach to support bottom-up planning. They should be prioritized to benefit the excombatants and their households. Investments in the SZOPAD's human capital (education) and the construction of physical infrastructure, especially roads, irrigation, and potable water, are a priority.

154. The quick reallocation of Government and external assistance resources to the SZOPAD area that requires a separate financial plan and creative approval and implementation mechanisms to fast-track the regular bureaucratic process urgently need to be accomplished. Certain institutions in Mindanao are currently calling for more infrastructure investments in the SZOPAD area in the context of the BIMP-EAGA initiative. Likewise, the LGUs, NGOs, private sector, and external support can play a catalytic role in supporting the peace process.¹ As more external assistance is in the pipeline, the Government needs to take a proactive role in managing and supervising the adjustment period toward peace, and in building sustainable structures to maintain it. Failure of the Government to address the current lack of funds and mechanisms to urgently start the growth process in the SZOPAD will erode the gains attained from the formalization of the peace accord and contribute to further discontentment among members of the MNLF.

5. The Need for Capacity Building and Governance Considerations²

155. The planning and absorptive capacity of local governments, particularly in Mindanao's SZOPAD area, needs special attention. For example, from 1992 to 1995, Mindanao received one fifth of the total DPWH infrastructure budget, but only 12.3 percent had been actually disbursed and less than 35 percent had been actually utilized (compared to 58.6 percent in Luzon and 57.7 percent in the Visayas). Poor fund utilization is systemic for the Philippines, but especially worrisome in the case of Mindanao, where peace can only be sustained by showing short-term development results for the majority of the population, and especially the MNLF excombatants, with long-term sustainable equity impact.

¹ For example, the relief project of the United Nations Development Programme had generated much goodwill among the excombatants and the MNLF leaders. The second phase of the relief measures is currently underway.

² Appendix 4 provides a broader discussion on governance and capacity building issues in the Philippines.

VI. THE BANK'S OPERATIONAL STRATEGY AND IMPLEMENTATION ISSUES

A The Proposed Operational Strategy

156. The emerging socioeconomic scenario in the Philippines suggests that the Bank's operational strategy for the country should give increased emphasis to poverty reduction and social development. In particular, the strategy should concentrate on (i) promoting equitable growth; (ii) better provision of basic social services like health and education; and (iii) management and protection of the environment. The promotion of equitable growth will require increased attention to rural development, more balanced regional development with special emphasis on the southern Philippines, and policies and programs to improve the country's infrastructure with an emphasis on greater private sector participation. Efforts to improve the provision of health and education should focus mainly on improving people's access to primary health care and basic education. Environmental protection should focus mainly on the management of natural resources and the urban environment. Since many of these areas are now devolved to the LGUs, it would necessitate greater interaction between the Bank and the local governments. An operational strategy founded on these lines is consistent with the Government's development strategy enunciated in recent official documents. The sectoral implications of the proposed strategy for the Bank's operations in the country are depicted in Table 12.

1. Infrastructure Development

157. In infrastructure development, given the increased role of the private sector in the future, the primary emphasis of the Bank's program should be to assist the Government in its infrastructure privatization program, including the task of creating an enabling environment for greater private sector participation. In addition, the Bank will be required to assist the Government in enhancing the efficiency of the public provision of infrastructure. There will still be a significant role for the Bank in traditional project financing of public sector infrastructure investment, but this role is likely to be limited to the transport sector, power transmission and distribution, and water supply and sanitation. Wherever possible, the Bank should also encourage complementary private sector investments in these sectors. Moreover, given that rural development is one of the cornerstones of the proposed strategy, a significant share of the Bank's assistance to public sector infrastructure financing should be aimed at the rural areas. For example, in road construction there is a need to direct Bank assistance toward the development of rural roads. Similarly, in the case of water supply and sanitation, there is a need for striking a better rural-urban balance.

158. The Bank's role in assisting the Government in creating an environment conducive to greater private sector participation in infrastructure development falls under three broad categories: (i) capital market development; (ii) assistance to the Government's privatization program; and (iii) policy advice and institutional capacity building. Through a program loan, the Bank recently provided assistance for the development of the equity segment of the capital market. This initiative needs to be followed up with assistance to develop the bond segment of the capital market. The Bank can also continue to play an important role in assisting the Government in its efforts to privatize many of the public enterprises currently engaged in the provision of infrastructure. Policy support and capacity- building assistance will be important to enable the Government to develop institutions and the overall regulatory framework for private sector participation in infrastructure.

Table 12: The Proposed Country Operational Strategy

Sector	Investment Support	Policy Advice/Capacity Building
Transport	Development of the transport sector with special emphasis on the expansion and improvement of roads, both national and rural, and regional ports and airports	Enabling privatization of public enterprises, developing the regulatory framework for private sector participation, and building local government capacity
Energy	Selected power transmission, consolidation of distribution operations, and rural electrification	Support for restructuring the power sector, privatization of NPC, developing the regulatory framework for private sector participation.
Urban Development, Water Supply, and Sanitation	Assistance to urban services, and water supply and sanitation, both rural and urban	Consolidation of water districts, encouraging private sector participation in urban services, water supply and sanitation, policy reforms in these sectors, commercialization of LWUA and water districts, and capacity building for the LGUs.
Agriculture and Rural Development	Development of irrigation, with an emphasis on improvement of existing systems; provision of rural infrastructure and agricultural research and extension services; forestry and fisheries resource management; crop diversification; provision of microcredit; and promotion of agribusiness.	Capacity building of the LGUs to undertake rural development activities including agricultural extension, farm-to-market roads etc., and better coordination between the LGUs and NGOs.
Health	Improvement of primary health care, including integrated community health services, maternal health care, childhood development, and population planning.	Capacity building of the LGUs and DOH to plan and implement health sector projects, better coordination between LGUs and NGOs.
Education	Basic education, including technical and vocational, and selected support for technical and scientific higher education	Decentralization of basic education, and capacity building of institutions, including the LGUs, and policy reform.
Finance	Capital market development and development of special facilities for infrastructure finance.	Further development of the capital market, including the bond segment and mutual funds, and the secondary market, policy reforms for capital market development, and building up the capacity of the LGUs to access commercial and public funds, including official development assistance.
Environment	Investment support for sustainable natural resource management and environmental protection	Promotion of local or community resource management; enhancement of NGO/LGU participation in development project planning, decision making, implementation, and monitoring.

2. Agriculture and Irrigation

159. In agriculture, the primary roles of the Bank will be to expand and upgrade the irrigation facilities, support crop diversification, promote agribusiness, and improve rural infrastructure and natural resource management. To maximize the development impact of the Bank's operations, Bank support for irrigation should continue to have a twin focus: (i) rehabilitation of the existing irrigation system; and (ii) expansion of the communal irrigation system. Because the private returns on investing in rural infrastructure, such as rural roads,

farm-to-market roads, agricultural storage and marketing facilities, and rural water supply and sanitation, are likely to be lower than the social returns, private investment is unlikely to meet the required investment in rural infrastructure. There is, therefore, a strong case for increasing public investment in rural infrastructure. Bank assistance to rural infrastructure can play a catalytic role in inducing greater public investment in rural infrastructure. In the case of upland agriculture, Bank assistance should concentrate mainly on promoting farming systems that improve crop rotation; better integration of crops, livestock, and soil conservation on the one hand, and a program of natural resources management (forestry and fisheries in particular) on the other. These efforts in agricultural development need to be supplemented by assistance to expeditiously complete the agrarian reform program and strengthen the institutional capacity of the LGUs to deliver agricultural extension services. With regard to credit assistance for microenterprise development, the strategy will have to examine the issue of the recent proliferation of credit programs. This will help in the rationalization of the credit system for small- and medium-sized enterprises.

3. Health and Education

160. In the Bank's 1993 country strategy, health and education received a secondary focus. As shown in Chapter IV, many of the health and education indicators stagnated for more than a decade following the debt crisis. Although these indicators improved somewhat in the last few years, there is a clear need to improve the public provision of health and education services. To increase the equity impact of these services, there is a particular need to enhance the access to these services by the poorer sections of the population. One way to do this is to concentrate on improving service delivery in those segments of the health and education sectors that have the widest coverage of primary health care and basic education. To further increase the equity impact, Bank assistance may also consider geographical targeting of its assistance to these sectors in such a way that the poorer regions get a larger share of the assistance.

161. Given the poor health and education status of children in the Philippines, within the overall framework of assisting the Philippine Government in improving the provision of primary health care and basic education facilities, the Bank will have to play an important role in improving primary health care, including maternal and child health care. In recent years, the Bank, in collaboration with the Philippine Government and the World Bank, has done substantial preparatory work in developing an integrated approach to early childhood development. Building on this preparatory work, the Bank should provide investment support to this key segment of the health and education sectors.

162. In the area of basic education, the World Bank has traditionally concentrated on elementary education and the Bank on secondary and technical education. This specialization of the two institutions needs to be continued. In addition to secondary education, the Bank may have to extend investment support to improving the standard and coverage of technical and scientific education at the postsecondary level. This would be required to ensure that an inadequate supply of technically and scientifically trained labor does not pose a constraint on industrial growth, especially in skill-intensive sectors. These interventions would be especially valuable, given that less than 6 percent of the labor force in the country currently have appropriate technical skills.

4. Environmental Management

163. Bank investment support for environmental management will have to concentrate on the protection and management of natural resources, including forests and fisheries and improving the urban environment. In the area of urban environment, assistance should focus on

the reduction of air and water pollution. For efforts at natural resource management to be effective, there is a need to involve the local communities and NGOs in almost every stage of preparation and implementation of projects and programs.

5. Balanced Regional Development: The Need to Focus On Mindanao

164. Within the broad sectoral orientation of the Bank's strategy indicated in Table 12, Bank assistance over the medium term should aim at helping the Government to promote physical and social infrastructure development in Mindanao. This is especially important given that the unbalanced regional development in the past has contributed significantly to the peace and order problem in Mindanao. Now that the Government and the Muslim secessionists in Mindanao are making a serious effort to promote peace and development in Mindanao, it is important for the Bank to accord top priority to increasing its assistance for development projects in the Southern Philippines.

165. As Chapter V explains, within Mindanao there are significant intraregional disparities in socioeconomic progress between the Muslim populated segment and the other areas. The Muslim populated segment, represented by the SZOPAD area and consisting largely of western Mindanao, central Mindanao, and the ARMM, lags behind the more progressive regions of northern and southern Mindanao. The nature of assistance required for the SZOPAD is also somewhat different from that for the rest of Mindanao. The immediate socioeconomic problem in the SZOPAD area is that of enabling the former militants to have some type of livelihood earning activities. Over a somewhat longer time horizon, promoting development in SZOPAD would require (i) substantial public investment in irrigation and other infrastructure facilities, especially in rural areas; (ii) promotion of agribusiness as the region is primarily agro based; and (iii) public provision of primary health care and basic education facilities.

166. As for the somewhat more developed parts of northern and the southern Mindanao, the Bank's role should primarily be that of assisting the Government in infrastructure development and channeling private investment to these regions. The BIMP-EAGA initiative provides a good starting point for such private sector participation. The Bank should continue its support for strengthening this initiative.

6. The Proposed Strategy: A Comparison to Earlier Bank Strategies

167. In many respects, the operational strategy proposed here is a synthesis of the two recent Bank strategies for the Philippines, one approved in 1988 and the other in 1993. The 1988 strategy focused on two broad goals: (i) poverty alleviation and employment generation, especially in rural areas; and (ii) improving balanced regional development in view of the wide disparities of income and quality of life prevailing among the different regions of the country. It was essentially an equity-oriented strategy. In line with its key goals, the 1988 strategy put less emphasis on infrastructure development. However, in view of the subsequent failure of the economy to show significant growth, and the severe infrastructural constraints that the country faced in the early 1990s, the Bank put generation of growth and infrastructure development at the center of its 1993 strategy. Although many of the socioeconomic inequities mentioned in the 1988 strategy were still prevalent at the time of formulating the 1993 strategy, severe infrastructure constraints and the continued economic stagnation prompted the Bank to give less importance to equity considerations. Therefore, in comparison with the 1988 strategy, the 1993 strategy was essentially a growth-oriented strategy.

168. The strategy proposed here builds on the key elements of both the 1988 and the 1993 strategies, in that it focuses on growth with equity and social development. The proposed strategy puts more emphasis on infrastructure development than the 1988 strategy, but in view

of the changed role of the public sector in infrastructure provision, the nature of Bank assistance for infrastructure is envisaged to be different from that of the 1993 strategy. At the same time, like the 1988 strategy, the proposed strategy gives more importance to rural development and balanced regional development than the 1993 strategy. In a way, the proposed strategy implies that the Bank's operations will have to give increased importance to what are traditionally considered as the soft sectors – rural infrastructure, urban services, health and education, and environment and natural resource management. At the regional level, it implies an orientation of the Bank's operations toward the southern Philippines, especially, Mindanao.

169. During the four years 1993-1997, covered by the Bank's 1993 country strategy, the Bank provided 27 loans amounting to about \$1.8 billion to the Philippines (Table 13). About 12 loans, or about 44 percent of the total number, accounting for about 73 percent of the total amount of loans, was for projects with economic growth as the primary objective. Most of the remaining loans, accounting for about 56 percent of the total number of loans and about 27 percent of the total amount, were for projects and programs with social and environmental objectives.

170. Given the equity and social development focus of the proposed strategy, and the increased importance of the Bank's nonlending operations in the traditional infrastructure sectors, the Bank should aim to change this lending composition away from traditional growth-oriented projects toward projects and programs with poverty reduction and social development objectives. Broadly, the share of the traditional growth-oriented projects will have to decline to about 50 percent of the volume of lending with the necessary adjustment in the number of these loans. Sectorally, the investment support to traditional infrastructure sector, especially to power generation, construction of airports and ports, and communication will have to decline over the next few years, and that for irrigation; roads, especially rural roads; primary health care; basic education; and urban social services, including urban water supply and sanitation, should increase.

171. It is encouraging to note that the forward lending program of the Bank for the next three years, 1998-2000, tentatively agreed to by the Government and the Bank in 1997, is already moving the composition of the Bank's lending operations in this direction. During the next three years, the share of the growth-oriented projects is expected to decline to less than 60 percent of the total Bank lending to the country, and the share of projects with social and environmental objectives is expected to increase to about 40 percent, with a sharp increase in lending to agriculture, rural development, and education. The proposed strategy would require an intensification of the change in the composition of Bank lending initiated by the recent annual country programming exercises. Given the smaller average size of Bank loans to soft sectors as compared with the traditional infrastructure loans, this would imply that the Bank will have to process and administer a larger number of smaller loans. This has implications for the staff resources of the Bank, both in terms of the composition and the number of staff.

Table 13: Loan Program by Type and Sector (1993-1997)

Item	Projects		Amount	
	No.	%	million \$	%
By Type	27	100.0	1,765.46	100.0
Economic growth projects	12	44.4	1,282.8	72.7
Projects directly aimed at social concerns (poverty reduction, Human Development and Women in Development)	13	48.1	427.3	24.2
Projects directly aimed at the environment	1	3.7	37.8	2.1
Growth-oriented projects with secondary features to address social and environmental concerns	1	3.7	17.5	1.0
By Sector	27	100.0	1,765.46	100.0
Agriculture and agro-industry	7	25.9	194.3	11.0
Energy	4	14.8	616.3	34.9
Transport and communications	4	14.8	324.5	18.4
Urban and water supply	6	22.2	280	15.9
Education	1	3.7	25	1.4
Health and population	3	11.1	125	7.1
Industry/finance	2	7.4	200.0	11.3

B. Implementation Issues

172. In general, the Bank's Philippines program faces more than normal implementation problems. An indication of this is its relatively poor implementation record. To date, 57 Bank-assisted projects in the Philippines were postevaluated by the Bank. Of these, only about 47 percent of the projects were rated as successful, and the remaining 53 percent were either only partly successful (about 30 percent) or unsuccessful (about 23 percent). At 23 percent, the percentage of unsuccessful Bank projects in the Philippines compares unfavorably with the Bankwide average of about 11 percent.

173. The overall delays as well as cost overruns in the Philippine projects are also higher than the Bankwide averages. About 91 percent of the postevaluated projects in the Philippines had implementation delays, and about 59 percent cost overruns. The average cost overrun, i.e., the excess of the actual cost of a project over its originally estimated cost, in the Philippines about 72 percent as compared with the Bankwide average of 53 percent, 52 percent in Malaysia, 33 percent in Thailand, and 18 percent in Indonesia. Similarly, on average, Bank projects in the Philippines experienced time overruns of about 94 percent, as compared with the Bankwide average of about 77 percent. The time taken for the completion of many projects was more than twice the original estimates.

174. Based on most implementation indicators, the Philippines compares unfavorably with many other borrowing member countries of the Bank. Moreover, implementation issues tend to reemerge almost regularly, as the decision-making process involving the executive, legislative, and judicial departments of the Government, private sector business groups, and civil society becomes unduly long, time consuming, and tedious. The debate surrounding the recent amendment of the Official Development Assistance Act was a good example of how suddenly unexpected implementation issues can cause delays in program implementation. The reopening of the Manila Hotel privatization decision and the recent developments with regard to the oil

industry deregulation are examples of uncertainties in the public decision-making process. Generically, many of the implementation issues that affect the Philippine program are of a governance nature, involving the efficiency, responsiveness, transparency, and predictability of the Government's decision-making process on the one hand, and the interactions between the Government, the private sector, and the civil society on the other (see Appendix 4 for a detailed discussion).

175. The weak project performance underscores the need to strengthen development administration and governance in the Philippines. Overlapping mandates and unclear and long bureaucratic procedures often tend to reduce the efficiency and effectiveness of the Philippine public sector. The public sector needs to be less procedure oriented and more results oriented, while at the same time not sacrificing transparency and accountability of public decision making.

176. It is encouraging that the Government is making serious attempts to establish a transparent and predictable system of government. This is reflected in the establishment of improved electronic data management systems and increasing the possibilities for participation in policy formulation. Transparency and predictability can be improved if the institutions created to ensure accountability of the public sector can be made more effective. With close to 17,000 persons, the Philippines has one of the largest audit forces in the world. The largest agency, the Commission on Audit employs 14,000 staff. The Commission, however, needs to give more attention to developing an effective and comprehensive approach to ensure greater accountability in public functioning.

177. Continuous dialogue with the Government both on project implementation issues as well as issues concerning governance in general will have to be the major modality through which improvements in this area can be effected. Targeted capacity building measures for key institutions would have to comprise the additional instrument.

178. Beside these generic problems of governance and development administration, the operationalization of the proposed strategy will need to address three additional implementation challenges: (i) the capacity of the LGUs, both financial and institutional, to implement development projects and programs in the devolved sectors; (ii) stakeholder participation in project design and implementation; and (iii) the multiplicity of institutions responsible for Mindanao's development.

1. The Capacity of the LGU

179. Many of the sectors to which Bank assistance will be directed under the proposed strategy, such as agricultural extension, communal irrigation, most of the rural infrastructure, health care, parts of education, and forestry, were devolved, and hence are under the jurisdiction of the local governments. This implies that operationalizing the strategy will depend crucially upon the capabilities, both institutional and financial, of the LGUs to undertake development projects and programs. The nature of the required institutional capacity building efforts at the LGU level were indicated in Chapters III and IV. A consensus appears to be emerging between the LGUs, National Government agencies, and the external funding agencies that, over the long term, a comprehensive program of capacity building of the LGUs needs to be implemented to improve project quality in the country. In the immediate future, capacity building efforts for the LGUs should concentrate on imparting on-the-job, project-specific training to the LGU staff. Such learn-as-you-go types of capacity building programs need to be incorporated as components in the Bank's development projects and programs wherever necessary.

180. The financial requirements of the local governments in the devolved sectors by far exceed their resource base in terms of both internal revenue allotments and own resources. The

key challenge is to enable the LGUs to finance this emerging resource gap. Recently, the Government formulated a policy framework for LGU financing. The framework is anchored on a two-fold categorization of the LGUs into those that are creditworthy and those that are less creditworthy. Their development projects are grouped as revenue-generating projects or as nonrevenue-generating socioenvironmental projects. The Government framework then develops a financing module in which the LGUs, depending upon their creditworthiness and the nature of projects, are expected to tap specific sources of financing. Revenue-generating projects, especially of the creditworthy LGUs, are expected to be financed mostly from private sources. The Government's financial institutions such as Development Bank of the Philippines and Landbank are expected to play an important role in preparing the more creditworthy LGUs for private financing. The Municipal Development Fund (MDF) will be the key conduit for financing the projects of less creditworthy LGUs. Over time, the Government expects the MDF to build up the creditworthiness of these LGUs, and encourage them to finance their own.

181. The Government's policy framework for LGU financing needs to be supported by funding balance. Operationalization of the framework would require, among other things, considerable efforts at restructuring and reorienting the MDF and the Government's financial institutions, and developing a private credit market both in equity and bonds. From the point of view of operationalizing the Bank's strategy, the issue of reorienting the MDF is of special importance, as MDF is expected to be the conduit for financing socially oriented projects of the LGUs. To enable the MDF to perform this role, there is a need for considerable institutional reorientation, including a major change of the organization from being a mere on-lending agency to evolving into a promotional financial institution. If the MDF is to play this promotional role effectively, some mechanism needs to be evolved to strengthen its financial position, so that it can meet the financial needs of the weaker LGUs on a continuing basis. In other words, a working mechanism for risk sharing to finance the socially oriented projects of the weaker LGUs needs to be developed.

182. The success with which the more creditworthy LGUs can tap private sources depends upon the evolution of a private credit market for the LGUs. In many respects, this is part of the somewhat larger problem of developing the country's capital market, discussed in Chapter II. The Bank is currently exploring the possibility of setting up of an LGU infrastructure facility that will provide funds to the LGUs for infrastructure projects, as well as provide guarantee for the LGUs borrowing from private sources. These initiatives at developing a credit market for the LGUs should be pursued with vigor, but there are limits to financing the resource gap of the LGUs with borrowed money, whether from public or private sources. Efforts should, therefore, be made to correct the underlying resource mismatch of the LGUs, by continually monitoring the internal revenue-sharing arrangement and evolving an incentive mechanism for better resource mobilization by the LGUs.

2. Stakeholder Participation

183. Operationalization of the strategy with a strong thrust on rural development, health, and education will require significant stakeholder participation. Unlike in the case of a power plant, an airport, or a national highway, the success of most rural development programs and projects targeted at the farmers and natural resource management would depend on the ability to effectively involve benefiting communities in the entire process of program design and implementation. Similarly, effective implementation of programs aimed at enhancing the poor's access to health care and basic education would depend very much upon the participation of the beneficiaries. In the Philippines, the various peoples organizations (POs) and NGOs institutionalize the representation of the ultimate beneficiaries and stakeholders in development

programs and projects. Hence, the success of the proposed strategy requires greater involvement of these organizations in project selection, design, and implementation.

184. At present, there are about 50,000 registered NGOs and about 10,000 registered POs in the country. Their strength lies in working with the ultimate beneficiaries of development programs and projects, and in their ability to ensure that these programs conform to local conditions. They also play an important role in developing innovative approaches for program and project development at the community level and methods of improving service delivery. The devolution of many fiscal responsibilities from the National Government to the LGUs should promote a more productive partnership between the government, and the NGOs and POs.

185. Under the LGC, the LGUs are required to give representations up to 25 percent to POs and NGOs in local development councils, which play an advisory role to the LGUs on matters of planning and implementing development programs and projects. This should enable a greater participation of the stakeholders in the development process. However, there are a number of factors that limit the effectiveness of NGOs and POs in the development process at the local level. In many cases, the development councils have not yet been constituted, or are meeting very infrequently. Moreover, experience suggests that the effectiveness of the NGOs and POs in the development councils depends upon the personality of the local politicians presiding over the councils. On the part of the NGOs and the POs, there are certain weaknesses that need to be addressed. Many NGOs lack the technical skills required for development program and project implementation. Also, there is an unbalanced representation of NGOs across regions. Some of the poorest municipalities and provinces have no or only a few NGOs, while others have a disproportionately high presence of NGOs. This would pose a constraint in targeting development assistance toward poorer provinces and municipalities. These constraints need to be taken into account when operationalizing the proposed country strategy.

3. Institutional Setup For Mindanao's Development

186. The institutional framework for development administration in Mindanao is unique in the sense that in addition to the regular set of planning and government agencies (including regional offices of the National Economic and Development Authority, the regional offices of the national government departments, and the LGUs), there are a number of additional organizations that were specifically created to plan and facilitate Mindanao's development. The most important of these institutions are: (i) the Mindanao Economic Development Council; (ii) the Office of the Presidential Assistant; (iii) the SPCPD; and (iv) the regional government for ARMM, with a governor and a council of ministers. These institutions were established in recognition of the particular sociopolitical needs of the region.

187. As explained in Chapter V, many of these institutions have overlapping functions and jurisdictions, either defacto or de jure, and hence this gives rise to problems with the coordination of development policies, programs, and projects. To some extent, these coordination problems were somewhat manageable in the past because the same person held the post of Presidential assistant as well as the chair of the Mindanao Economic Development Council. Similarly, the governor of ARMM also happens to be the chair of the SPCPD. Moreover, the SPCPD with its Consultative Assembly was set up only recently and is only now beginning to be very active in development interventions in Mindanao.

188. In the future, these circumstances may not be obtainable. The various institutions with overlapping functions and jurisdictions, headed by powerful personalities with conflicting interests, could then pose problems in the planning and coordination of Mindanao's socioeconomic development. These problems could be aggravated because of the differences

in the time horizon of the various institutions: some of these institutions were created by executive orders of the President; the SPCPD initially has a three-year term, and a plebiscite within the SZOPAD will determine its life beyond three years. These institutions could then pull Mindanao's development efforts in different directions. This could be a constraint to operationalizing the Bank's strategy with a strong regional focus on Mindanao. Considerable streamlining of the institutional setup would, therefore, be required to ensure that development efforts for Mindanao are coordinated properly and implemented expeditiously. Perhaps at an early stage of the implementation of the Bank strategy it may be advisable to provide Bank assistance to streamline the institutional setup for Mindanao.

Table 14: Sectoral Distribution of the Three Major Aid Sources
(percent of loan projects)

Sectors	Japan	World Bank	Asian Development Bank
Agriculture	2.9	10.2	5.0
Communications	4.8	5.1	-
Power, energy and electrification	24.5	31.5	39.8
Environment and natural resources	1.6	6.0	6.8
Industry, trade, and tourism	6.7	9.4	4.1
Macroeconomic management	-	2.4	-
Science and technology	1.4	2.3	-
Social infrastructure	-	8.8	5.7
Social services	-	12.2	4.3
Transportation	43.2	5.7	18.0
Water resource development	14.9	6.5	10.2
Integrated area development	-	-	6.0
Total	100.0	100.0	100.0

Source: Coordinating Committee of the Philippine Assistance Program (CCPAP).

C. Aid Coordination

189. Traditionally, the Bank's assistance program for the country was implemented with close coordination with the other aid agencies, both multilateral and bilateral. In recent years, the Bank substantially increased its interaction with the other agencies through consultations aimed at maintaining funding levels commensurate with macroeconomic needs, addressing critical issues of common concern, and maximizing the development impact of aid assistance. In particular, the Bank's assistance program has been coordinated closely with those of the two biggest funders, the OECF and the World Bank. The sectoral composition of the ongoing investment programs of these three agencies is given in Table 14, and the sectoral distribution of projects assisted by bilateral agencies is given in Table 15. Several bilateral agencies not mentioned in the lending table have provided key assistance in vital sectors of the economy (such as Spanish assistance in telecommunications and LGU capacity building, Nordic assistance in environment, Belgium in education, and Netherlands and Finland in NGO capacity building).

Table 15: Sectoral Distribution of Projects Assisted by Major Bilateral Agencies
(excluding Japan)

Sectors	Germany		Australia	U.S.	France	Canada
	GTZ	KfW	AusAID	USAID		CIDA
No. Of Ongoing Projects	21	10	24	21	17	15
Agriculture	x		x	x		
Communications					∕	
Power and Energy		∕		x	x	
Environment	∕		x	x		
Industry	x		x	x		
Macroeconomic management				x		
Science and technology					x	
Social infrastructure	x	x	∕		∕	
Social services	∕	∕	∕	∕	x	∕
Transportation			x			
Water resource development			x			
Integrated area development						
Others			x	∕		∕

x at least one project; ∕ strong fields

Note: The following abbreviations have been used: GTZ: German Agency for Technical Cooperation; KfW: Kreditanstalt fuer Wiederaufbau (German Bank for Reconstruction and Development, KfW); USAID: United States Agency for International Development; CIDA: Canadian International Development Aid.

190. The past concentration of the aid agencies in infrastructure development is reflected in the high shares of investment in energy and transportation. These two sectors account for about two thirds of the portfolio of the OECF, about 60 percent of the Bank's portfolio, and about 40 percent of the World Bank's portfolio. The World Bank has, however, decided to move away from traditional project financing of infrastructure projects and accord greater importance to poverty alleviation, provision of basic services, management of natural resources, and facilitating private sector participation in infrastructure. Japanese assistance which had also focused primarily on physical infrastructure development and development of export promoting industries, has gradually been shifting towards the social sectors.

191. The development needs of the country are considerable and there is room, therefore, for increased assistance from donors simultaneously in several sectors without causing any overlaps. Donor assistance needs close coordination, however. The Bank's coordination with the World Bank has served to enhance the complementarity of the programs of the two institutions by delineating the areas of focus, while also fostering close cooperation through the joint preparation of projects and strategies within selected areas. In recent years, the Bank has entered into several cofinancing arrangements with the World Bank, OECF and the EXIM Bank of Japan, in many sectors. The government and the World Bank have started a process of regular informal meetings of aid sources in Manila. These meetings have served to resolve differences between agencies and to discuss many of the development issues of aid agency interest as preparatory to the more formal annual Consultative Group meetings for the country. Given the excellent aid cooperation of the recent years, no major problems of aid coordination are foreseen in operationalizing the proposed country strategy.

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THE SOCIAL REFORM AGENDA

A Introduction

1. The Social Reform Agenda (SRA) is the Government's program for poverty reduction, and sustainable and equitable development. This program has a sector-integrating, beneficiary-oriented, and local focus approach. The SRA aims at poverty reduction by addressing both poverty of income and poverty of opportunities. Its underlying concept is the minimum basic needs (MBN) approach that addresses the main facets of inequity and poverty from the perspective of the people. The SRA has changed the country's orientation toward equitable socioeconomic development. This has a major impact on the Bank's new country strategy and implications for the Bank's future cooperation with the Philippines.

B. The SRA, the Government's Program for Poverty Reduction

2. The SRA was launched in mid-1994 as an "... agenda to put people, especially the poor and the marginalized, back in the center of development."¹ The SRA institutionalizes major policy reforms for poverty reduction and sustainable social development at the national and local levels.² The Agenda is a joint undertaking between the Government, NGOs and People's Organizations representing various sectors and social groups.

3. The SRA initially concentrated on the three intervention areas of basic services delivery, employment generation, and institution building in 20 priority provinces. The coverage was later extended to include all regions, and all fifth and sixth class municipalities, as well as special communities and ecosystems. Since 1995 the Government has promoted the MBN approach among the local government units (LGUs)³ to fast-track the localization of the Social Reform Agenda.

4. The SRA secretariat reports directly to the President and is chaired by the Secretary of the Department of Agrarian Reforms (DAR). It is a facilitating body whose objectives are (i) to advocate for the streamlining of policies on poverty reduction and sustainable development in the line ministries, and (ii) to coordinate with the different actors at the local government and nongovernment level. Apart from DAR, the Department of Social Welfare and Development (DSWD); the Presidential Commission to Fight Poverty (PCFP); the Presidential Commissions for the Urban Poor and for Countryside Development; the National Commission on the Role of Filipino Women (NCRFW); and National Economic and Development Authority (NEDA) are the major advocacy groups within the Government for the SRA. The civil society is officially accounted for in the SRA through NGO representation. The LGUs are not directly represented.

5. The SRA does not entail any funds for project implementation. However, resources from the Poverty Alleviation Fund (under the President) are used to foster SRA development programs at the local level. There is a high commitment to closely link the programs of line departments to the SRA under a convergence approach, however, its actual

¹ President Ramos at the World Summit on Social Development in March 1995, Copenhagen, Denmark.

² Recently the SRA was harmonized with the Philippine Agenda 21 calling for major actions on sustainable environment and the "Pole-vaulting strategy into the 21st Century" in the context of Association of South East Asian Nations.

³ The LGUs comprise 41,927 barangays (villages); 1,541 municipalities; 67 cities; and 77 provinces.

resources are very limited. The SRA secretariat estimates that in 1997 only 16.4 percent of the total budgetary resources were allocated for SRA-related activities, up from 15.7 percent in 1995. The Government targets 20 percent of all Official Development Assistance funds and 30 percent of the Congressional funds to be allocated for SRA purposes.

6. To enhance transparency and achieve its objectives, the SRA together with the LGUs, the Department of Finance, and NEDA advocate for regional and beneficiary oriented breakdowns of the budget and aid programs. As a result, in 1996 a matrix of indicative SRA resources by flagship program and region/province was prepared and shared with the lending agencies. Since 1997 the national budget comprises a Poverty Alleviation Budget Allocation Scheme annex, which gives a regional breakdown of Government-allocated sector funds.

Table 1: Major Thrusts (so-called convergence areas) of the SRA

Beneficiaries (Basic Sectors)	Equity Issues	Policy Agenda (Flagship Programs)	Major objective
Farmers	Agrarian reforms, asset distribution	Agrarian reform communities	Modernizing Philippine agriculture and increasing the poor's access to rural infrastructure and equitable rural development
Fisherfolk and indigenous people	Alternative employment; environmental protection	Recognition and protection of ancestral domains; fisheries and aquatic resources development	Enhancing sustainable management of coastal resources; ensuring integrity of the indigenous people; providing sustainable livelihood, access to productive resources (including credit) and economic opportunities to promote countryside development
Urban poor	Human development	Social housing	Providing decent, affordable housing to the urban poor
Disadvantaged groups (women, victims of disasters, elderly children)	Social protection, gender, family-focused approach	Comprehensive and integrated delivery of Social Services	Providing social protection for vulnerable groups
Labor force (formal, informal, and household)	Employment-oriented growth	Workers welfare and protection; livelihood; expansion of finance	Empowering workers in the informal sector.
All basic sectors	Access to social and municipal infrastructure	Comprehensive and integrated delivery of social services	Empowering disadvantaged families and communities, and improving their access to basic services
POs, NGOs, LGUs	Institution building and effective participation in governance		Fostering an environment to enhance the capacity of the people to participate effectively in governance

C. The SRA's Convergence Program

7. The SRA follows a people-centered rather than a sector-focused approach. It aims at improving the quality of life through the empowerment of the poor and vulnerable groups. Table 1 provides an overview of the SRA approach, its special target groups (so-called basic sectors), and 9 integrated programs (so-called flagship programs). This framework is broken down into regional and sectoral objectives. These are spelled out in regional social reform agendas and action plans, that targets for poverty reduction, social reforms, and social infrastructure provision. At the national level, the SRA advocates for major legislative and institutional actions. The following sections describe SRA sectoral and macro objectives by target group.

1. Small Farmers and Landless Laborers

8. In the past, Government programs to support agriculture often concentrated on subsectors owned by the more affluent. The SRA calls for an integrated approach which targets small farmers and landless laborers by (i) fast-tracking the implementation of rural reforms; (ii) enhancing the poor's access to agricultural extension services and rural finance; (iii) improving natural resource management; (iv) providing more infrastructure investment, particularly farm-to-market roads, communal irrigation, and potable water, in rural areas; (v) creating additional nonagricultural rural jobs, particularly in small-scale industry; (vi) strengthening the quality of human capital in rural areas; and (vii) improving the management of local and community-based affairs. The Government made agrarian reform a priority under the SRA. The two major instruments are the Agrarian Reform Community (ARC) Program and rural livelihood programs.

9. The ARC program follows an integrated (and not production-focused) rural development approach. It considers the ARCs as conduits for agricultural development, through communal irrigation, agricultural extension, and rural roads; basic infrastructure provision, mainly potable water supply; and productivity enhancements, through training and rural finance. The program, although covering less than 10 percent of the poor rural households in 863 ARCs, is crucial for reducing rural poverty.

10. However, the majority of the rural poor will not be affected by land reforms because of the dualistic rural economy. Nonfarm income derived from the rural areas or through remittances is very important for the poor. But the income opportunities for the poor are very limited due to the weak rural industry, service, and financial sectors. The SRA is not yet specifically focusing on the rural labor market. Similarly, the 58 livelihood programs in the country, managed by different department and agencies, have barely improved the situation of the rural poor so far.

2. Fisherfolk and Indigenous People

11. The problems of the upland and fishery communities are directly caused by the interrelation of poverty and environmental degradation. Therefore, the SRA closely links poverty reduction with environmental protection, while promoting development for the fisherfolk and the upland communities. In 1996, the Philippine Agenda 21 adopted by the Government as "the national action agenda for sustainable development" was integrated into the SRA to promote both environmental sustainability and poverty reduction in the country. The SRA approach emphasizes community-based coastal resources and forestry and watershed management over growth in fish or tree production. Since 1995, fisheries and aquatic resources management councils in coastal villages and municipalities were institutionalized. The SRA is also a major promoter of ancestral domain policies to protect the interests of indigenous people.

3. The Urban Poor

12. More than half of the Philippine population is living in cities and more than 60 percent of the urban citizens are in and around Metro Manila. The high concentration of people in the National Capital Region (NCR) causes many problems that are typical for megacities: availability of potable water, limited garbage collection, unhygienic sewage systems, scarcity of housing, transport crisis, environmental problems, and high crime rate. But unlike rural areas, megacity poverty also has immense negative effects on the living conditions of the middle and upper classes, and puts immense strains on the entire urban environment. The SRA is currently reforming its development approach and emphasizing the problems of urban poverty and the quality of life in the megacity of Manila. So far, the SRA has promoted a shift in the Government's housing programs¹ toward urban land and property markets. Moreover the SRA plays a strong advocacy role for issues like Manila's environment, water and sanitation, livelihood and employment for the poor, slum development, and mass transport.

4. Disadvantaged Groups

13. The SRA qualifies victims of disasters, elderly, children and the youth, people with disabilities, indigenous people, and women as disadvantaged groups for which special programs and policies are to be executed. The approach aims at supporting these beneficiaries in the context of strengthening the social safety net and the family system. The social safety net comprises the social welfare system under the DSWD and the LGUs; social protection programs such as food subsidies and livelihood projects; and the social insurance system. The key SRA flagship program for social protection of disadvantaged groups is the Comprehensive and Integrated Delivery of Social Services program, administered by DSWD.²

14. The SRA does not advocate for social protection programs such as food subsidies, which are evaluated in the Philippines as being inefficient, fragmented, and not poverty targeted. However, the SRA under its flagship program for workers' welfare and protection addresses the great need to establish social security for the informal sector.

15. Women are a major target group of the SRA and of the National Commission on the Role of Filipino Women (NCRFW).³ The SRA, DSWD, and other institutions and social groups promote gender equity and social security in the context of the special role that the extended family system has in the Philippines. However, the SRA has not yet come up with proposals to make the family system an instrument of sustainable social and economic development in the context of the ongoing sociocultural changes.

¹ The PCFP suggests that between 1987 and 1992 only 13.5 percent of the estimated total housing needs could be met. In 1994 the 147,268 households provided with habitat assistance accounted for only 24 percent of the total housing needs. In the past, housing programs did not benefit the urban poor, were focused on disaster programs, and actually financed private developers and landowners.

² Before 1992, DSWD assisted about 5.8 million people with transfer payments. These were, however, very low at only \$2 per year and beneficiary. With devolution, DSWD lost its role as provider of social welfare programs and is currently graduating to a national policy and regulatory institution for safety nets

³ Appendix 2 provides with the strategic focus of the Bank's policy to promote gender and family issues in the Philippines. More recommendations can be found in the Bank's upcoming Women in Development Briefing Paper.

D. The MBN: An Integrated Developmental Approach Based on People's Perspective

16. The major component of the SRA is the MBN approach. The MBN reflects the comprehensive living conditions of the poor rather than sectoral and macropolicies. It aims at identifying effective interventions for poverty reduction at the local level. Its indicators reflect the most important needs perceived by the poor in terms of health, water and sanitation, clothing and housing, peace and safety, income and employment, education, family care and social protection, and community development and governance. The poor subjectively describe their situation in an environment that represents the complex background of individual and social welfare (Table 2). People's capabilities to meet their basic needs include survival, security, empowerment, and the participative aspects of equitable development.

Table 2: Determining the Minimum Basic Needs in the Philippines

Needs	Issue/Sector	Indicators
Survival	Health	Infant mortality rate; child mortality rate
	Nutrition	Prevalence of moderate and severe underweight; prevalence of acute and chronic malnutrition; prevalence of micronutrient deficiency (anemia, endemic goiter, xerophthalmia)
	Water and sanitation	Proportion of households with sanitary toilet facilities, proportion of households with access to safe water supply
Security	Income	Income above the total poverty threshold, amount of households' savings, un- and underemployment
	Shelter	Housing by type of material; proportion of households in makeshift housing
	Peace and order	Crime incidence, incidence of armed encounters
Enabling	Basic education and literacy	Elementary enrollment, completion rate, basic and functional literacy
	Participation	Membership in area-based community organization, participation in formal electoral exercises

Source: Presidential Commission to Fight Poverty (1995): A Strategy to Fight Poverty. page 14.

17. The MBN index is based on eight variables: (i) number of families below the official poverty line in the province, (ii) poverty incidence, (iii) infant mortality rate, (iv) malnutrition rate, (v) adult literacy rate, (vi) proportion of households without access to sanitary toilets, (vii) proportion of households with access to potable water, and (viii) cohort survival rate. It broadens the four criteria, i.e., life expectancy, adult literacy, mean years of schooling, and real Gross Domestic Product per capita, used in Human Development Index (HDI) of the UNDP. By comparing HDI and MBN indexes¹ one can measure the effect of additional social investments, for example in water and sanitation or in child development.

18. Table 3 provides a regional comparison of income; poverty; and gender, human development, and basic needs indexes. The Table shows the expected correlation between (i)

¹ As the MBN index includes similar, but also more, criteria than the HDI index, its value is generally higher.

human and social development; and (ii) between income (per capita, employment, poverty incidence) and the poor's access to social and communal infrastructure (MBN and HDI). This is best seen in the respective figures for the region. The data also suggest regional differences in social, human, and economic development. For example, in Bicol, the social and human development indexes are relatively high, notwithstanding the very high incidence of poverty and the very low per capita income. This would suggest the need to prioritize Bicol investments in income-generating activities over social and human infrastructure. On the contrary, in Central Mindanao, both the MBN and the HDI indexes are relatively low in comparison with current income levels. Moreover, the MBN index is relatively lower than the HDI index, suggesting that especially water and child development-related issues, which are not covered under the HDI, may play a crucial role for the development of this region. An analysis at the provincial or even municipality levels would provide more specific directions for investments.¹

19. The Presidential Commission to Fight Poverty (PCFP) under the SRA is currently supporting local governments (mainly 5th and 6th class municipalities) in undertaking barangay-based MBN surveys. These surveys are designed to support the local communities in bottom-up planning and to provide the National Government and line agencies with better insights on how to achieve the SRA goals. In addition, opportunities were created for local governments undertaking MBN surveys to obtain support directly from the President's Poverty Allocation Fund. By mid-1997, about 36 percent of the targeted barangays were surveyed. The results show that the poor in all regions and island groups rank income and employment as their major unmet basic needs. They further indicate the need for community organization and early childhood development (preschool, and health and nutrition facilities for children) and then access to quality municipal infrastructure (housing, potable water, and sanitation issues). Health, family planning, and education are seen as less important when not directly targeted to childhood development. The preliminary survey results call for more integrated and beneficiary targeted social development projects. Since the poor in some regions perceive income and community needs as a priority over social infrastructure investments, the Government and the aid community should take this into consideration when planning their sectoral assistance and growth-related strategies.

E. Improving the Quality of Life for the Poor in the Philippines

20. To achieve the SRA goals and reduce poverty the Philippine Government and various funding bodies support a three-tier strategy focusing on (i) bottom-up planning through the MBN approach at the family level; (ii) beneficiary targeting through social reforms in the basic sectors; and (iii) integrated area development through converging socioeconomic programs on a regional basis. The overall goal is to improve the quality of life for the poor by creating labor-intensive rural development growth, providing basic social services, targeting infrastructure to the poor, and assisting those who fall behind and/or suffer temporary setbacks through transfers and safety nets.

21. With the implementation of the Local Government Code in 1992 and the increased responsibilities of the private sector for providing infrastructure, the LGUs are becoming increasingly important for planning and managing rural, social, and municipal

¹ For the national level, the Bank, in conjunction with the Country Operational Strategy, is preparing a compendium of social statistics for the Philippines to be published together with the Statistical Information Board at the end of 1997.

development matters.¹ Hence they are the major thrust of the SRA. At the local level, the approach of SRA stakeholders is succeeding in promoting convergence and effective participatory bottom-up planning where people's needs at the center of interventions. But the SRA has not yet found an adequate mechanism to strengthen LGU capacities, finance and institutions according to their new responsibilities, and to the fast changing national economic policies and decision making procedures. NGOs and LGUs supporting the SRA are, therefore, concerned that devolving (assigning) responsibilities without actually decentralizing (transferring) resources, accountability means and institutional structures may not result in an effective poverty reduction and development for all on a sustainable basis.

22. Initially, the SRA was the anti-poverty program of the Ramos administration to be completed by 1998. Although major policies have yet to be implemented and the majority of SRA-related laws are still pending in Congress or the Senate, the Agenda has changed the mindset of policymakers and is well institutionalized in the administrative structure even beyond 1998. However, with the coming elections, the NGO community and DAR, which have previously been the strongest promoters of the SRA, are meanwhile skeptical about the Government's commitment to the program in the election year as well as about the agenda of the Government to come.

F. Implications for the Bank

23. Another goal of the Government is to mainstream the SRA approach among funding agencies. The Bank's new Country Operational Strategy responds to this by synchronizing economic and social development with area- and beneficiary-focused interventions, and by linking economic projects with social and environmental objectives. Following the SRA approach, the Bank needs to (i) reshape its sector focus and provide more assistance to area-based integrated social and environmental programs; (ii) insist on a multisectoral approach toward poverty and sustainable development; (iii) pave the way for more interactive governance at the national and local levels; and (iv) strengthen its catalytic role, together with funding agencies in facilitating major social policy reforms, supporting the development of institutional capacities, promoting stakeholder diversification, and enhancing private sector and NGOs participation. As a precondition, the Bank will thus require new mechanisms for a participatory bottom up planning, tailored to the needs of the people in a regional context, rather than on national sector interventions.

24. Under the SRA, the LGUs are graduating from implementing to executing agencies. Therefore, the Bank will have to broaden its opportunities to work directly with the LGUs at different levels by using multisectoral menu-type lending and capacity-building approaches. It will aim at geographically focused operations and enhance direct partnerships with the LGUs, NGOs, the private sector, and civil institutions.

¹ Most of the functions and more than half of the personnel of National Government agencies were devolved to the LGUs. The LGUs are now responsible for communal and small water irrigation, rural roads, agricultural extension, forest management, fishery, repair and maintenance of infrastructure facilities, promotion of trade and industry, water supply, housing, environmental management services, as well as health and social protection programs. However, the LGUs are so far little involved in the preparation of the Government programs, nor has adequate funding been provided. For example, to fulfill the targets of the Medium-Term Agricultural Development Plan (1993-1998), the LGUs expected to receive P112.7 billion (62 percent) of the total P181.5 billion central budget and external assistance allocations. Only P47.6 billion (42 percent of the originally proposed LGU share) were actually allocated and even less released. For a further discussion on decentralization, see the main text and Appendix 4 on governance.

ENVIRONMENT AND ITS MANAGEMENT

A Introduction

1. In recent years, the Government has become more concerned about the worsening environmental condition and its effect on sustainable development in the country. The political will and the operational arrangement to address these concerns are embodied in the Philippine Agenda 21 adopted by the Government on 26 September 1996. This Appendix will look into the environmental situation of the country and identify the major problems and constraints faced by the Government in its effort to improve it. With a brief review of the Bank's operations in this particular sector, this Appendix will further explore the potential of the Bank's interventions.

B. Environmental Status: Major Issues and Problems

2. In general, urban pollution including toxic and hazardous waste from industries, the degradation of forest and watersheds, and problems with marine and coastal resources management are the major environmental concerns for the country.

1. Urban Air Quality

3. Urban environmental problems are directly related with pressure from high population and the intensified economic activities. Air pollution is considered to be one of the most serious environmental concerns of the country, particularly in Metro Manila. Studies elsewhere estimate that 80 percent of the metropolitan population are exposed to excessive air pollution. Other studies suggest that 20 percent of the jeepney drivers have pollution-caused heart diseases aggravated by low oxygen levels in the blood stream. The incidence of bronchitis among schoolchildren in the Metro Manila area is 11 times higher than the national average. Another survey found that 85 percent of all respiratory diseases in Metro Manila are caused by air pollution.

Table 1: Major Air Pollutants in Metro Manila Area By Sources (percent)

Pollutant	Transport	Industry	Energy Generation
Sulfur Oxide	15.9	7.8	76.9
Particulate Matter	63.1	7.9	29.4
Lead	100	0	0
Nitrogen Oxide	86.7	2.2	11.0
Carbon Monoxide	99.4	0.5	0.2
Hydrocarbons	99.7	0.2	0.1

Source: Asian Development Bank. 1996, Potential Uses of Market-based Instruments for Environmental Management of the Philippines, Manila.

4. Vehicle emission is the major contributor to Metro Manila's air pollution (Table 1). Diesel emissions account for 70 percent of the total suspended particulate of sulfur dioxide emissions. Another pollutant of primary concern is lead (Table 2). According to a World Bank study, the pollutants of primary concern often exceeded critical levels by factors of 2 to 4.

Table 2: Ambient Air Quality in Metro Manila Area
(percent over standards, 1992)

Pollutant	Philippines Standard	WHO Standard
Particulate (PM ₁₀)	170	110-170
Sulfur Dioxide (SO ₂)	2-53	2-27
Carbon Monoxide (CO)	140	46
Nitrogen Dioxide (NO ₂)	42-250	20-120
Ozone	more than 1	more than 1
Lead (Pb)	17-260	26-780

Source: Philippines Environmental Sector Study, World Bank, 1993

5. Addressing the air pollution problem in Metro Manila is urgently needed as the damage to public health alone is estimated by the URBAIR (a recently concluded research program) to be as high as ₱4,594 million for particulates and ₱2,300 million for lead in 1992. Addressing this requires an integrated approach including the introduction of new vehicle emission standards and more effective law enforcement on vehicular pollution control, adopting new fuel standards, reducing the use of inefficient second-hand motors, exploring alternatives in public transportation system, improving traffic management, and investing in pollution control equipment by industries. All of these are the actions needed to streamline and strengthen the environmental management system through legislative and administrative initiatives. An Executive Order mandating the use of unleaded gasoline as one of the means to solve air pollution has already been issued. Also, the Clean Air Act which was under deliberation by Congress is expected to be passed by the new Congress after the elections.

2. Surface Water Quality

6. Water pollution is another major environmental concern of the country. In many large urban centers, urgent actions are needed to provide the urban areas with (i) new freshwater resources and distribution systems; (ii) adequate sewage disposal systems; and (iii) effective garbage collection and waste management schemes, at least, to prevent dumping.

7. The Philippines has approximately 400 rivers of which about 10 percent have been polluted to a degree of critical concern. The river basins of the country are still the major water supply sources for industries and large population centers. The freshwater resources are classified in terms of their designated beneficial uses (Table 3). A study in 1993 revealed that 65 percent of the water quality monitoring stations have documented poor quality: 47 percent of the river stations and 60 percent of the coastal stations showed lower water quality compared to the worst possible designated official classification. The same study stated that only 36 percent of country's water resources meets official standards, whereas 16 percent has quality worse than for its officially designated use, and is good only for industrial purposes, and 49 percent is of such poor quality that it has no potential use.

Table 3: Classification of Fresh Surface Waters

Classification	Beneficial use
Class AA	Public Water Supply Class I: only requiring approved disinfection to meet the national standards for drinking water
Class A	Public Water Supply Class II: requiring complete treatment to meet the national standards for drinking water
Class B	Recreational Water Class I: for primary contact recreation such as bathing and swimming
Class C	(i) Fishery Water: for the propagation and growth of fish and other aquatic resources; (ii) Recreational Water Class II: for noncontact recreation like boating; (iii) Industrial Water Supply Class I: for manufacturing process after treatment
Class D	(i) Agriculture, Irrigation and Livestock Watering; (ii) Industrial Water Supply Class II, e.g., cooling

Source: Government of Philippines. 1996. *Philippine Environmental Quality Report 1990-1995*, EMB/DENR

8. Water pollution in urban areas is mainly caused by domestic waste due to lack of sanitary and sewage facilities and inadequate garbage management system (Table 4). A recent Bank study on the Pasig River, the major water system in Metro Manila, showed that despite the high industrial density in Metro Manila, the industrial and commercial sector accounts only for 45 percent of the water pollution. In 1993 only 15 percent of household garbage and half of total solid waste generated in Metro Manila were collected. Most of the households' wastes are still disposed of without any treatment into the water system of the Pasig River. This causes immense social costs and health problems, especially for the children.

Table 4. Distribution Of Water Pollution Discharges in the Philippines,
(by pollutants, percent, 1988)

Source	Biochemical Oxygen Demand 5-days (BOD₅)	Suspended Solids	Nitrogen	Phosphorus
Households	59	10	12	44
Urban Runoff	0.0	47	4	16
Agriculture	32	27	83	40
Industry	9	15	1	0.0
Electric Power	0.0	1	0.0	0.0

Source: USAID. 1994. Environment and Natural Resources Accounting Project (ENRAP II).

9. According to the official designated use, the water quality of river should fall in Class C, implying that it should be appropriate for "propagation and growth of fish, noncontact recreation; and industrial water supply following treatment." The principal water quality standards

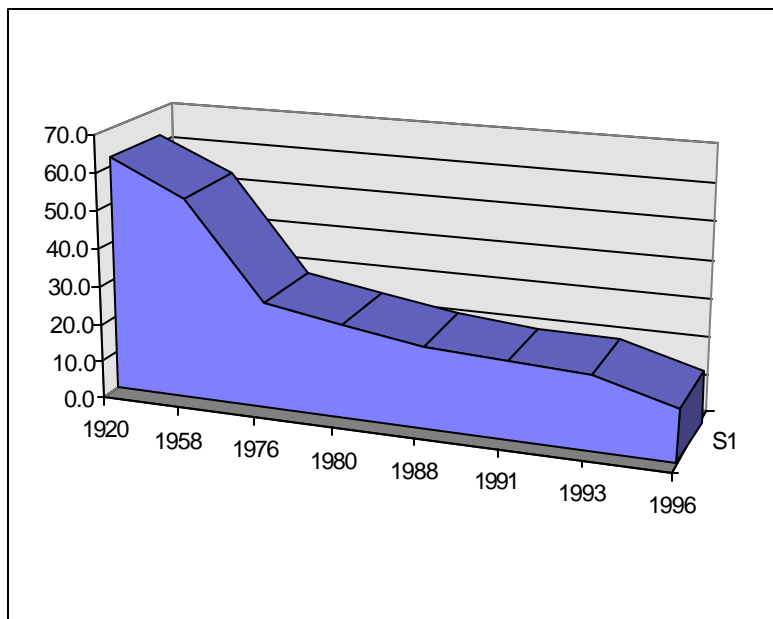
of such water are Dissolved Oxygen 5 mg/L (minimum); Biochemical Oxygen Demand 5-days average BOD₅, 10 mg/L (maximum); and total Coliform 5,000 MPN/100ml (maximum). A recent Bank study revealed, however, that the actual BOD₅ is 80-120 mg/liter with Dissolved Oxygen dropping to zero. Coliform bacteria counts exceed the Government limit by several times. With such water quality, the river is biologically dead.

10. Cleaning the Pasig River and greening its banks would immensely improve the living quality of the people in Metro Manila. However, this requires an integrated approach to urban planning and management taking into account land use planning, social considerations, financing mechanisms, as well as environmental aspects. In this context, the recent introduction of market-based instruments such as the Environment User Fee in the Laguna Lake by the Laguna Lake Development Authority to control wastewater discharge is a welcome step.

3. Forest Resources

11. Between 1920 and 1993, the country lost two thirds of its forest cover, from 18.7 million hectares (62.3 percent of its total land) to 5.8 million hectares (Figure 1). To date, deforestation of the country still continues at a rate of about 100,000 hectares per year despite all the efforts made in reforestation. If this momentum remains unchanged, the country would likely lose its entire forest cover within the coming decade.

Figure 1: Forest Cover in the Philippines
(percent of land area)



Source: Asian Development Bank, Department of Energy and Natural Resources

12. It is projected that the country will face a significant deficit of industrial wood, ranging from 1.5 million cubic meters (m³) in the mid-1990s to about 5.6 million m³ by the year 2015 unless increased efforts are made to reforest, rehabilitate, and improve forest management and protection strategies. The function of the forest is not limited to providing material for industry. It protects the watershed, stabilizes soil against erosion, provides habitat for various animal and plant species, and provides recreation function for human beings. Forests also have a function of atmospheric integrity by absorbing carbon dioxide, producing oxygen, cleaning air, and regulating the climate.

13. Given the special importance of watersheds in conservation of water resources and in the national environment, the Government has established watershed forest reserves. In 1995, 117 forest lands were classified as watershed forest reserves with a total area of 1.369 million hectares which contain the country's freshwater supply. In general, however, the country's watersheds are subject to exploitation and destructive land use practices, particularly in the form of shifting cultivation or kaingin farming and uncontrolled logging. The depletion of the forests has resulted in two thirds of the nation's watersheds being damaged.

14. Rapid depletion of forest has put a significant part of the potentially renewable forest resources at the risk of permanent loss. The principal causes of deforestation are illegal logging, and slash-and-burn farming, which normally follows illegal logging. There are 34 timber license agreement (TLA) holders who control about 1.5 million hectares (27 percent) of the forest land. According to estimates of the Department of Energy and Natural Resources, only 10 of the 34 license agreement holders in 1995 strictly follow forestry regulations. Poverty and lack of livelihood for the upland communities and indigenous people further aggravate the cutting of forests.

15. The continued deterioration of the country's forest cover can also serve as an indication of the performance of reforestation and rehabilitation efforts. Obviously urgent actions are needed to curb the rate of deforestation and to rehabilitate forest resources. Against this background, a number of initiatives have been taken by the Government with support from the Bank and other funding bodies for policy reforms in the forestry sector. While their effectiveness still remains to be seen, it is often argued that policy reforms themselves will not automatically lead to significant reforestation activities without significant increases in enforcement and administrative activities.

4. Coastal Resources

16. As an archipelago of some 7,100 islands, the Philippines has an extensive coastline of more than 22,500 kilometers in length. According to Bank estimates, marine and coastal resources have provided the country with 4 percent of its GNP; 5 percent of its employment; and \$578 million foreign exchange export earnings (1994) through fishing activities alone. Fish supply is so important in diet of Filipinos that it is considered an issue of food security in the country. It accounts for 70 percent of the total animal protein intake of the people and 30 percent of total protein intake.

17. Although the present condition of the marine system as a whole is a subject of general concern, the most urgent challenge is in the management of the coastal resources—the most productive and accessible portion of the country's marine system. The main problem faced by the coastal ecosystem is the ever-increasing pressure from human economic activities, which are exhausting its carrying capacity. According to the country's classification, waters within 15 kilometers from the shore are considered municipal waters. These waters are rich

fishing grounds, including most of the productive shelf areas, with abundant coral reefs, mangroves, and fish stocks. As a result of the depletion of fish resources caused by overfishing, intrusion by large vessels, destructive fishing, and degradation of fish habitat, municipal fishery production has declined rapidly with an annual reduction rate of 12 percent despite the increasing number of fishing boats and improved fishing gear technology.

18. From the ecological point of view, the coral reefs and mangrove forests are the two most important features of the marine and coastal ecosystem. Unfortunately, both resources are overexploited and in a state of deterioration. Mangroves, which serve both as nursery grounds for a variety of fish, prawns, crabs, and bivalves, and as buffer zones against typhoons and wave action, are also sources of firewood, charcoal, tanning, and dyebanks of the coastal people. The country's mangrove forests were reduced from 500,000 hectares in 1918 to less than 150,000 in 1988. One important factor behind this rapid destruction of mangrove forests was the conversion of these forests into fish and prawn farms. It is estimated that mangrove conversion occurred at a rate of 5,000 hectares per year during the 1970s and about 3500 hectares per year through 1987. This land conversion significantly aggravated the problems caused by the increasing need for fuelwood.

19. The Philippine coral reefs belong to what is known globally as the Coral Triangle. They constitute one of the country's more resplendent coastal resources, with around 400 of the world's 500 known coral species found in coastal waters of the country. These coral reefs serve as a home to about 2,000 species of fish. Unfortunately, as early as 1981, one third of the country's coral reefs were already in poor condition, while only 5.5 percent still had intact coral cover. The destruction of coral reefs is caused largely by destructive fishing methods such as cyanide, dynamite, and trawling; the collection of coral for ornamental or construction purposes; silting; natural calamities (mainly typhoons); and pollution. In conjunction with the loss of mangrove forests, the damage of the coral reefs places severe stress on fish habitats, further constraining the regeneration of fish populations and biodiversity, and thereby threatening the sustainability of the ecosystem.

C. Environmental Management: Issues and Challenges

20. In a broad sense, environmental management activities in the country can be roughly grouped into two general categories, namely, (i) pollution control, and (ii) conservation and rehabilitation of the natural resources such as forests, and coastal and marine resources. Generally speaking, the Philippines has a very comprehensive legal framework for environmental management. The main pillars of this system include an environmental impact assessment system leading to permits and accreditation; and the environmental standards and their monitoring. Some of its environmental standards (e.g. SO₂ emission from stationary sources) are even more restrictive than those of the developed countries (e.g., the United States). With the current Social Reform Agenda, the issue of sustainable development has gained momentum. In September 1996, the Government officially adopted the Philippine Agenda 21: A National Agenda for Sustainable Development.

21. With DENR as the lead agency, the country has a complicated institutional structure with many departments, agencies, public corporations, and specialized agencies responsible for environmental management in one way or another. It is quite common that other agencies treat environmental issues as a problem that concerns only DENR. Moreover, DENR itself is under severe financial and human resource constraints. Only a very small number of its 20,000 staff have technical expertise in environmental management. Furthermore, DENR is also

the agency responsible for logging and timber development, which makes it sometimes difficult to keep up with its expected targets of reforestation and environment protection.

22. Since 1991, the Local Government Units (LGUs) have been assigned direct responsibility for protecting the environment. Although LGUs may follow a more participatory decision making and bottom-up planning process, recent experiences with the devolution of environmental functions show problems of coordination, unsustainable and technically inappropriate activities, and financial limitations to actual performance of sustainable environmental management at the local level.

23. The effectiveness of the country's environmental management is also hampered by the lack of prioritization in some aspects of its policy framework. It is often observed that existing regulations are passed due to bureaucratic and political factors, and need a rational planning process that explicitly identifies the priorities for concrete actions. An example is the prolonged debate in Congress over the country's badly needed Fishery Code. Further, regulations and policies in place are not always based on cost-effective analysis and sometimes prove difficult to implement and enforce.

24. To achieve the Government's strategic goals of sustainable development and more effective environmental management, great efforts need to be made in both pollution control and resource rehabilitation. This will involve substantial financial investment by the public and the private sector for environmental protection and rehabilitation. A recent Bank- financed study estimates that the annual cost of environmental remediation for the Philippines will be \$600 million (1990 based). More important, however, will be the efforts to rationalize the environmental policy framework, to streamline the institutional structure for environmental management, and to improve the capacity of the institutions responsible for the environment.

D. The Bank's Operational Strategy

25. The Bank's past support for the country's environmental management was mainly in forestry, fisheries and water supply. The project and program results in the natural resources sectors are mixed. As the Bank's new operational focus is shifting toward social and environmental concerns under a decentralized setting, the Bank must take a more systematic approach to help the Government to address environmental concerns in the course of sustainable development stipulated in the Philippine Agenda 21.

26. The Bank is seeking a more active involvement in addressing the problems of urban air and water pollution. Given the unavailability of Asian Development Fund resources for the Bank's operations in the Philippines beyond 1997 and the devolution of Government responsibilities to the LGUs, the Bank's lending operations for pollution control might have to be limited to the large population and industrial centers where higher LGU and private sector contributions can be expected and environmental change is urgently warranted as special national priority, e.g., Pasig river rehabilitation and Metro Manila air quality improvement. For smaller urban centers and newly developed industrial areas, the Bank will focus on ensuring that the ambient environment quality will not be negatively impacted with development activities. Hence, the Bank will require strict Environment Impact Assessment (EIA) compliance, use loan covenants for environmental protection and improvement, and support basic municipal services related to environmental protection and management.

27. Bank projects and programs to rehabilitate and restore natural resources will need to be based on lessons learned from previous operations. Efforts to address the continued deforestation and damage to watersheds should be given high priority. Public participation in

project design and a more focused goal orientation, including a clear assessment of the socioeconomic context of the beneficiaries, are required to maximize the effectiveness of limited lending resources. The fisheries resource management and proposed community-based reforestation projects could serve as vehicles for the Bank's intervention in this field. The key to success with this kind of project would eventually rest with whether the Bank can help poor people in the project areas find alternative livelihoods other than continuing to deplete the natural resources. Such projects would have strong social dimensions while achieving environmental goals. They need a multidisciplinary approach and deserve interdepartmental efforts within the Bank.

28. The Bank will further focus on improving the effectiveness of the overall environmental management system through technical assistance. In particular, policy studies of strategic importance, including priority setting, demarcation of responsibility between the Central Government and the LGUs, appropriate institutional arrangements at the central and local levels and their coordination will be supported. Special efforts will be given to strengthen the institutional capacity of the LGUs in the field of environmental management, particularly with regard to policy formulating, monitoring, and enforcement. The Bank will further advocate institutional reform and encourage the use of market-based instruments in environmental management. Policy studies to introduce clean production by upgrading local industrial technology shall also be given priority to help the country maintain its competitiveness in the current international trade and investment framework.

29. In line with the Bank's overall regional focus on the development of Mindanao, special attention will be given to environmental issues on the island. In the near term, as a matter of policy, the Bank – in its nationwide environment-related resources rehabilitation projects – will give consideration to special components for Mindanao. In the long run, a systematic approach to environmental protection should be established based on a master plan of sustainable development for Mindanao. Technical assistance on capacity building and policy study in implementing the agenda for sustainable development need to be given high priority. The Bank can provide technical assistance and large-scale project and sector development program loans, facilitate private sector involvement and aid cooperation, promote policy reforms at the national and local levels, and support capacity and institution building. These mechanisms allow the Bank considerable flexibility in addressing the environmental problems of the country.

wwwGOVERNANCE AND CAPACITY BUILDING ISSUES

A Background

1. Based on most project implementation indicators, the Philippines compares less favorably with many other member countries of the Bank (see Chapter VI, section B). As a result, much needs to be done to improve project implementation performance in the Philippines. In a recent study of the Bank's Philippines portfolio, undertaken by the Post-Evaluation Office, major factors identified as contributing to poor implementation performance were (i) inconsistent quality in project preparation and project design by the Bank and executing agencies; (ii) constrained capabilities of executing agencies in implementing projects; (iii) untimely release of funds for project implementation, ineffective legal system and enforcement, and unsuitable policies; and (iv) unanticipated factors such as natural calamities and peace and order incidents.

2. Weak project performance and the important changes in the institutional context in which the Bank's projects are situated underscore the importance of striving to strengthen the quality of development administration and governance in the Philippines. This Appendix deals with governance and capacity building issues in an integrated manner. It is based on the growing insight in the Bank that the two concepts are closely interrelated.

3. Relationships between the National Government and the local government, and the interfaces between the Government and the private sector and civil society have changed considerably during the last four years. The four processes that largely shaped the debate on governance and capacity building are (i) the growing call for a more results-oriented and transparent management of the public sector; (ii) the devolution of functions and powers from National Government agencies (NGAs) to local government units (LGUs); (iii) the increased privatization and growing deregulation of the economy; and (iv) the enhanced participation of civil society in policy debates and project administration. In addition, peace and development issues, and a stronger emphasis on the promotion of equity and social development are also influencing the manner in which the institutional context for development is evolving in the Philippines.

B. Governance and Capacity Building Issues in the Philippines

1. Scope for Better Output Orientation of the Public Sector

4. The performance of the public sector in the Philippines needs improvement in efficiency and effectiveness. Overlapping mandates, and complex bureaucratic procedures are some of the negative characteristics often mentioned. The Philippine public sector can be characterized as procedure oriented, rather than results oriented. This is reflected in the emphasis on projects as a preferred method of service delivery, and the often short-term and ad-hoc solutions that are proposed for structural long-term problems.

5. This limited efficiency and effectiveness of the public sector can be attributed to a combination of factors:

- (i) The budget and policy processes are, to a large extent, separate processes driven by different departments. Policy formulation is the responsibility of concerned line departments and to a certain extent NEDA, while the responsibility for budget allocation rests with the Department of Budget and Management (DBM). Budgets are allocated on an annual basis. Long-term strategic planning is often not well articulated, especially at

the LGU level. Policies often lack a clear sense of direction, and a transparent analysis of implications and required implementation structures.

- (ii) With the exception of the Department of Trade and Industry there is no Government line department that has been able to develop and introduce a comprehensive performance-based management system. It is interesting to note that Department of Trade and Industry is also the only line department in the Government in which the productivity bonus is actually determined by the outcome of the annual performance assessment of the employee. This is in contrast to all other departments where an across the board calculation is made.

6. The growing concern, of Government and aid organizations, about the increased size of the civil service resulted in 1992 in a plan to streamline the bureaucracy plan. The delays surrounding the adoption of the Reorganization Act, however, are indicative of the difficulties faced in reaching a consensus on the desired scope and direction of restructuring the public sector institutions. The general expectation is that major administrative changes are likely to be introduced only after the next Presidential elections in May 1998. The current draft of the Reorganization Act provides major powers to the Executive branch to carry out restructuring of public sector organizations.

7. The policy drive is to focus the roles of the NGAs versus the LGUs, with the NGAs increasingly concentrating on policy formulation, coordination, and monitoring of local development. This can potentially contribute to the desired output orientation of the public sector as a whole. Increased support from multilateral and bilateral development agencies for the introduction of performance management systems, both at the level of coordinating departments and line departments, is likely after basic decisions on the scope and direction of the change are finalized by Congress.

8. Only marginal changes have occurred in the size and composition of the civil service in recent years. Overall, it increased by about 50,000 to about 1.4 million between 1993 and 1995. As a result of the implementation of the 1991 Local Government Code, the largest change was in the growth of LGU staff, through the transfer of about 70,000 persons from the NGAs to the LGUs. Civil service reform efforts were hampered by the divided responsibility between the Civil Service Commission and DBM.

9. Privatization of state-owned enterprises (SOEs) and deregulation of the economy contributed to the changing interface between the public and the private sector in the Philippines. An important benefit of privatization and deregulation has been improvements in service delivery. Examples are the improved electricity supply in Metro Manila and the provision of telecommunications in the rural areas. Although service delivery as such was improved, the large-scale divestiture of the SOEs has not yet resulted in a streamlining of the departments which were in control of the majority of the privatized SOEs. Neither has the number of persons employed in Government corporations been drastically reduced.

10. A specific problem that is actively hampering a more output orientation of the public sector in the Philippines is the rather thinly spread knowledge on new economic policies and related policy instruments. Although there is a small concentration of experts in key institutions like the Bangko Sentral ng Pilipinas (BSP); Department of Finance (DOF), and NEDA; the overall number of such experts in other national and local bodies is considered to be lacking.

2. Enhancement of Transparency and Predictability

11. The Government is making attempts to establish a transparent and predictable system of government. This is reflected in the establishment of improved electronic data management systems and through increasing the possibilities for participation in policy formulation. Transparency and predictability will continue to improve as progress is made in the functioning of institutions created to ensure the accountability of the public sector, such as in the Commission on Audit and the Office of the Ombudsman.

12. The efficacy of governance is also limited by the specific characteristics of the legal system in the Philippines and the limited capacity of the judiciary to contribute in an active manner to combating graft and corruption. At the local level, however, civil society groups are becoming increasingly vocal in their pursuit of public accountability.

13. With regards to regulatory frameworks in the Philippines, there is scope for improvement in the clarity of role and objectives of regulators, especially in the relationship between the top authorities of Government departments and regulating bodies. The present regulatory framework is the outcome of a process of incremental change, rather than the outcome of an overall reflection on the ideal setup for a regulatory framework. The usual pattern is that after privatization or deregulation of an economic sector the privatized organization or concerned department takes on the role of regulator. This has resulted in a large number of a regulating bodies, each with their own separate set of procedures. This has not contributed to the furtherance of transparency.

3. Decentralization and Devolution

14. The Philippines has a long tradition of centralized government. The present Local Government Code (LGC), passed in 1991, is the most recent step in a process of decentralization that has been ongoing with varying intensity since independence. The present Local Government Code can be traced back to the end of the Marcos regime through the so-called EDSA revolution in 1986. During the martial law years, the autonomy of local government units was seriously eroded. In the Local Government Code, this was overturned, partially due to pressure of civil society, which had played an important role in mobilizing opposition against Marcos. The 1987 Constitution specifically calls for the enactment of a local government code that will provide for a more responsive and accountable local government structure.

15. The 1991 LGC is often referred to as a decentralization initiative. However it is more correct to look at it as a devolution initiative. The LGC devolves the responsibility for delivering a number of basic services, and the enforcement of certain regulatory powers to local governments. The most important basic services devolved until now are health, agriculture, rural development, and parts of urban services, environment, tourism, education, telecommunications, housing projects, investment support, and local infrastructure.

16. One of the features that makes the Philippine LGC such a unique approach to local government is that the devolution was not limited to the transfer of functions and powers, but also included equipment, staff, and assets. Especially the transfer of staff from the NGAs to the LGUs resulted in a substantial number of problems due to differences in salary and incentives levels and the lack of sufficient local finance.

17. The lack of a detailed specification of the mechanisms for delegation of functions and responsibilities to the three levels of local government: province, city, and municipality and barangay has resulted in confusion and misunderstandings between the different levels of local government. These impediments are only slowly being addressed. The NGAs and their staff at

the national and regional level apparently have difficulties in changing their basic approach to dealing with local governments. The LGUs complain about the persistent over-guidance of NGAs or about the requests for extensive reporting. The NGAs in their turn complain about the inadequate level and quality of data supplied by the LGUs. The LGUs are often also confronted with national policy directives or guidelines, but are not provided with the accompanying resources to implement them.

18. The financial position of the LGUs received most attention in the debate on the success of the Local Government Code. In the current review of the functioning of the LGC it is the main issue being brought up by the LGUs in the Oversight Committee. LGUs would like to see an increase from 40 percent to 60 percent of the internal revenue allotment and a revision of the calculation mechanism. At present, the LGU share is computed based on the revenue collection of three years back. Although the overall financial transfer to the LGUs increased from P12 billion to P71.5 billion between 1992 and 1997, the actual share of total public finance does not exceed 13 percent. Another important area of dispute is the relative shares given to the different levels of the LGUs. There is a feeling that chartered cities are receiving a disproportionate share in relation to the functions and responsibilities allocated to them. This at the expense of the provinces it seems. A specific concern of the LGUs is the absence of a mechanism by which the National Government guarantees direct lending by local governments from foreign aid agencies.

19. There has until now not been a comprehensive and systematic evaluation of the impact of the Local Government Code on service delivery in the devolved sectors. The general consensus is that service delivery is improving now that initial problems have been overcome and that ownership at the local level and the transparency of local government is increasing. Another positive impact appears to be that a new breed of local politician is emerging at the local level. These politicians, who are mostly elected officials, like the mayor or governor, put less emphasis on power politics and more emphasis on developmental issues. The devolution of functions and responsibilities also contributed to increased ownership for development schemes through a more participatory approach to policy formulation and implementation. The growing cooperation with the NGOs and POs is a part of this process.

20. The implementation of the LGC enabled more genuine demand-driven capacity building programmes aimed at establishing a core competency in planning and delivery of basic services. This includes strengthening of organizational structures and the redesign of business processes. Learning through exchange of best practices is becoming increasingly important. Training activities are becoming part of an integrated and comprehensive approach focussed on the local situation.

21. At present, the Oversight Committee charged with monitoring the implementation of the LGC is in the process of finalizing the recommendations for its possible revision. The composition of the Oversight Committee is broad based and will allow for inputs from all parts of society. However, the Oversight Committee's mandate does not extend to approval of its own suggestions. It is not expected that major changes will be made in the contents of the LGC itself. In preparing for the revision of the LGC, NGOs and the Leagues of the various locally elected officials have proposed to increase the powers of the LGUs and to improve their financial situation. Also discussed are the strengthening of LGU representation through the local governments and the desirability of creating a separate department for local government that would focus exclusively on promoting LGU development.

4. Private Sector and Civil Society Participation

22. The private sector has always been an important actor in the political and economic process in the Philippines. The deregulation and opening up of the economy, and the democratization process further strengthened the private sector's role. Today, the Philippines has a lot of characteristics of the East Asian consultative model in which the Government is not acting as a referee between various business groups but rather acts as the creator and facilitator of an enabling environment for the private sector.

23. The opening up of the economy has been accompanied by an increased emphasis by the Ramos administration on the establishment of joint public-private business councils to discuss economic policy. Although the majority of the business councils are Manila based, as is most of the industry, there are attempts by lower administrative units to set up similar councils. An example is the Naga Development Council. The active attempts to involve the private sector in the BIMP-EAGA structure in Mindanao and Palawan is another example of this trend.

24. Among the different private sector interest groups in the Philippines the Makati Business Club, an association of about 400 Manila-based big businesses, is one of the most influential. Other relevant groups are the Philippine Chamber of Commerce and Industry which has a strong representation of small- and medium-sized enterprises. The Chinese businesses, an important segment of the private sector, are represented through the Federation of Filipino Chinese Chambers of Commerce and Industries.

25. In addition to increased private sector cooperation and participation, the Philippine public sector is also opening itself to participation by civil society groups. Organizational plurality is an important characteristic of the Civil Society. The Church, trade unions, and community-based organizations have played, and still play, an important role in the political and development process in the country. From a development perspective, the NGOs and POs are important representatives of civil society. The POs are organizations at the local level, established mainly to improve service delivery for socioeconomic development. The NGOs in the Philippines have a broader scope of activities. Apart from providing capacity- building support to the POs and implementing projects, they are also involved in policy advocacy and have become, in a number of cases, part of the development administration success through their participation in local special bodies, like regional and provincial development councils or the Social Reform Agenda. The number of NGOs and POs in the Philippines is still growing. Estimates for 1995 point at a number that exceeds 60,000.

26. The policy advocacy role of the NGOs and POs is institutionalized in the LGC. Community-based organizations have reserved seats in development councils, often up to 25 percent. There are a number of factors, however, that have limited the effectiveness of participation of the NGOs in policy debates. In many cases development councils have not yet been constituted, or they are meeting very infrequently. Experience has shown that the scope and quality of representation by the NGOs in development councils and other types of consultative bodies depends strongly on the leadership of the mayor, governor, or other functionary presiding over the body.

27. The Government of the Philippines has made certain efforts to regulate the NGO movement and to ensure the genuine character of the NGOs. Regulation of the NGOs has resulted in several, largely uncoordinated, accreditation processes by various departments. The majority of accreditation criteria are formal in nature and do not relate to the nature and quality of activities of the NGOs. To provide a counterbalance to this often formalistic accreditation

process imposed by the Government, the NGO movement in the Philippines has also started a process of self-regulation through the Philippines NGO Code of Conduct.

28. There is a growing trend toward networking between NGOs, at the sectoral and regional levels. In most of the provinces throughout the country, there are now local NGO networks. The Caucus of Development NGOs is an national umbrella organization of 14 development NGO networks, representing about 3,000 individual NGOs and POs. The NGOs engage in networking to strengthen their policy position on specific issues and to learn from each other. The Caucus also facilitates cooperation with other institutional actors, like Government agencies, private sector, and aid agencies. There are, however, still large differences in the quality of the representative character of the different networks.

C. Governance and Capacity Building in the Southern Philippines

29. The Government of the Philippines has decided to strengthen its development efforts in the Southern Philippines. This is in response to the peace settlement with the Moro National Liberation Front, and in acknowledgment of the relative low development indicators of the area. From a governance and capacity building perspective there are two issues that call for specific attention. First, the National Government has set up a number of special institutions for Mindanao. The resulting institutional multiplicity has resulted in organizational arrangements that duplicate functions and responsibilities and is an area of concern. The second issue is the institutional context resulting from the peace process, linked to the capacity of the various stakeholders involved to effectively deliver services.

30. The specially created institutions for Mindanao include (i) Office of the Presidential Assistant for Mindanao, which is to function as an extension of the President's Office in Mindanao; (ii) Mindanao Economic Development Council established to function as an island-wide supra-regional coordinative planning body, however without implementation responsibilities; and (iii) the Secretariat of the Brunei-Indonesia-Malaysia-Philippines - East Asian Growth Area (BIMP-EAGA), set up to coordinate and facilitate the Philippines input into BIMP-EAGA. The establishment of these special institutions, combined with the institutional discussions of the peace process (ARMM, SZOPAD and SPCPD) have resulted in a complex and sometimes confusing institutional setting for promoting development in Mindanao. Coordination problems not only arise between the three specially created institutions for Mindanao, but also between these and the institutions set up in the context of the peace process. There are also coordination problems between the regional offices of the NGAs and the LGUs.

31. Under the Organic Act in 1990, the ARMM was created. This resulted in the establishment of an administrative entity that differs from the administrative structure in other parts of Mindanao and the Philippines. ARMM consists of four provinces, it has a Regional Legislative Assembly with actual law-making powers. The ARMM Executive Branch, headed by a governor, has jurisdiction for all development-related issues, but not for areas like defence, monetary issues, and foreign relations. For the administration of justice in ARMM, Sharia'ah courts and a Sharia'ah Appellate Court were established in addition to the regular judicial system. The National Court has increased the distribution of development resources to the ARMM/SZOPAD area. However, institutional and organizational capacity in the region will need to strengthen substantially if growth is to be accelerated.

32. The creation of the SZOPAD in 1996 and the establishment of the SPCPD completed the present set of institutions set up for the Muslim population of the Southern Philippines. The establishment of the SPCPD is the outcome of years of negotiations which

stretched over almost three decades. An important point of contention in the negotiations was the extent of autonomy to be extended. The outcome was that the SZOPAD and the SPCPD were created as temporary units. A plebiscite is planned for 1999 to determine the future of these temporary units. The mandate of the SPCPD is predominantly related to the coordination of development, although a certain amount of confusion appears to exist over the possibility for the SPCPD itself to engage in implementation activities. Overlapping mandates, then, are a major obstacle to development in the SZOPAD.

D. Scope for Bank Support

33. The analysis of the institutional setup and the main institutional actors responsible for socioeconomic development in the Philippines – the public sector, the business community, and civil society – point to a number of areas where major change processes would be beneficial. The institutional context for development is starting to change in a substantial manner as a consequence. These processes include (i) the devolution of powers and functions from the National Government to the local government; (ii) the opening up of the Philippines economy through a substantial process of privatization and private sector participation; and (iii) the increased emphasis of policymakers on an economic policy that combines growth with attention to equity and social development, and the sustainable development of the country's natural resources. It is clearly in the interest of the Bank to support the further implementation of these policies, both in the growing policy dialogue with the Government during programming and in the context of individual projects.

1. Supporting Public Sector Reform and Strengthening

34. The Bank's experiences with the administration of its Philippines program, and the planning and processing of individual projects, underscore its interest in strengthening the functioning of the public sector in the Philippines. This is entirely in line with the Bank's Medium-term Strategic Framework, which mentions the need for assisting in the streamlining of public sector management and public policy formulation. The Framework further highlights the importance of policy support and capacity building as part of the operating objectives of the Bank.

35. Bank support for strengthening the public sector could consist of assistance for the introduction of performance management systems and assistance to processes aimed at improving budget processes whereby the emphasis would be on linking budgeting processes to the policy processes and the adoption of the concept of medium-term strategic budgeting. An early adoption and implementation of the Reorganization Act will further contribute to strengthening the public sector.

2. Promoting Decentralisation

36. To ensure a wide ownership and a smooth implementation of projects best implemented with the LGUs, the Bank together with the National Government and the LGUs may facilitate innovative approaches to enable the Bank to deal more directly with the LGUs as executing agencies. Financial issues including LGU access to Bank funds need to be addressed along with implementation arrangements that promote bottom up planning and capacity building at the local level.

37. The adoption and implementation of the LGC resulted in a large range of capacity-building activities for the LGUs. Although progress has been made, there is a substantial scope

for further activities. The Bank's LGU support program will be based on the lessons learned from ongoing projects and from dialogues with LGU officials. Training will need to be accompanied by work on institutional structures and organizational processes. The potential role of the local government leagues in the delivery of capacity building assistance to the LGUs will be maximized.

3. Enhancing Policy Capacity for Sustainable Social Development

38. A successful shift of the Government's and the Bank's development strategy toward the social sectors will be influenced by a number of governance and capacity building related processes and factors. The majority of problems addressed by projects in the social sector are multi-actor problems that call for solutions that include government and nongovernment institutions at both the national and local levels. The government and the Bank need to work jointly on developing approaches for project design that acknowledge this institutional multiplicity. To arrive at a sound understanding of what hampers service delivery in the social sectors a comprehensive institutional review can be expected to identify critical governance and capacity building-related constraints. This would enable the design of capacity building activities directed at overcoming short-term implementation constraints and promoting institutional efficiency and sustainability.

4. Improving Private Sector Participation

39. It is expected that the Government will continue its efforts to create an enabling environment for private sector participation in the delivery of social and economic development. From a governance and capacity building perspective, this calls for the Bank to focus on the following

- (i) Further strengthen the legal and regulatory framework for private sector participation, to ensure social acceptability and environmental sustainability. Transparency and predictability of the public sector, especially in relationship to privatization and deregulation of the economy are also expected to benefit from improvements in the legal and regulatory framework.
- (ii) Further develop capital markets. A specific focus in the development of capital markets could consist of the opening up of capital markets to local governments.
- (iii) Further consult with joint public-private business councils, especially at the local level.

5. Consulting with NGOs and Civil Society

40. The Bank recognizes the growing involvement of the NGOs and POs in the formulation of development policies and the implementation of development programs and projects. The NGOs are increasingly involved in the implementation of Bank projects. However, there is further scope to involve NGOs more fully in the programming cycle of the Bank. Full implementation of provisions made in various pieces of legislation for the participation of the NGOs in special bodies, e.g., development councils, and other consultative bodies will improve project quality and will contribute to increased accountability and greater transparency of decision making. The Bank can complement the Government's approach to enhanced NGO and PO participation in development processes through appropriate consultations with the NGOs and POs during country programming as well as in loan and TA processing.

6. Focusing on Southern Philippines and Mindanao

41. The Bank is fully supportive of the Government's request to aid organizations to direct more resources to Mindanao. The Government's request is based on development considerations, as well as the desire to strengthen the Government's peace initiative. The Bank's program will be responsive to the Government's request to increase resource flows to the southern Philippines in a heightened effort to reduce poverty in the region. Similarly, other less-developed areas like Bicol, the Cordilleras, and the Eastern Visayas should also receive increased attention in the Bank's program.

42. The Bank's response to the Government's request for increased assistance to Mindanao should be a long-term one. The strategic focus of the Bank's program in the region should be on livelihood promotion and poverty reduction; social development, particularly in the education and health sectors; support for basic infrastructure such as farm-to-market roads, communally operated irrigation systems, and agriculture production inputs and post harvest facilities; and the sustainable development of the environment. Administrative capacity building will also need to be a fundamental and essential element of the Bank's assistance program for Mindanao.