

## ECONOMIC AND FINANCIAL ANALYSIS

### I. ECONOMIC ANALYSIS

1. The economic analysis for the proposed KALAHI–CIDSS National Community-Driven Development Project accords with paragraph 2 of the Operations Manual (Operational Procedures) on Economic Analysis of Projects.<sup>1</sup>

#### A. Macroeconomic Context

2. The Philippines has continuous gross domestic product (GDP) growth since 1999. Growth was a robust 7.8% in the first quarter of 2013. However, job generation lags, with unemployment at 7.5% and underemployment at 19.2% in April 2013. Poverty incidence has declined slowly from 40.6% in 1994 to 27.9% in the first half of 2012. This explains the government's emphasis on growth that is inclusive, reduces poverty, and enhances employment.<sup>2</sup>

#### B. Sector Context

3. Past failure to generate sufficient public revenues has caused under-investment in the social sector. Social spending in the Philippines has trailed that of its neighbours in the Association of Southeast Asian Nations (ASEAN). Public spending on education is the lowest at 2.7% of GDP in 2009, in contrast with 4.1% average in the rest of ASEAN. Public spending on health is also low, at 1.3% of GDP in 2010, as against 2.1% for the rest of ASEAN.<sup>3</sup>

4. However, support for social spending has been rising. Spending by the national government on social services was 27.9% of the budget in 2004 and has been increasing, reaching 33.8% in 2012.<sup>4</sup> In 2013, 34.8% of the budget is allocated to social services,<sup>5</sup> which equals 5.8% of the 2013 GDP forecast.<sup>6</sup> The Department of Social Welfare and Development (DSWD) budget in 2012 is more than seven times its level in 2008, with the bulk in 2012 used mostly for a conditional cash transfer (CCT) program.<sup>7</sup> The CCT program covered 336,000 households in 2008, and the number has expanded ninefold to 3.1 million in 2012. The 2013 budget for the self-employment assistance program is almost 18 times its 2012 level.

5. As the government's social spending has risen, the need to find more cost-efficient and sustainable infrastructure delivery mechanisms has become more urgent. Community-driven development (CDD) adopted under KALAHI–CIDSS and to be scaled up under the KALAHI–

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<sup>1</sup> ADB. 2003. Economic and Analysis of Projects. *Operations Manual*. OM G1/BP. Manila.

<sup>2</sup> National Economic and Development Authority. <http://devplan.neda.gov.ph/> (accessed on 29 May 2013).

<sup>3</sup> ASEAN data are from <http://data.worldbank.org/> (accessed on 11 May 2013). The averages exclude Myanmar and the Lao People's Democratic Republic, which have no available data.

<sup>4</sup> R. Manasan. 2011. *Analysis of the President's Budget for 2012*. Discussion Paper Series 2011–20. Makati: Philippine Institute for Development Studies.

<sup>5</sup> President Benigno S. Aquino III. 2012. *2013 Budget Message to Congress*. Manila.

<sup>6</sup> This still falls short of what is required. Public spending on education and health averaged 6.1% of GDP in Indonesia, Malaysia, Thailand, and Viet Nam over 2002–2007. World Bank. 2010. *Closing the Gap in Public Spending*. Philippines Discussion Notes No. 4. Washington, DC.

<sup>7</sup> Republic of the Philippines. Government Appropriations Act for fiscal years 2008, 2009, 2010 and 2011. Department of Budget and Management. [http://www.dbm.gov.ph/?page\\_id=93](http://www.dbm.gov.ph/?page_id=93) (accessed on 11 May 2013); Department of Social Welfare and Development. <http://www.dswd.gov.ph/downloads-2/financial-stewardship/> (accessed on 11 May 2013).

CIDSS National Community-Driven Development Project (KC-NCDDP), has proven to be a cost-effective mechanism for delivering rural infrastructure. International experience has shown the usefulness and effectiveness of CDD in responding to community needs in emergency and post-disaster situations.

6. The KC-NCDDP will improve the efficiency of government social protection programs. Economies of scale will be gained through the convergence of poverty reduction programs. For example, basic village infrastructure built under the KC-NCDDP will support human capital development to increase economic activity and improve access to health and education services. Clinics and school buildings support activities funded through the CCT program. CDD can be a cost-effective mechanism to meet urgent community needs following disasters, particularly for rehabilitating and rebuilding rural infrastructure.<sup>8</sup> It can help lighten the immediate burden on local governments that have many demands on them during such situations. The KC-NCDDP can provide this kind of support in disaster situations.

7. In this regard, the KC-NCDDP will be used to respond to post-disaster recovery and rehabilitation needs of communities severely affected by Typhoon Yolanda. Preliminary government estimates indicate that Typhoon Yolanda and other recent natural calamities may cut the national economic growth rate by 0.3–0.8 percentage points in the fourth quarter of 2013 alone, which is equivalent to \$900 million–\$2.5 billion in lost GDP in 2013. ADB’s preliminary forecast for 2014 is that the drop in the growth rate could be as high as 1 percentage point. The combined regional economies of Central Visayas, Eastern Visayas, and Western Visayas—which account for 12.5% of the country’s GDP—could shrink by 4.0%–8.0% in 2014. The Eastern Visayas’ economy could contract by 30.0% or more in 2014.

### C. Demand Analysis

8. Inadequate infrastructure is a critical development constraint. Public spending on infrastructure has been insufficient in recent years at about 2% of annual GDP, below the World Bank (WB) benchmark of 5% for middle-income countries. Demand for more infrastructure and basic services is robust considering the scarcity of provision.<sup>9</sup> About 18.6% of the population lacks safe water. Local roads are insufficient, with only 7% of *barangay* (village) roads paved. More than 10,000 additional classrooms are needed for basic education. Less than half of *barangays* have health stations. Rehabilitation of infrastructure is frequently needed as the country is hit by 20 typhoons every year that increasingly become more destructive.

### D. Program Rationale

9. Extending the reach of basic services is vital, as limited access to basic services is a major cause of Philippine poverty.<sup>10</sup> The KC-NCDDP thus intends to build community infrastructure in the poorest municipalities using CDD, including those that have been adversely

<sup>8</sup> L. Campeau. 2007. *Aceh and Nias, Indonesia: Results Achieved using Community Reconstruction following the Tsunami-Disaster in December 2004*. Sourcebook on Emerging Good Practice on Managing for Development Results, 2nd Edition. Washington DC: World Bank; World Bank. 2012. MDF - JRF Knowledge Notes: *Lessons Learned from Post-Disaster Reconstruction in Indonesia*. Jakarta, Indonesia: World Bank.

<sup>9</sup> Annual CDD investments average only 2.0% of the national government infrastructure budget and 0.3% of the total national government budget.

<sup>10</sup> ADB. 2009. *Diagnosing the Philippine Economy: Toward Inclusive Growth*. Manila; ADB. 2007. *Philippines: Critical Development Constraints*. Manila; A. Balisacan. 2007. Local Growth and Poverty Reduction. In A. Balisacan and H. Hill, eds. *The Dynamics of Regional Development: The Philippines in East Asia*. Cheltenham: Edward Elgar.

affected by disasters. CDD has been proven effective in delivering basic services as well as in local disaster prevention and response.

## E. Program Alternatives

10. International trends show that basic community infrastructure is delivered more cost-effectively through CDD than by the traditional methods of sector line agencies. CDD brings lower costs for access and overheads. Goods and services are procured through competitive local bidding. Labor is provided by communities at local daily rates. Communities provide in-kind contributions, the value of which is included in the budgeting and reporting processes.

11. A 2007 WB study of KALAHI–CIDSS found the costs of its subprojects lower than for the small infrastructure projects undertaken by government agencies (Table 1).<sup>11</sup> The costs of water systems were a fourth of the cost of equivalent systems built by government agencies. These findings are typical of those found in CDD projects. Infrastructure costs in Indonesia's first Kecamatan Development Project were 20%–30% lower than those constructed by government agencies. Under Indonesia's National Program for Community Empowerment (PNPM), construction of village infrastructure was 40% cheaper than under conventional projects.<sup>12</sup> Comparative data<sup>13</sup> show that CDD can secure large cost savings, too, for irrigation projects (24% in Indonesia), health centers (44% in the Philippines), and classrooms (60%–66% in Burkina Faso). Another review shows costs lower by 13%–39% in Indonesia, Nepal, and the Philippines, mainly from eliminating the overhead of the contractor.<sup>14</sup>

**Table 1: Comparing Infrastructure Costs**

Infrastructure Type	Unit	KALAHI–CIDSS Benchmark	Benchmarks from Traditionally Implemented Government Projects
Level 2 water system	Pesos/household	4,331	15,000–18,000
Road rehabilitation	Pesos/kilometer	824,539	900,000–2,000,000
School building	Pesos/square meter	7,442	8,036
Health center	Pesos/square meter	11,154	20,000
Day-care center	Pesos/square meter	10,608	8,500

KALAHI–CIDSS = Kapit-Bisig Laban sa Kahirapan (Linking Arms against Poverty)–Comprehensive and Integrated Delivery of Social Services.

Source: E. Araral and C. Holmemo. 2007.

12. In a post disaster context, CDD is an appropriate modality for the disbursement of recovery grant and loan funds. Within a few months of the disaster, utilizing the CDD modality, hundreds of communities can, in parallel, identify and prioritise immediate needs, appoint village project implementation groups, manage funds, procure goods and construct basic village infrastructure (footnote 8).

<sup>11</sup> E. Araral and C. Holmemo. 2007. *Measuring the Costs and Benefits of Community-Driven Development: the KALAHI–CIDSS Project, Philippines*. Social Development Papers, Community-Driven Development, Paper No. 102. Washington, DC: World Bank.

<sup>12</sup> R. Gonzalez. unpublished. *The Indonesian PNPM–Mandiri Program: Lessons for Philippine CDD*. A report prepared for the Asian Development Bank (Final).

<sup>13</sup> J. Van Domelen. 2007. *Economic Results of CDD Programs: Evidence from Burkina Faso, Indonesia, and the Philippines*. World Bank: Social Development.

<sup>14</sup> S. Wong. May 2012. *What Have Been the Impacts of World Bank Community-Driven Development Programs? CDD Impact Evaluation Review and Operational and Research Implications?* Washington D.C.: World Bank Social Development Department, Sustainable Development Network.

## F. Economic Internal Rates of Return

13. Under CDD, the cost of road construction is reduced as profit margins are cut, farmers contribute their labor, and corruption is contained by community scrutiny. Delivering roads through CDD under Indonesia's PNPM has proven significantly cheaper than through engaging private contractors. Further, under the ADB-financed Rural Infrastructure Support Project the economic internal rate of return (EIRR) for community-built roads was 21%. Schools built under CDD benefit from cheaper construction, improved operation and maintenance (O&M), and longer classroom life. Day-care centers under CDD are more accessible.<sup>15</sup> The 2007 WB study estimated the EIRRs of KALAHÍ-CIDSS by examining the most common types of subprojects as shown in Table 2 (footnote 11). The EIRRs ranged from 16% to 65%.

**Table 2: Subproject Types and Economic Internal Rate of Return**

Subproject Type	EIRR (%)
Level 2 water system using gravity	65
Level 2 water system using pumps	58
Road improvement	20
Road construction	21
School building	16
Health center	20
Day-care center	16
KALAHÍ-CIDSS project average	21

EIRR = economic internal rate of return, KALAHÍ-CIDSS = Kapit-Bisig Laban sa Kahirapan (Linking Arms against Poverty)—Comprehensive Integrated Delivery of Social Service.

Source: E. Araral and C. Holmemo. 2007.

## G. Distribution of Program Effects

14. The groups that gain most from KALAHÍ-CIDSS are poor households in terms of income, consumption, and employment; children through improved access to schools; and women enjoying higher workforce participation. An ADB survey on the impact of KALAHÍ-CIDSS found that CDD subprojects raised household incomes.<sup>16</sup> This is consistent with earlier findings that per capita consumption in beneficiary municipalities was 6% higher than in other areas.<sup>17</sup> The gap between beneficiary and non-beneficiary municipalities reached as high as 14% for those with more subprojects. Employment improved significantly, particularly among women, and was more diversified, building household resilience against economic shocks.

15. The ADB survey found that schools built children's future earning capacity. They also opened up livelihood opportunities like selling school supplies and food. With schools and health stations nearer, households saved on transport. Day-care centers gave parents more time to engage in economic activities. Common service facilities, like corn mills, brought down the cost of hauling and processing agricultural products.

16. The revised WB impact evaluation in 2013 found that KALAHÍ-CIDSS resulted in a 12% increase in per capita consumption,<sup>18</sup> which is greater than the 9.1% increase seen in

<sup>15</sup> P. Dongier et al. 2002. Community-Driven Development. In Jeni Klugman. A Sourcebook for *Poverty Reduction Strategy*. Washington, DC: World Bank.

<sup>16</sup> ADB. 2012. *The KALAHÍ-CIDSS Project in the Philippines: Sharing Knowledge on Community-Driven Development*. Manila.

<sup>17</sup> R. Edillon et. al. 2011. *Impact Evaluation of the KALAHÍ-CIDSS: Final Survey*. Washington, DC: World Bank.

<sup>18</sup> J. Labonne. 2013. *The KALAHÍ-CIDSS Impact Evaluation: A Revised Synthesis Report*. Discussion Papers, Sustainable Development: East Asia Pacific Region. Washington DC: World Bank.

Indonesia's PNPM.<sup>19</sup> Poor households' consumption rose by 19%. No impact on others' income demonstrates that the local elite did not capture project benefits. KALAHÍ–CIDSS also raised the share of non-food items in the family budget by 5 percentage points. The WB 2013 study also found that KALAHÍ–CIDSS resulted in a 6 percentage point decline in the probability of being poor, an 8 percentage point increase in the likelihood of females being employed, and a 9 percentage point increase in the number of households whose houses are accessible throughout the year.

## II. FINANCIAL ANALYSIS

17. The financial analysis for the proposed project follows the key principles and methodology described under para. 6 of the Operations Manual, on Financial Management Systems, Financial Analysis and Financial Performance Indicators.<sup>20</sup> A quantitative and qualitative examination has been undertaken to determine the reliability of the financial data relating to the implementation of the KC-NCDDP by the DSWD as the executing agency. DSWD financial management arrangements meet ADB requirements described under OM Section G2/BP, which requires the executing agency to adopt sound accounting policies, adequate accounting records, proper internal control systems, timely reporting to management, and sound and timely auditing practices.

### A. Adequacy of Financial Management Systems

18. A risk assessment and risk management plan undertaken by ADB in 2009 reported that the financial management regime of the DSWD functions well, with strong leadership and sufficient systems and controls to minimize corruption risks.<sup>21</sup> Within the DSWD, the division of duties among financial management services, finance units, and accounting units nationally and regionally ensures that all payments are authorized according to funds available under specific budgets. DSWD budget, disbursement, monitoring, and reporting systems are well developed.

19. Under the KC-NCDDP, subproject grants will be managed by communities following the KALAHÍ–CIDSS community finance and procurement manuals, which have been in use since 2003. The manuals have been updated to reflect design improvements under the KC-NCDDP. Oversight is provided by project facilitators and community volunteers. Accountability and transparency are ensured through public accountability meetings between tranches at *barangay* level, with financial records published on community information boards. The project's grievance redress system is being improved to better capture and report grievance resolution. The Commission on Audit performs regular audits on the DSWD and its audit reports have been used to improve the financial management performance of DSWD field offices.

20. The DSWD has gained extensive experience in, and an excellent reputation for, managing large-scale foreign-assisted programs such as the CCT program supported by ADB and WB and the WB-supported KALAHÍ–CIDSS. The Millennium Challenge Corporation also finances KALAHÍ–CIDSS. The DSWD further manages the Technical Assistance Facility funded

<sup>19</sup> Report available at <http://pnpm-support.org/sites/all/sites/default/files/PNPM+IE+Final+REVISED%20done.pdf>

<sup>20</sup> ADB. 2003. Financial Management Systems, Financial Analysis, and Financial Performance Indicators. *Operations Manual*. OM G2/BP. Manila.

<sup>21</sup> ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Technical Assistance Grant, and Administration of Technical Assistance Grant to the Republic of the Philippines for the: Social Protection Support Project* Manila. Linked document: Risk Assessment and Risk Management Plan. Accessible at <http://www.adb.org/sites/default/files/linked-docs/43407-01-phi-ra.pdf>

by the Government of Australia and, WB. The WB has found DSWD systems for procuring goods and services, including community-level procurement, to align with its procurement policies and procedures. The Department of Budget and Management (DBM) cited the DSWD as the most improved department in terms of disbursement performance in 2012 among the agencies that created Account Management Teams.<sup>22</sup>

21. In emergency and post-disaster context, DSWD has committed to ensuring that staffing numbers and skills, management systems, and oversight from the national level are aligned to the level of transactions while maintaining robust fiduciary control. To achieve this, DSWD has prepared a detailed regional recruitment and training plan. Project manuals have been updated to ensure that management controls reflect decentralization of fund release. A system for national and regional electronic management of community requests for fund release is being developed to handle the numerous and simultaneous financial transactions under the program. In summary, the financial management system of DSWD meets the financial management requirements of the project.

## **B. Adequacy of Investment Cost and Financing Plan**

22. The proposed project will support the following components of the KC-NCDDP (i) community planning and subproject grants, (ii) capacity building and implementation support (CBIS), and (iii) project management and monitoring and evaluation (M&E). Community grants will be used to support the rehabilitation and recovery needs of disaster-stricken communities. CBIS will provide adequate facilitation and oversight in the field to ensure efficient program implementation and robust fiduciary control. The ratio of field staff will be increased during the scaling up to strengthen control, particularly in more remote areas. The amounts allocated to capacity building are sufficient to ensure that training programs continue to be provided as in the past. The project management budget supports the decentralization of management functions to DSWD regional offices. Resources will fund the extension of regional technical support to the provinces where appropriate. M&E includes upgrading the management information systems required by significantly larger numbers of transactions as the program scales up.

## **C. Analysis of the Executing Agency**

23. The DSWD has proven to be a capable, reliable, honest, and cost-efficient agency, through which CDD projects are delivered. Under the DSWD, KALAHI-CIDSS and the CCT project have thrived and served millions of households. The DSWD's national financial management unit has a proven ability to manage designated imprest and special accounts funded by ADB, the WB, and the Millennium Challenge Corporation.

24. **Executing agency's ability to fund recurring costs.** The DSWD's annual budget, including that for KC-NCDDP, must be passed by Congress. The KC-NCDDP was approved by the National Economic and Development Authority (NEDA) Board on 18 January 2013. The DBM has issued a forward obligational authority for the program, under which a total of P51 billion is programmed for the KC-NCDDP in the national budget.<sup>23</sup>

<sup>22</sup> Department of Social Welfare and Development. <http://www.dswd.gov.ph/2013/02/dbm-cites-dswd-as-the-most-improved-department/> (accessed on 13 May 2013).

<sup>23</sup> A forward obligational authority is a certificate of commitment or authority issued by the Department of Budget and Management to a national government agency certifying that funds shall be made available to cover all project costs. This assures that the loan proceeds and the peso counterpart contribution are included in the long-term capital program of the national government.

25. **Program implementation and operational practices of DSWD.** Under the KC-NCDDP, the DSWD can achieve economies of scale by building on existing and proven systems and structures instead of piloting a new program. To improve operational efficiency, the DSWD will decentralize responsibilities and authority from national to regional offices, while maintaining adequate management and fiduciary control. The national office will concentrate on oversight, quality assurance, and overall program management.

26. **DSWD solvency and liquidity.** The adequate and timely release of funds is essential to supporting component 1 and to financing other program delivery costs of components 2 and 3. The DSWD's solvency, specifically with regard to the proposed project, depends upon Congress approving funding for recurrent costs annually. The DSWD draws down its approved annual budget from the DBM on a monthly basis.

#### D. Analysis of the Program

27. **Assessment of program cash flow.** Total funding required from 2014 to 2017 is \$663.8 million, of which \$372.1 million (56%) will be provided by ADB and \$291.7 million (44%) will come from the government. Of the total ADB loan proceeds, 94% will finance component 1, 4% component 2, and 2% component 3 (Table 3). Financing the project through ADB affects the borrower's fiscal balance less than if financing were obtained through commercial borrowing.

28. **Ensuring financial viability.** The source and use of funds for the subprojects is determined according to detailed design and budgeting undertaken during project planning. Subproject funds provided by ADB will finance up to 83% of the subproject cost. Local governments and the communities themselves become legally committed for the balance, provided to the subproject in cash or in kind. Funds are disbursed to communities in tranches following established completion targets, thereby mitigating the risk of funds not being used to complete the intended subproject.

**Table 3: Summary of Program Financing, 2014–2017**

	Total (\$'000)	% of Project Total	Government Funding (\$'000)	ADB Funding (\$'000)	% from ADB
Component 1	<b>403,774</b>	<b>58.0</b>	<b>45,192</b>	<b>358,581</b>	<b>94.0</b>
Planning grants	93,698	9.0	45,192	48,505	11.0
Subproject grants	310,076	48.0	0	310,076	83.0
Component 2: capacity building & implementation support	<b>182,977</b>	<b>34.0</b>	<b>172,874</b>	<b>10,103</b>	<b>4.0</b>
Component 3: project management, M&E	<b>51,470</b>	<b>8.0</b>	<b>48,571</b>	<b>2,899</b>	<b>2.0</b>
Contingencies	1,240	0.2	720	521	
Financing costs	24,376	3.7	24,376		0.0
Total	<b>663,838</b>	100.0	<b>291,734</b>	<b>372,104</b>	100.0
Funding sources (%)			44	56	

ADB = Asian Development Bank, M&E = monitoring and evaluation.

Note: The project was budgeted using the exchange rate \$1.00 = P40.60.

#### E. Sensitivity and Risk Analysis

29. Experience from KALAHÍ–CIDSS shows subprojects yielding EIRRs of 16%–65%, with each of the seven most common types of subprojects passing the 15% hurdle rate set by the NEDA (Table 2). KALAHÍ–CIDSS subprojects posted an EIRR of 21%. Subprojects were generally sensitive to a 20% increase in costs and to a 20% decrease in benefits. As EIRRs are more strongly affected by decreases in benefits than by increases in investment costs, a

significant increase in the number of beneficiaries improves financial viability. Costs should also be closely monitored.

30. The project was budgeted at the exchange rate of P40.60 = \$1.00. If the peso strengthens against the dollar, peso proceeds from the fixed US dollar loan amount decreases. As there is no contingency built into the project budget for adverse exchange rate movements, this could affect project implementation unless additional resources from government or other sources are applied.

31. Fund leakage will be avoided as funds for subprojects will be transferred directly from regional DSWD offices to community bank accounts. Built-in anticorruption measures to ensure the proper management of funds include division of duties, crosschecking prior to authorization, dual signatures, and regular meetings. Transparent procurement procedures also mitigate opportunities for fund leakage. Separate community teams oversee the procurement and checking of goods to ensure that quality and quantity match specifications. In a post-disaster recovery context, fiduciary controls are maintained through built-in mechanisms to ensure that funds are traceable and auditable. Adequate oversight by and technical support from trained facilitators also help ensure that funds are used for purposes intended.

## **F. Program Sustainability**

32. The KC-NCCDP is of relatively modest size, with program cost estimated at less than 0.1% of GDP. Government commitment to sustaining social spending appears firm. Support for social spending has risen from 27.9% of the budget in 2004 to 34.8% in 2013. The government is strongly committed to using the KC-NCDDP as a platform for addressing social development and broader anti-poverty needs while embedding CDD processes into government planning and budgeting processes.

33. KC-NCDDP stakeholders will undergo capacity building to sustain CDD. To address potential bottlenecks, the DSWD will decentralize subproject approval and fund disbursement to its regional offices, deploy adequate skilled staff to maintain robust financial integrity and fiduciary control. The national program management office will ensure close supervision and technical assistance. The grievance redress system will be enhanced. Engagement with civil society organizations in program implementation and oversight will be also strengthened. Third-party M&E is part of program design. Under the KC-NCDDP, community implementation of subprojects engenders pride and ownership among community members, which contributes to cost-effective O&M. O&M groups, are established and trained during project implementation, helping to improve the sustainability of subprojects.