ECONOMIC AND FINANCIAL ANALYSIS

A. Background

1. Inadequate or underdeveloped infrastructure has been identified as one of the key constraints on the Philippines' growth. The Global Competitiveness Report, 2018 of the World Economic Forum ranked the Philippines 56th out of 140 countries, advancing it by 29 places since 2010, mainly based on improvements in the macroeconomic environment. However, the country ranked low on infrastructure (92nd), below other Southeast Asian countries such as Indonesia (71st), Thailand (60th) and Malaysia (32nd).[1] Among the direct impacts of inadequate infrastructure are the high costs of doing business, which undermine business potential and economic opportunities, especially in rapidly growing urban areas. Poor infrastructure has also resulted in significant disparities in economic growth and poverty rates among regions, as it has limited mobility, access to employment, and social services. Of the country's 18 regions, three (Metro Manila and two adjacent regions in Luzon) account for nearly two-thirds of gross domestic product (GDP). The national poverty incidence was 21.6% of the population in 2015 but it is much higher in the Visayas (28.2%) and Mindanao (36.2%).

2. Inadequate infrastructure is attributed to the following factors: (i) low public infrastructure investment (2% of GDP since 2000) relative to needs (estimated at 7%–8% of annual GDP); (ii) the need to fast-track and enhance project planning and preparation; (iii) limited access to international technical and managerial know-how for project preparation, innovation, and implementation; and (iv) the need for stronger interagency coordination. Delays in safeguard compliance, procurement, and land acquisition, as well as poor project management, hamper project delivery.

B. Project Overview

3. The government has been increasing public infrastructure investment to raise the Philippines' long-term growth potential. In 2016, it announced a Ten-Point Socioeconomic Agenda, which includes increasing investment in public infrastructure such as national roads, expressways, bridges, airports, subways, and railways.[2] Public spending on infrastructure is targeted to reach 7% of GDP by 2022, up from 3.4% in 2016. The government has already achieved substantial progress on this agenda. In 2018, public spending on infrastructure rose to 5.1% of GDP. The difference between the current level of investment and the government's target indicates that efforts to accelerate infrastructure investments should be sustained in the coming years.

4. The government has requested additional funding from the Asian Development Bank (ADB) to extend ADB's ongoing support under the Infrastructure Preparation and Innovation Facility (Loan 3589-PHI) to the Government of the Philippines to meet its accelerated infrastructure development objectives.[3] The current project supports project preparation and improves the management capacity of infrastructure projects by the Department of Transportation (DOTr) and the Department of Public Works and Highways (DPWH). The additional financing will build on the current project to (i) improve the quality of priority infrastructure project proposals for

[1] World Economic Forum. 2018. *The Global Competitiveness Report 2018*. Geneva. http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf.
[2] National Economic and Development Authority. 2016. *Philippine Development Plan 2017-2022*. Manila. http://www.neda.gov.ph/wp-content/uploads/2018/02/PDP-Brochure.pdf.
[3] ADB. Republic of the Philippines: Infrastructure Preparation and Innovation Facility. https://www.adb.org/projects/documents/phi-50288-001-rrp

approval by the National Economic and Development Authority's Investment Coordination Committee; (ii) accelerate early project implementation following such approval through detailed engineering design and tendering support, with a focus on complex and large projects requiring international expertise; and (iii) strengthen the government's capacity to implement projects under the DOTr and DPWH.

5. ADB approved funding for the current project on 27 October 2017, and subsequently programmed a record volume of ADB financing for the Philippines (reaching $11 billion from 2019 to 2021).[4] Foreseeing that the demand for investment support activities would exceed current project funding, the government requested additional funding from ADB to scale up the project through the project steering committee during a meeting on 1 March 2019. The additional financing will finance project pre-investment readiness activities for large projects and build capacity in agencies to implement them. It will extend project assistance by bringing selected flagship projects initiated under the current project to the stage when civil works can commence. Particularly, it will finance the detailed engineering design for projects undergoing feasibility studies under the current project.

6. The additional financing is expected to cost $241.7 million, of which ADB will finance $200 million. It has the following outputs: (i) road and bridge projects prepared; (ii) water projects prepared; (iii) rail, public transport, port, and airport projects prepared; and (iv) project management capacity of the government improved. The cost of the first three outputs is estimated at $176 million, and the fourth output is expected to cost $4 million. The average cost of public project preparation in the Philippines is 3%—comparable to international norms. The total public investment in national infrastructure projects of the DOTr and DPWH, supported by the facility, is estimated at $5,866 million.[5]

C. Benefits

7. The government plans to establish a sustainable transport system in the Philippines that would not only improve the mobility of the country's population but would also significantly increase the development of the various provinces. The project will demonstrate the commitment of the government to provide critical infrastructure, the lack of which has impeded economic growth and capital investment. It will also strengthen the government's capacity to implement large infrastructure projects. This will result in benefits including accelerated project approval time and quicker project start-up time. The project approval time is estimated to accelerate from about 18 months in 2016 to 10 months by 2024. The project start-up time between approval and start-up is estimated to decrease from 36 months in 2016 to 18 months by 2024.

8. Indirect economic benefits will occur through larger investments made as a result of the initial investment, known as the investment multiplier effect. The medium-term government spending fiscal multiplier in the Philippines is 1.36—higher than 0.19 in Indonesia but lower than 3.83 in the People's Republic of China.[6] The Philippines' short-term government spending fiscal

[4] ADB. 2018. *Country Operations Business Plan: Philippines, 2019-2021*. Manila.

[5] Based on the National Economic and Development Authority, project preparation (e.g., feasibility studies and detailed engineering designs) absorb about 3% of the total project cost. Therefore, government spending on public infrastructure catalyzed by the facility can be estimated at $5,866 million ($176 million divided by 3%).

[6] The government spending fiscal multiplier measures the impact on gross domestic product as a result of an increase in government expenditure by 1% of gross domestic product in the first year. "Medium-term" encompasses the 4-year period that includes the year in which the government spending occurs. Source: G. Ducanes et al. 2006. Macroeconomic Effects of Fiscal Policies: Empirical Evidence from Bangladesh, People's Republic of China,

multiplier, which captures the immediate demand-side effects arising from increased government spending, is estimated at 0.74—slightly lower than 0.79 in Bangladesh and 0.76 in Indonesia. Hence, if government spending on public infrastructure takes place in 2019, the short-term benefits cover 2019–2020, and the medium-term benefits are generated during 2021–2024.

9. Near-term benefits to the economy include the boost to domestic demand, with gains in consumption, investments, and employment. Over the medium term, infrastructure projects potentially augment economy-wide productive capacity, stimulate overall potential growth, and reduce poverty. These benefits, however, largely depend on the efficiency of the public investment process, such as project selection and implementation.

Indonesia, and the Philippines. *Economics and Research Department Working Paper Series*. No. 85. Manila: Asian Development Bank.