Philippine Institute for Development Studies
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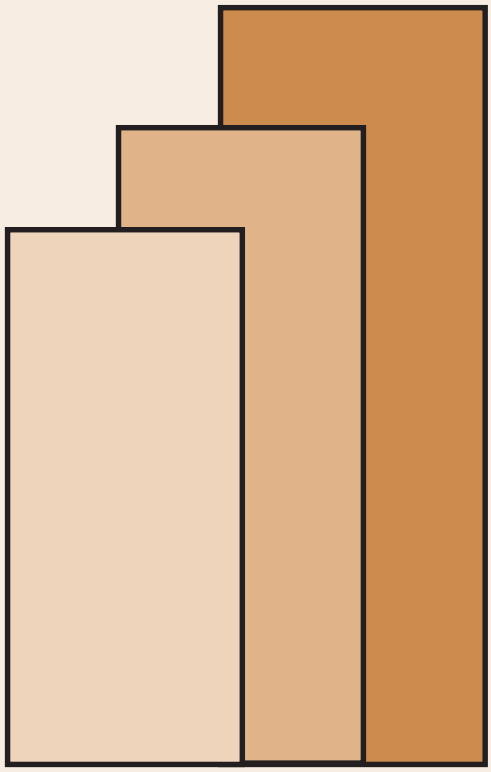
The Philippines' Absorptive Capacity for Foreign Aid

Hyewon Kang

DISCUSSION PAPER SERIES NO. 2010-15



July 2010

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The author would like to thank Romeo A. Reyes for guiding this study.

Abstract

This study evaluates the Philippines' absorptive performance for foreign aid, particularly during the six-year period 2003 to 2008, and compare this to that of the previous period, 1986 to 1988. We observe that the country's capacity to absorb foreign aid has declined during the period under study compared to that of the previous period. The study traces the causes of the reduction in aid absorptive capacity to several factors -- both from the side of the recipient and donor country behavior -- which negatively affected the aid absorptive capacity. The study discusses in detail these bottlenecks to aid absorption and provides policy recommendations to improve the country's capacity for foreign aid absorption.

Key words: official development assistance, Philippines, absorptive capacity for foreign aid, remittances, ″Divide-by-N" syndrome, Donor's motivation

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Introduction

Aid from donor to recipient countries on per capita basis declined from the decade of the 1980s to the 1990s.[1] The main reason cited for this decline was "aid fatigue syndrome", which refers to the serious doubts about the effectiveness of aid for development emerged after years of increasing aid flow during the preceding decades. Consequently, "aid effectiveness" became the subject of frequent meetings not only among donors but also between donors and recipients.

The international community has been seeking a new direction to increase the quantity and quality of foreign aid. At the 2002 Monterrey Conference on Financing for Development, the need to scale up official development assistance (ODA) in order to meet development goals was acknowledged. In particular, the consensus document, otherwise known as the "Monterrey consensus", encouraged developed countries to increase ODA to 0.7 percent of gross national income.

This milestone in development cooperation was followed by the Paris Declaration on Aid Effectiveness in 2005. More than 100 countries promised to make an effort to enhance aid effectiveness by reinforcing the following principles: ownership, alignment, harmonization, managing for results, and mutual accountability. The declaration reaffirmed that donors and recipients are and should be mutually accountable for development results.

Looking at the recipient countries' ability to absorb aid promptly, efficiently, and effectively would be useful to identify ways and means to improve aid effectiveness. Increasing the volume of aid without the consideration for the aid absorptive capacity of the recipient country will not result in a positive impact on aid effectiveness.

This paper thus addresses the absorptive capacity for foreign aid in the Philippines covering the period 2003-2008. It looks at the aid absorption performance of the country in by comparing the actual disbursement with the targeted and the committed disbursement. It identifies bottlenecks to aid absorption from the side of both recipients and donor countries.

The first part of Chapter 1 defines foreign aid and revisits the two gap theory as its economic justification. The two gap theory suggests that foreign aid is a critically important development input to reduce the resource gap and the foreign-exchange gap in developing

[1] The per capita ODA contribution from Development Assistance Committee donor countries averaged only $66 a year in the period 1996-1997, declining from $75 a decade earlier.

countries. The second part of Chapter 1 then briefly explains the concept of absorptive capacity in foreign aid and looks at absorptive capacity constraints.

Chapter 2 examines the economic performance of the Philippines in terms of GDP growth, investment efficiency and capital absorption between 1999 and 2008. It attempts to measure the resource gap and the foreign exchange gap during the same period and the extent to which aid contributed to close the gaps.

Chapter 3 focuses on the aid absorption in the Philippines from 2003 to 2008 in terms of: (a) translation of the commitment to the actual disbursement; and (b) the actual disbursement in relation to the scheduled disbursement. To the extent possible, the analysis is done for specific ODA sources and on a comparative basis, e.g., loans versus grants, and multilateral versus bilateral sources of aid. It also makes an assessment of the aid absorption performance in 2003-2008 compared with that in 1986 -1988.

Chapter 4 looks at the constraints for aid absorption from both the recipients and the donor countries. From the recipient side, the paper traces (a) the macroeconomic constraint, (b) the institutional and policy constraints, and (c) the technical and managerial constraints to aid absorption. Then it analyzes the constraints generated by the donors, focusing on the cases of China, Japan, and Korea.

1. Foreign aid and absorptive capacity

Foreign aid is favored by developing countries as a source of development finance due to its concessional nature. Despite an on-going dispute regarding its impact on economic development, developing countries continue to depend on foreign aid to combat poverty. This section defines foreign aid and the concept of aid absorptive capacity.

1.1 Definition of foreign aid

The Organization for Economic Cooperation and Development (OECD) defines ODA as "flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent".

ODA's particular objective is to support developing countries in the attainment of their economic development and social welfare. When provided as a loan, it requires a minimum grant element to be considered as an ODA. This means that its annual interest rate should

generally be lower than the commercial rates, and its repayment and grace period longer. Altogether, these concessional terms should translate into a grant element of at least 25 per cent.[2]

ODA is provided by bilateral and multilateral donors/creditors. Bilateral ODA refers to ODA provided on a government to government basis. Multilateral ODA refers to grants or loans provided by international or regional institutions such as the World Bank, the Asian Development Bank, or the United Nations. It is important to note that military assistance are not considered as ODA.

This study adopts OECD's definition of ODA. Foreign aid and ODA will be used interchangeably. All grants and concessional bilateral and multilateral loans are regarded as foreign aid or ODA.

1.2 Economic justification for foreign aid

The importance of foreign aid derives from the usual constraints to development such as lack or insufficient capital, foreign exchange, and technical knowledge. Typically, the main constraint to attain self-sustained growth for a developing country is the lack or the insufficiency of capital. Domestic savings and exports from goods and non-factor services are usually inadequate to finance investment and import requirements, respectively. The insufficient domestic capital thus generates a resource gap and a foreign-exchange gap. Foreign aid can be tapped to close those gaps. Thus,

$$S+F = I,$$

Domestic investment (I) can be financed either by domestic savings (S) or by foreign capital inflow (F). So too, can be

$$X+F=M,$$

That is, import (M) can be financed either by exports (X) or by foreign capital inflow (F). It follows that

$$F = I – S = M – X.$$

Developing countries can either utilize foreign private capital, or it can avail of official capital to close the resource gap and/or the foreign-exchange gap, instead of private commercial loans with high interest rate and short repayment period.

[2] The formula for computation of the grant element of a loan can be found in Reyes (1993).

Empirical studies have shown that aid helps recipient countries to achieve national economic development goals. Chenery and Strout (1966) suggested that the Philippines is one of several countries where foreign aid have made a positive contribution. Several countries including Greece, Taiwan, Israel, and the Philippines have had an accelerated growth of their national income, while being assisted with foreign aid during the postwar recovery program.[3] Papanek (1973) investigated thirty-four less developed countries (LDCs) in the 1950s and fifty-four for the 1960s. He found that savings and foreign aid explain about one third of the variation in GDP growth.[4] Mosley (1980) added that twenty five percent of the growth in LDCs had been affected by domestic savings and foreign aid in the 1970s. Recent research on the effect of foreign aid to domestic saving was conducted by Islam (1992). He explained that foreign capital, especially when provided in as ODA loans, along with food aid, had a positive role in the economic growth of Bangladesh.[5]

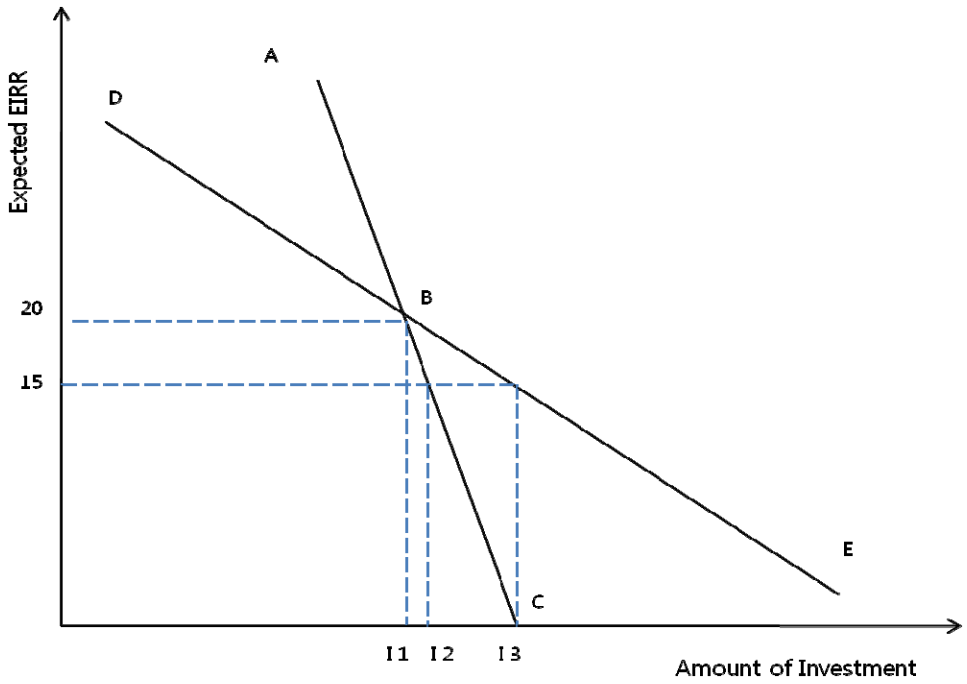
1.3 The concept of absorptive capacity

When donor countries decide to commit ODA to developing countries, concerns about the recipient's ability to absorb large amount of aid are invariably raised. The reason is that the potential benefits from additional aid may often be constrained by weak capacity in the recipient country, frequently failing to meet intended objectives.[6]

Absorptive capacity derives from the ability to use capital productively in general. When it is used in the context of foreign aid, it refers to the recipient's capacity to use aid for projects with acceptable returns. After a certain level of additional aid, the expected economic internal rate of return (EIRR) tends to fall. This 'saturation point' of the marginal efficiency of capital determines 'absorptive capacity' in the recipient country.

[3] Irma Adelman and Hollis B. Cherery(1966), p1.
[4] Bichaka Fayissa and Mohammaed I, El-Kaissy(1999), p39.
[5] Ibid.
[6] Francois Bourguignon and Mark Sundberg(2006), p2.

Figure 1-1. The graph of absorptive capacity



Source: Reyes, 1993

The concept of absorptive capacity can be more clarified with Figure 1-1. The recipient or developing country performance in terms of expected economic internal rate of return is depicted by the line ABC while that of the developed country by the line DBE. Let's suppose that economic-opportunity cost of capital is 15 percent in both countries.

At *I1*, we can see that the expected EIRR for both countries is 20 percent, which is above the opportunity cost of capital at 15 percent. Thus, at that level of investment, the two countries can generate the same economic returns. The slope of the EIRR performance in the developing country is steeper than that of the developed country. The reason for this is as follows. At I2, the return on the capital in the developing country goes down to 15 percent, equivalent to the opportunity cost of the capital. I2 therefore is 'saturation point' in developing countries. In the case of developed countries, the "saturation point" is reached only at I3. At that level of investment, the return to capital already approaches zero in the developing country. This simply illustrates the point that

the availability of economically profitable investment opportunities is greater in developed countries than in developing countries, as the number of economically profitable investment projects and tends to be generated by the development process itself.

We can say that in general the absorptive capacity of developed country is higher than in less developed country at the same level of investment. When absorptive capacity of recipient country increases, the line ABC moves to the line DBE in the graph.

The general rule is that a proposed investment project should be implemented if expected EIRR is equal to or greater than the opportunity cost of capital.

1.4 Constraints of aid absorption

A 2005 Overseas Development Institute (ODI) Briefing Paper[7] proposes a useful framework for identifying the constraints to the capacity of a recipient country to absorb foreign aid. It classifies constraints into four types: (1) macroeconomic constraints, (2) institutional and policy constraints, (3) technical and managerial constraints, and (4) constraints generated by donor behavior. We discuss each of this type below.

Macroeconomic constraints

There are several constraints that could hamper aid absorption in a macroeconomic context. First, the abrupt increase or decrease of foreign aid can have an adverse impact on the recipient country's economy. Sudden increases in the supply of foreign currency can cause an appreciation of the exchange rate and a negative effect on the exports sector. This is often referred to in the economic literature as the "Dutch disease" problem. Second, when the aid is provided to the recipient country as a loan, questions regarding debt sustainability arise, as the increasing debt service burden can eventually lead to a negative net capital inflow (i.e., or net capital outflow). Third, the unpredictability of aid can contribute to inflation and interest rate and exchange rate.

Institutional and policy constraints

In a developing country, institutional and administrative capacity determines the efficiency and the timeliness in the use of foreign aid. Towards that end, an effective system

[7] Overseas Development Institute (2005), p2.

for ODA administration, including the formulation and implementation of ODA policies and programming guidelines, would be critically important. In line with this, the transparency and efficiency of budget system, the efficiency in the allocation of the aid resources, the effective delineation of the responsibilities among institutions responsible for aid management, and the systematic approach to the setting of the development priorities are the main factors that would determine aid effectiveness.

Technical and managerial constraints

The lack of human resources with the right skills at the technical and managerial level can also be a major constraint. Skilled manpower is usually necessary to implement foreign aid projects, along with an effective enabling environment for a transparent process of project preparation and implementation, anchored on economically and financially sound evaluation criteria and competitive procurement procedures.

Constraints generated by donor behavior

In general, donors have two motivations in giving aid to recipients. One is to support recipient country's development. The other is to protect or advance the donor's economic and political interest. Donor's motivation affects the terms of aid, i.e., whether aid is to be provided as grant or loan, and if a loan, its grant element; and whether aid is to be tied or untied to donor country as a source of procurement. If donor's purpose is the latter, aid is usually given in the form of loans rather than grants and its use is tied to the donor country as a source of procurement. When aid is tied to procurement, the recipient country must procure goods and materials only from the donor country. This causes import dependency of ODA funded projects thereby reducing the recipient's capacity to absorb aid.

Classification into short-and long-term constrains

Aside from classifying the constraints to aid absorption into the types mentioned above, it is also possible to classify these constraints into short-term and long-term constraints (Table 1-1), thus:

Table 1-1 Short and long-term constraints to aid absorptive capacity

Short-term constraints	Long-term constraint
• 'Dutch disease' effects • Aid volatility • Inadequate public expenditure management system • Perverse incentives in public officials performance • Lack of adequate infrastructure and equipment • Post-conflict and post-emergency constraints • Uncoordinated donor interventions	• Debt sustainability • Major deficiencies in institutions and policy process • Levels of aid-dependency • Technical and managerial skills of public officials (doctors, teachers, accountants) • Social/cultural factors determining demand for services • Difficulties in full donor shift to improved practices

Source: ODI report, 2005

2. Philippine Economic performance

2.1 Economic growth performance

The Philippines is a lower middle-income country with a population of 90.5 million in 2008. It registered a fairly stable and respectable economic growth from 2003 to 2008. Average gross domestic product (GDP) growth was 5.4 percent during that period, higher than 3.0 percent average GDP growth during 1990-2000. The Philippines can achieve the Millennium Development Goal of eradicating extreme poverty and hunger by 2015 if the Philippines make an effort to implement its reform program.[8]

[8] USAID, (2007).

Table 2-1. The Philippines GDP performance (in million pesos, at constant 1985 prices)

	2003	2004	2005	2006	2007	2008
GDP growth rate	4.9	6.4	5	5.3	7.1	3.8
GDP (Total)	1,085,072	1,154,295	1,211,452	1,276,156	1,366,493	1,418,952
GNP (Total)	1,171,431	1,252,331	1,320,000	1,391,289	1,495,589	1,587,797

Source: National Statistical Coordination Board (NSCB)

The Philippine economy showed resilience with 4.9 percent GDP growth in 2003 (Table 2-1). The growth is significant despite serious external and domestic threat like the Iraq war, SARS, and Sovereign credit-rating downgrades. In 2004, GDP growth accelerated to 6.4 percent. In 2005, the GDP growth of 5.0 percent was below the target range of 5.3 percentages to 6.3 percent suggested out in the Medium-Term Philippine Development Plan (MTPDP) 2004-2010[9]. Weaker agricultural performance and slower growth in the service sector accounted for the performance.[11] One of the main economic concerns is the national government's total debt stock. According to the National Statistics Office, the national government's total debt stock was equivalent to 72 percent of GDP as of end 2005. As a result, the unemployment rate rose to 21.0 percent from 17.5 percent a year earlier,[13] contributing the increase in the number of overseas workers. The lender's data show that 10.8 percent of the country's population survives on just $1 a day, and another 41.2 percent make do with less than $2 daily, as of 2005.[14]

In 2006, the Philippines economy expanded by 5.3 percent. The Philippines was still behind the growth performance of Asian economy and outperformed only Thailand GDP performance. In 2007, GDP soared 7.1%, which was the highest in 31 years. GNP substantially expanded from 5.4 percent in 2006 to 7.5 percent in 2007. The high growth was attributed to substantial growth in the finance, trade and private service sectors. Consumption spending led the growth on the demand side and contributed to 4.7 percentage points to the GDP growth.[15]

In 2008 however, the economy showed down due to the global economic crisis, and

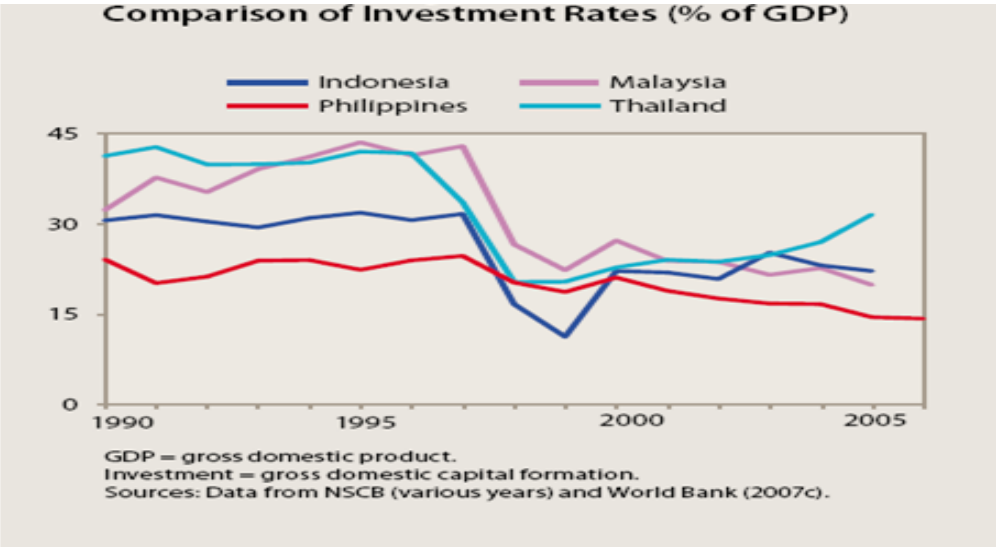
[9] President Arroyo's administration was outlined in the MTPDP for 2004-2010, which include goals towards the acceleration of growth, job creation, and reform of the energy sector.
[11] Asian Development Outlook (2006).
[13] http://www.census.gov.ph/data/sectordata/datalfs.html.
[14] http://www.gmanews.tv/print/25393.
[15] Senate Economic Planning Office, Economic Report ER-08-02 (2008).

expanded by only 3.8 percent. Due to weak global demand, export drastically decreased in 2008, from an away the growth from 2003 to 2007. Unemployment rose in 2008 as the global downturn hit the manufacturing sector. The country's jobless rate stood at 6.8% in October 2008, compared with 6.3% a year earlier.[16]

2.2 Capital absorption and investment efficiency

One of the critical development constraints is low investment. Between 2003 and 2008, capital formation amounted to an average of P233 billion annually. Although its neighbors in Southeast Asia had recovered their investment rate after the 1997 financial crisis, the Philippines' share of the investment to GDP had fallen to its lowest level since the crisis years of the early 1980s. (Figure 2-1)

Figure 2-1. Comparison of investment rates in South east Asia



Source: Philippines: Critical Development Constraints

Table 2-2. The Philippines investment efficiency (in million pesos, at constant 1985 prices)

	2003	2004	2005	2006	2007	2008
Capital formation	218,412	234,065	213,469	224,289	252,018	256,244

[16] http://www.qfinance.com/country-profiles/the-philippines.

ICOR*	4.28	3.38	3.73	3.47	2.79	4.91

*ICOR=Annual investment/Annual increase in GDP
Source: NSCB

In 2003, capital formation reached P 218 billion. In 2004, the capital formation increased to P234 billion. This investment yielded the investment efficiency in terms of ICOR of 3.38. In 2005, the investment declined and the investment efficiency grew worse, yielding an ICOR of 3.73. In 2006, the capital formation increased from P 213 billion to P224 billion. It is observed investment efficiency grew increasing yielding the ICOR 3.47. In the 2007, the Philippines faced the significant GDP growth rate of 7.1 with help from the amount of capital formation representing P252 billion yielding 2.79 of ICOR. Stimulus spending helped capital formation in 2008 to increase from P 252 billion to P 256 billion.

While the Philippines economy shows the stable economic growth performance, the portion of investment of GDP is still below to attain self-sustaining growth.[20]

2.3 Resource gap and government deficit

A comparison of the gross domestic savings rate with the gross domestic investment rate represents the resource gap.[21] The Philippines' resource gap which reached $2.9 billion in 1999 had been steadily decreasing (Table 2-3). The resource gap disappeared when the current account balance reached positive territory in 2003. (Before 2003, the Philippines had suffered from a resource gap)

Table 2-3. Resource gap (in million U.S. dollars)

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
	-2874	-2225	-1744	-279	288	1628	1984	5347	7118	3633

Source: BSP

Note: S-I represents current account balance by definition. The data I used for resource gap is equal to the current account balance from balance of payment.

While the entire domestic economy had been generating a surplus since 2003, it is

[20] It is defined as growth at a given rate with capital inflow limited to a specified ratio to GNP which can be sustained without concessional financing.

important to note that the public sector had consistently been operating with a huge gap or deficit (Table 2-4). While government consumption has increased, tax collection stagnated. In a sense, therefore, foreign aid was being used since 2003 to finance the "third gap", i.e. the fiscal gap.

Table 2-4. General government income and outlay account (in million pesos)

	2002	2003	2004	2005	2006	2007	2008
Government Income	239,686	229,953	288,943	337,668	388,015	442,621	502,123
Government consumption expenditure	456,904	477,411	492,110	521,664	589,930	653,760	716,544
Government saving	-217,218	-247,458	-203,167	-183,996	-201,915	-211,139	-214,421

Source: NSCB

2.4 External transaction

Although the foreign exchange gap[22] has been closed since 2003, the Philippines has suffered from trade deficit. (Table2-5) The trade deficit increased from 1999 to 2001 and it soared to $ 9,113 million in 2005. With the economic crisis, the Philippines faced the highest trade deficit in 2008, which is about two-times of the deficit in 2006. It is worth noting the lowest deficit in 2007 during period between 1999 and 2008. The driving force to make the lowest deficit was exports of $ 59,278 million which is 1.6 times of the exports of 1999.

Table 2-5. Balance of payments, 1999-2008 (in million U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Goods	-5977	-5971	-6265	-5530	-5851	-5684	-7773	-6732	-8391	-12885
Credit: Exports	34243	37347	31313	34403	35339	38794	40263	46526	49512	48253
Debit: Imports	40220	43318	37578	39933	41190	44478	48036	53258	57903	61138
Services	-1620	-1870	-2288	-2002	-1963	-1777	-1340	137	2249	1160
Credit: Exports	3468	3377	3072	3428	3389	4043	4525	6444	9766	9717

[22] Foreign exchange gap is by definition equal to current account balance.

Debit: Imports	5088	5247	5360	5430	5352	5820	5865	6307	7517	8557
X-M	-7597	-7841	-8553	-7532	-7814	-7461	-9113	-6595	-6142	-11725
Current transfers	5784	5643	6860	7680	8386	9160	11391	13197	14153	15247
Worker's remittance	5212	5161	6328	7167	7681	8617	10668	12481	13255	14536
Income	-1061	-27	-51	-427	-284	-71	-294	-1255	-892	111
compensation of emp.incl.border, seasonal, and ogher workers	1481	1763	2432	2568	2558	2851	2893	2758	3030	4092
Current Account Balance	-2874	-2225	-1744	-279	288	1628	1984	5347	7119	3633
Net direct investment	1114	2115	335	1477	188	109	1665	2818	-620	1285
Net long-term loans (Liability-Assets)	1138	448	13	-871	-46	-562	-488	-2621	2704	-1327
liability	2219	1556	1046	321	1269	672	858	-437	4292	-971
Assets	1081	1108	1033	1192	1315	1234	1346	2184	1588	356
Net short-term loans (Liability-Assets)	311	838	-1556	716	-264	238	212	-2812	-670	1250
capital and financial account	4185	3363	911	1056	726	-1630	2229	20	3527	-1802
Net unclassified items	2280	-1647	631	33	-899	-278	-1803	-1598	-2089	-1742
Overall BOP	3591	-509	-202	810	115	-280	2410	3769	8557	89

Source: BSP

The external current account balance became a surplus during that year as current transfers (consisting mostly of OFW remittances) more than offset the X-M deficit. Current transfers averaged about $11,922 million annually in 2003-2008, of which $11,206 million was remittance and $401 million was ODA grants.

Looking at the Philippines's external transaction in 1970s and 1980s, the Philippines borrowed capital from abroad to finance its current account deficit. In 1975, 40 percent of the deficit was financed by net inflow of medium- and long-term loans (MLT); 20 percent by

net inflow of short-term (ST) capital and direct foreign investment; and the remaining 40 percent by use of existing international reserves.[23] In 1982, the share of net inflow from MLT loans in financing the current account deficit increased to 48 percent of the deficit of $3.2 billion. Net direct investment was minimal at $ 1.7 billion. The remainder of $1.5 billion was thus financed through drawdown in reserves or inflow not captured in the BOP, reflected by errors and omissions.[24]

Let's look at the 2003-2008 period. In 1999, long-term loans (ODA) continued to play an important role in financing the current account deficit of $2,874 million. As in 1975, it financed 40 percent of current account deficit. In 2001, net inflow of long-term loans was down to $13 million. In 2002 and succeeding years, repayment of long-term loans exceeded inflow, implying that proceeds from ODA loans were not even enough to meet payments for debt service.

It is found that the Philippines entered a new stage in its external transactions at the turn of the century. In the 1970s and succeeding decades, the current account deficit was financed by foreign loans mainly. Since 2003, however, the Philippines has had a current account surplus due to an increase in current transfers, mainly in the form of OFW remittances. With regard to ODA loans, a net outflow has been registered implying that part of OFW remittances was being used directly or indirectly for ODA loan servicing.

2.5 Net transfer and balance of payment

According to Balance of Payments data, total transfers to the Philippine economy ranged between $5,784 million in 1999 and $15,247 million in 2008 **(Table.2-6)** Of the total, private transfers including worker's remittances amounted to $5,351 million or 93 percent and official transfer to $433 million or 7 percent. The latter amount may be roughly considered as ODA grants. After experiencing a slight decline in 2000, total transfers steadily increased to $15,247 million in 2008, of which $14,945 million or 98 percent was private consisting mostly of OFW remittances. Obviously, the latter has become the main driving force to achieving a positive current account balance.

[23]Reyes, (1993) 52p.
[24] Ibid, p53.

Table 2-6. Classification of total transfers to the Philippines

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Official transfer	433	442	471	497	555	387	437	313	506	302
Private transfer	5351	5201	6389	7183	7831	8773	10954	12884	13647	14945
Total transfer	5784	5643	6860	7680	8386	9160	11391	13197	14153	15247
Official/Total transfer	0.07	0.08	0.07	0.06	0.07	0.04	0.04	0.02	0.04	0.02
Private/Total Transfer	0.93	0.92	0.93	0.94	0.93	0.96	0.96	0.98	0.96	0.98

Source: BSP, 200?

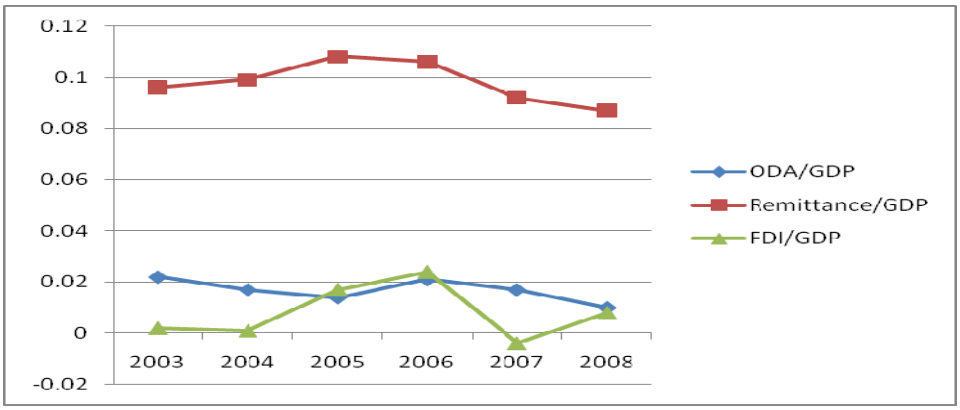
Table 2-7 and Figure 2-2 shows the relative significance of worker's remittances, Overseas Development Assistance (ODA) and Foreign Direct Investment (FDI) as a source of development financing in the Philippines. Clearly, worker's remittances have become the most importance source. ODA's significance has been decreasing over time. As a source of development finance, FDI overtook ODA in 2005 and 2006. In 2007, FDI suffered a net outflow but became positive again in 2008.

Table 2-7. ODA, Remittances and FDI as percentages of GDP (in million U.S. dollars)

	2003	2004	2005	2006	2007	2008
ODA	1772	1435	1353	2467	2399	1648
Remittance	7681	8617	10668	12481	13255	14536
FDI	188	109	1665	2818	-620	1285
GDP	79633	86933	98847	117590	144354	167609
GNP	85446	93652	106966	127356	156948	186282
ODA/GDP	0.022	0.017	0.014	0.021	0.017	0.010
Remittance/GDP	0.096	0.099	0.108	0.106	0.092	0.087
FDI/GDP	0.002	0.001	0.017	0.024	-0.004	0.008

Source: BSP, NEDA

Figure 2-2. ODA, Remittance and FDI flow as % of GDP



Source: BSP, NEDA

3. The Philippines absorptive performance for foreign aid

3.1 Distribution of ODA in the Philippines, 2003-2008

Since 1946, the Philippine has been a recipient of foreign assistance from bilateral and multilateral donors. Japan and U.S both played an important role in the post-war rehabilitation. Together, the two donors accounted for 81.5 percent of the development assistance flows from bilateral sources and nearly 40 percent of total foreign aid during the period 1952-1986.[25] Over time, new donors and creditors emerged thereby changing the patter of aid distribution in the Philippines by origin.

This chapter makes an assessment of aid absorption performance of the Philippines between 2003 and 2008, based on the following two indicators adopted from the study of Reyes (1993):[26]

(a) Disbursement as a proportion of commitment, which indicates ability to absorb aid programmed for specific uses; and

(b) Disbursement as a proportion of what was scheduled, which indicates ability to absorb aid according to schedule.

[25] Filologo Pante, Jr (year), Reyes (1989), p1.

[26] Reyes (1993), p65.

Table 3-1. Total cumulative ODA committed to the Philippines, 2003-2008 (in million U.S. dollars)

Source	Grants	Loans	Total
Multilateral			
ADB	170	8,754	8,924
WB	631	8,884	9515
Bilateral			
China	35	3710	3745
Japan	159	32,326	32,485
Korea	26	592	618
Germany	423	780	1,203
France	1	324	324
Austria	0	558	558
Spain	44	345	389
Australia	867	231	1,098
UK	0	2,529	2,529
United States	1,813		1,813
Others	1,827	1,099	2,926
Total	5,996	60,131	66,127

Note: Loans as of December 2008; grants as of December 2008

Source: NEDA Project Monitoring Staff, 200?

The total ODA committed[27] to the Philippines for the 6-year period 2003 to 2008 amounted to $ 66.1 billion, of which 91 percent was in loans and only 9 percent was in grants.

Among the multilateral institutions, the World Bank led with 14.3 percent of total ODA. ADB was next with 13 percent. Among the bilateral donors, Japan was the largest with 49 percent. It is worth noting that China emerged as the second largest donor between 2003 and 2008. Historically, Japan and the U.S had contributed significant amount of ODA to the Philippines since 1946. From 2003 to 2008, ODA from China increased rapidly with strengthening of Philippines-China economic relations. China became the Philippines'

[27] Committed aid is made upon signing of a loan or grant agreement specifying the amount, terms, and purpose of aid, responsibilities of both parties, and other provisions relating to the use of aid and its repayment.

fourth largest trading partner in 2005, up from 12th place in 2001.[28] United Kingdom was third and the United States was fourth. It is worth noting that aid from the United States was provided entirely in grants. Korea emerged as a new donor contributing $ 618 million or 0.9 per cent of the total.

Among the major projects funded by ODA during this period were two infrastructure projects: the Php 36 billion Light rail Transit Line 6 and the Php 19.4 billion extension of the North Luzon Expressway.[29]

Table 3-2. Total ODA disbursement in the Philippines, 2003-2008 (in million U.S. dollars)

	Grants	Loans	Total
Multilateral			
ADB	98	2,299	2,398
WB	215	1,165	1,380
Bilateral			
China	10	301	311
Japan	7	4,044	4,051
Korea	10	41	52
Germany	44	113	157
France	1	24	24
Austria	0	66	66
Spain	15	94	109
Australia	177	58	234
UK	0	341	341
United States	998		998
Others	825	185	1,009
Total	2,400	8,673	11,073

Loans as of December 2008; grants as of December 2008

Source: NEDA Project Monitoring Staff

[28] Eduardo C. Tadem(2007), p40.
[29] IBID , p23.

For the same period, total disbursed ODA reached $11 billion. Of that amount, Japan was the biggest contributor among the bilateral donor at 37 percent and ADB among multilateral institutions at 22 percent of total disbursement.

With regard to the percentage of disbursement to commitment, the Philippines disbursed only 16.7 percent of committed ODA during the period 2003 to 2008.

The annual ODA portfolio review[30] mentioned that a disbursement ratio in the range of 18-20 percent may be regarded as normal, based on the assumption of five-year implementation period and straight-line schedule of disbursements. Considering that some big projects were implemented only for a couple of years, the utilization of ODA in the Philippines based on disbursement-commitment ratio was below the norm during the period under review. One NEDA staff confirmed that the absorptive capacity in the Philippines for foreign aid is indeed low. Former Socioeconomic Planning Secretary Romulo Neri admitted in 2007 that "At the moment, ODA utilization is very poor and the Department of Finance and the Department of Budget and Management are rationalizing the country's development financing profile" [31]

3.2 Commitment vs Disbursement

In terms of grants from 2003 to 2008, the traditional and new sources of aid committed were around US$ 6 billion. Of this amount, around $2.4 billion was disbursed, thereby registering a disbursement ratio of 40 percent. In 2003, $766 million was committed and 48 percent was disbursed. The ratio was 45 percent in 2004, 14 percent in 2005, 45 percent in 2006, 44 percent in 2007, and 45 percent in 2008. Thus, except for 2005, which an exceptionally low disbursement ratio of 14 percent, grant absorption performance was stable at an average of around 40 percent during the period under review.

Among multilateral donors, the ADB and the World Bank disbursed 58 and 34 percent of the total commitment, respectively. Among the bilateral donors, the U.S registered a disbursement-commitment ratio of 55 percent, followed by China and Korea with

[30] Annual ODA Portfolio Review of implementation of all projects financed through Official Development Assistance is conducted by NEDA in compliance with NEDA Board instructions and RA 8181.
[31] IBID, p39.

a ratio of 30 and 32 percent respectively. On the other hand, Japan which is traditional big donor country, showed a low rate of 5 percent.

With regard to loans, a total amount of US$ 60.1 billion was committed between 2003 and 2008, of which US$ 8.7 billion was disbursed, yielding a disbursement-commitment ratio of 14 percent. Of the total US $ 60.1 billion committed, 14 percent was disbursed in 2003, 10 percent in 2004, 12 percent in 2005, 21 percent in 2006, 20 percent in 2007, and 11 percent in 2008. In 2005, the disbursement-commitment ratio of 12 percent showed a slight improvement compared to ratio of 10 percent in 2004. Year 2006 showed a significant improvement of the ratio at 21 percent. Year 2007 maintained a similar absorptive performance, but the performance drastically fell (20 percent disbursement-commitment ratio), to a ratio of 11 in 2008.

Among the multilateral creditors, the ADB disbursed 26 percent of the total committed loans. This figure is regarded as high compared to the other creditors. It should be noted that the ODA was provided by the U.S to the Philippines entirely in grants.

With regard to China, the disbursement-commitment ratio in grants was 30 percent, but the ratio in loans was only 8 percent. Also, loans from Korea were disbursed at a low rate of 7 percent.

Overall, ODA aid absorption performance was better in grants than loans. For the 6-year period, the Philippines disbursed 40 percent of commitments in grants and 14 percent in loans.

Aid absorption performance in the period covered by this study suffered in comparison with performance in the 1980s. According to Reyes (1993), $743 million was committed in 1986. Of this amount, $243 million was disbursed, representing a disbursement-commitment ratio of 33 percent. The next year, the Philippines disbursed $357 million from the committed amount of $1.1 billion, representing a 32 percent disbursement rate in 1987. Even with a low disbursement ratio of only 9 percent in 1988, the average for the 3-year period was 20 percent.

Considering that overall disbursement rate in 2003-2008 was computed at only 16.7 percent, it may be concluded that there was a reduction in the absorptive capacity of the Philippines compared to the 1980s.

Table 3-3. Percent of disbursement to commitment in grants, 2003-2008 (in million U.S dollars)

	2003		2004		2005		2006		2007		2008		Total Commitment	Total disbursement	% of disbursement to commitment
Funding source	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement			
ADB	31	23	34	22	34	10	29	20	15	9	27	16	170	98	58%
WB	60	24	80	20	104	44	139	48	109	40	139	39	631	215	34%
Australia	64	29	90	0	158	0	154	0	147	0	254	147	867	177	20%
Canada	59	38	50	38	75	0	50	32	76	35	113	74	422	217	52%
China			7	1	7	1	7	3	7	3	7	3	35	10	30%
Czech Republic	1	0	1	1	1	1	2	0	2	0	52	1	59	3	5%
France	1	1											1	1	88%
Germany (GTZ)	56	0	46	0	36	0	28	0	47	9	88	16	300	25	8%
Germany (Kfw)	34	0							99	19			133	19	15%
Japan	60	0	59	4	35	4	4	0	2	0	4	0	163	7	5%
Korea					10	10			1	0	21	0	32	10	32%
New Zealand	5	0	5	0	5	2					0	0	14	2	12%
Spain	8	0	10	6	10	8	4	1	1	0	10	0	44	15	34%
Sweden	0	0	1	1	0	0	11	1	11	0	0	0	24	1	6%
U.S	147	147	139	134	390	0	467	250	356	267	313	200	1,813	998	55%
Others	240	102	232	116	174	69	222	149	162	76	273	93	1,303	605	46%
Total	766	364	753	341	1,039	148	1,116	502	1,033	458	1,303	590	6,011	2,403	40%

Loans as of December 2008; grants as of December 2008; Source: NEDA Project Monitoring Staff

Table 3-4. % of disbursement to commitment in loans, 2003-2008, (in million U.S. dollars)

	2003		2004		2005		2006		2007		2008		Total Commitment	Total Disbursement	% of disbursement to commitment
	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement			
Multilateral															
ADB	842	335	1,147	160	1,217	241	1,766	824	1,980	419	1,802	321	8,754	2,299	26%
WB	1,392	200	1,434	138	1,186	126	1,520	133	1,838	370	1,514	197	8,884	1,165	13%
Bilateral															
China	60	5	460	106	460	11	510	63	1,110	100	1,110	16	3,710	301	8%
Japan	6,797	764	6,448	546	6,055	714	4,608	633	3,946	968	4,473	418	32,326	4044	13%
Korea	35	1	70	2	87	1	82	0	153	0	165	37	592	41	7%
Germany	127	12	113	13	143	24	162	37	145	14	90	13	780	113	15%
France	45		36	1	3						240	23	324	24	7%
Austria	171	3	179	12	97	4	49	35	15	0	48	11	558	66	12%
Spain	97	46	84	14	85	12	26	5	26	14	26	3	345	94	27%
Australia	83	17	81	26	67	14							231	58	25%
UK	374		374	54	542	32	588	209	357	46	357		2,592	341	13%
Others	233	41	250	48	229	41	166	26	176	10	212	19	1,266	185	15%
Grand Total	10,172	1,408	10,595	1,094	10,104	1,205	9,477	1,965	9,746	1,941	10,037	1,059	60,131	8,673	14%

Source: NEDA Project Monitoring Staff

Loans as of December 2008; grants as of December 2008

3.3 Scheduled disbursement vs actual disbursement

For the period from 2003 to 2008, the Philippines planned to disburse US$ 10.6 billion but disburse only US$ 8.7 billion, yielding a ratio of 81.7 percent. According to Reyes (1993), the ratio for the period 1986-1988 was 87.5 percent. Based on this indicator, a slight reduction in absorptive capacity can also be observed. Looking at the disbursement performance in 2003, the Philippines achieved 90 percent of the target disbursement of US $1.6 billion. However, it declined sharply to 72 percent in 2004, due to the budgetary issues and the elections during that year. The change in the heads of agencies following the election adversely affected the implementation of ODA projects. It caused delay in contracts and procurement. According to 2004 ODA portfolio review, the changes in the leadership eventually led to the appointment of new project managers of all on-going projects.

One big constraint to aid absorption is procurement delay. The 2004 review pointed out that the procurement period (from the submission of bids to the issuance of the award) takes between 2.5 months to 28 months. The latter is way above the norm of 3.2 months cited in Republic Act 9184. The delay in the procurement affects the timeliness of aid absorption.

On a yearly basis, 80 percent and 87 percent performance were recorded in 2006 and 2007, respectively. In 2008, however, the performance of 77 percent fell short of the target. According to 2008 ODA portfolio review, out of the 14 effective ODA project loans with time elapsed of less than 50 percent, 8 program/projects loans lagged behind schedule. The factors cited by implementing agencies for disbursement rates of below 50 percent were the delays in the procurement and the processing of contracts[32]. Also, limited LGU technical capability constrained implementation of projects.

Looking at the Philippines' absorptive performance for foreign aid between 2003 and 2008 using the two indicators; 1) % of disbursement to commitment 2) % of actual disbursement to scheduled disbursement, the Philippines shows low performance compared to previous period from 1986 to 1988. It may be concluded that there was reduction in the aid absorptive capacity in the Philippines. Next chapter will explain about which factors constrain the aid absorption.

[32] NEDA, ODA portfolio (2008) ,p8.

Table 3-5. Loans aid disbursement ratio: Schedule vs Actual (in million U.S. dollars)

	2003		2004		2005		2006		2007		2008		Total Target disbursement	Total actual disbursement	Disbursement rate
	Target disbursement	Actual disbursement	Target disbursement	Actual disbursement	Target disbursement	Actual disbursement	Target disbursement	Actual disbursement	Target disbursement	Actual disbursement	Target disbursement	Actual disbursement			
ADB	376	335	199	160	282	241	897	824	493	419	326	321	2,573	2,299	89%
WB	270	200	220	138	173	126	212	133	369	370	257	197	1,501	1,165	78%
China	7	5	110	106	13	11	159	63	319	100	165	16	773	301	39%
Japan	803	764	799	546	822	714	893	633	928	968	450	418	4,696	4,044	86%
Korea	2	1	1	2	3	1	2	0	4	0	51	37	64	41	65%
Germany	14	12	55	13	60	24	32	37	31	14	33	13	225	113	50%
France	2		1	1							35	23	38	24	62%
Austria	8	3	15	12	7	4	35	35	3	0	11	11	80	66	83%
Spain	48	46	16	14	12	12		5	13	14	3	3	93	94	101%
Australia	24	17	27	26	9	14							60	58	96%
UK			57	54	21	32	207	209	44	46			328	341	104%
Others	27	24	22	21	30	26	32	26	24	10	42	19	176	127	72%
Total	1,582	1,408	1,522	1,094	1,431	1,205	2,470	1,965	2,229	1,941	1,374	1,059	10,607	8,673	81.7%

Loans as of December 2008; grants as of December 2008

Source: NEDA Project Monitoring Staff

4. The constraints of aid absorption from recipient country

This section attempts to examine the constraints in both recipient country and donor country by looking at (1) the macroeconomic constraints; (2) the institutional and policy constraints; (3) the technical and managerial constraints; and (4) the constraints generated by donor behavior.

4.1 Macroeconomic constraints

A key issue for aid absorption is the overwhelming debt which imposes a large debt service obligation to the recipient country. The Philippines, along with Sri Lanka, India, and Pakistan stands out as the "most vulnerable" in Asia if a financial contagion should take place, given the four countries' high debt levels relative to GDP.[33] The Philippines' total external debt in 2000 stood at US$ 51.2 billion, equivalent to 67.5 percent of GDP. While the amount increased in 2008, it should be noted that its ratio declined to 33 percent. The Philippines spends between 8 to 10 percent of its GDP for debt service every year.

Table 4-1. Selected external debt ratio (in million U.S. dollars)

	Debt Service Burden	External Debt	DSB to GDP ratio (%)	External debt to GDP ratio (%)
2000	6,265	51,206	8.3	67.5
2001	6,530	51,900	9.2	72.9
2002	7,762	53,645	10	69.8
2003	7,948	57,395	10	72.1
2004	7,217	54,846	8.3	63.1
2005	7,624	54,186	7.7	54.8
2006	8,091	53,367	6.9	45.4
2007	7,680	54,938	5.4	38.1
2008	7,365	53,856	4.4	33

Source: BSP

The share of ODA loan to the country's external debt stood at 45 percent as of end of 2008. The average share of ODA over nine-year period from 2000 to 2008 was 44 percent.

[33] Philippines 'most vulnerable' in Asia to European debt contagion, Business mirror, 12 May, 2010 http://businessmirror.com/ph.

The highest level was in 2000 at 49 percent and the lowest level was in 2006 with 38 percent. Most ODA loans were provided by bilateral creditors (see Table 4-2 below). Servicing of maturing ODA loans continues to represent a large portion of the debt burden. The pressure of debt servicing makes countries even more dependent on ODA so the debt burden must be significantly eased in order for aid effectiveness reforms to take root.[34]

Table 4-2. ODA as share of External debt, 2000-2008 (in million U.S. dollars)

	Multilateral	Bilateral	Total	% share of total external debt
2000	9,665	15,336	25,001	49%
2001	9,553	14,531	24,084	46%
2002	8,970	15,621	24,591	46%
2003	9,031	16,895	25,926	45%
2004	8,440	16,800	25,240	46%
2005	7,349	14,282	21,631	40%
2006	7,123	13,400	20,523	38%
2007	7,708	13,709	21,417	40%
2008	8,902	15,418	24,320	45%

Source: BSP

4.2 Institutional and Policy Constraints

4.2.1 Role of National Economic and Development Authority (NEDA)

According to Robert Klitgaard as cited in the article of Bologaita, “Corruption is the result of monopoly plus discretion minus accountability”.

The planning, programming, and use of ODA is coordinated by the NEDA. The NEDA is the Philippines’ highest social and economic development planning and policy coordinating organization. The power and function of the NEDA resides in the NEDA Board, consisting of the President as the Chair, the Secretary of Socio Economic Planning and NEDA Director-General as Vice-chair, and the Executive Secretary and the Secretaries of Finance, Trade and Industry, Agriculture, Environment and Natural Resources, Public Works

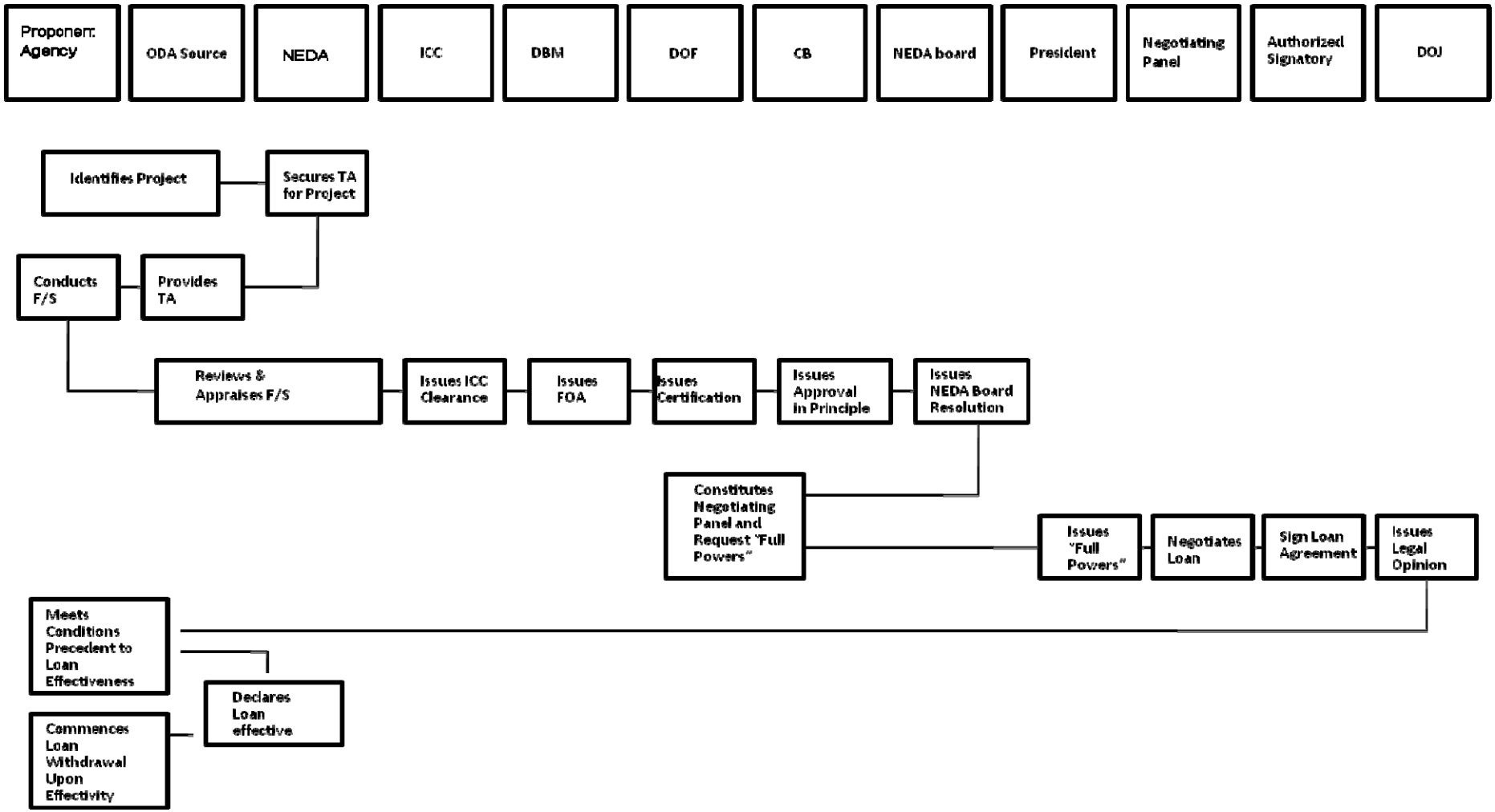
[34] CSO statement on Aid and the Debt Crisis, September 2008, http://betteraid.org.

and Highways, Budget and Management, Labor and Employment, and Interior and Local Government, among others, as members. The assignment of this responsibility to the NEDA Board, chaired by no less than the head of government, is based on the premise that the economic and human development can best be achieved through the active involvement of the country's top political leadership in the allocation of resources, including ODA.[35] The Investment Coordination Committee (ICC) is a cabinet-level committee of the NEDA Board, and has played a pivotal role in ODA resource allocation and programming. The ICC evaluates the monetary and balance of payments implications of the proposed projects and advises the President on matters related to the domestic and foreign borrowing program.[36] The NEDA secretariat provides technical support to the ICC and the NEDA Board in exercising their ODA allocation and programming functions.

Let's look at general flow of ODA loans in the Philippines. After the donors and the Philippines government agencies determine which projects would be implemented, the proposed project goes to the ICC for endorsement. Figure 4.1 shows, the issuance of NEDA Board resolution is the final step towards approval of projects proposed for ODA support.

[35] Leonara S. Garcia and Eden Grace R. Lumilan(2004) , p2.
[36] www.neda.gov.ph.

The Figure 4-1. General Flowchart on ODA Loan Programming



Source: Reyes, 1985

It is worth noting that under the revised implementing rules and regulations of R.A. No. 6957, the local development projects may be submitted to the different local government units depending on the project cost, as follows: i) to the municipal development council for projects costing up to PHP 20 million, ii) to the provincial development council for those costing above PHP 20 million up to PHP 50 million. iii) to the city development council for those costing up to PHP 50 million iv) to the regional development council (in the case of Metro Manila projects, to the regional development council for Metropolitan Manila) for those costing above PHP 50 million up to PHP 200 million. Projects costing above PHP 200 million must be submitted to the ICC.[37]

For national projects, those costing up to PHP 300 million shall be submitted to the ICC for approval, and projects costing more than PHP 300 million shall be submitted to the NEDA board for approval upon the recommendation of the ICC.[38] These regulations mean that the project's endorsement should be carried out by the different agencies depending on the costs. NEDA-ICC exercises the main responsibility for the review and endorsement of major projects for approval of the NEDA Board.

4.2.2 Corruption

Corruption in the programming and the use of ODA has been a major concern. Apart from its impact on the marginal efficiency of investment due to unnecessary cost escalations, corruption directly aggravates the country's ability to absorb aid promptly and effectively. In the 2006 Philippines Development Forum (PDF), the international donor community "urged the government to plug expenditure leakages caused by corruption"[39].

At the project implementation stage, no less than the World Bank called the attention to irregularities that it uncovered in the procurement of goods and services for a package of road projects funded through a World Bank loan. At the project preparation, evaluation, and approval stage, irregularities were similarly uncovered in the case of the National Broadband Network (NBN) project proposed for financing through an ODA loan from China. In particular, whistle-blowers made allegations of attempted pay-offs to the NEDA Director-

[37] Revised Implementing rules and regulations of R.A. NO. 6957, Section 2.7 a.
[38] Revised Implementing rules and regulations of R.A. NO. 6957, Section 2.7 b.
[39] A citizen's report on Official Development Assistance(ODA) to the Philippines(2008), p11.

General, who is the Head of the NEDA Secretariat and Vice-Chair of the NEDA Board. They claimed that mainly due to pay-offs, the estimated project cost increased from the original estimate of $262 million to $329 million. Following those allegations, the President cancelled the signed contract with the Chinese supplier (ZTE). Consequently, the use of the ODA loan from China was aborted.

The NBN-ZTE project was aimed at setting up a nationwide computer and telecom network connecting national government organizations to state corporations, financial institutions and 23,000 barangay Internet centers. This was expected to reduce the government expenditure in telecommunications from P4 billion to P3.6 billion.[40] Apart from the expected financial benefit through savings in telecommunications cost, the project was justified in terms of national security as it envisaged establishment of a new telecommunication backbone for exclusive use of the government.

The NBN project was reportedly approved by the NEDA Board with an endorsement by the ICC. On that basis, a supply contract was signed between the Philippine government's Department of Transportation and Communications (DOTC) with Zhong Xing Telecommunications Equipment Limited (ZTE) of China, designating the latter as the supplier of goods and services for the project. It was considered irregular because a supply contract is normally signed only when the financing has been secured through a loan agreement. In the case of the NBN project, the supply contract was signed even before the loan agreement was signed.[41]

It is worth noting that a private company Amsterdam Holdings Inc (AHI) had earlier proposed a build, operate and transfer (BOT) scheme for the NBN project with an estimated cost of $242 million, which would cover 80 percent of the country.[42] On the other hand, the NBN project for which ZTE was to be the supplier had an original estimated cost of $262 million that would cover only 30 percent of the entire country.

4.2.3 The "Divide-by-N" syndrome

The huge public sector deficits[43] constitute a serious bottleneck to investing in infrastructure which requires high input cost, education, health, and government expenditures

[40] "National broadband network to save RP billions, says DoTC "INQUIRER 07,12,2007.
[41] "NBN revisited: Was the deal under an executive agreement?" INQUIRER, September 16, 2008
[42] "The case of the 'missing' ZTE broadband contract" ,The daily PCIJ, September 11, 2007.
[43] Public investment takes less than 5 % of total GDP since 2002

in general. Between 2003 and 2005, the government's expenditure for transportation is slight, averaging 8.1 % despite an increasing demand.[44] The political-economy reason behind this can be traced from the fact that congressmen have incentives to approve the budget towards local projects of limited significance (local bridge, local irrigation etc.) for potential votes in their districts instead of nationwide project.[45] Medulla called this phenomenon as "Divide-by-N" syndrome, which refer to the mechanical and meaningless dissipation of government funds across localities instead of their rational allocation to where these might have the most impact.

It seems the offshoot of the "Divide-by-N" syndrome affected ODA process. The projects funded by the aid are prone to being geographic dispersed. According to the ODA portfolio review, nationwide ODA projects accounts for only 22.5 % in 2001, and 23.3% in succeeding year among total committed projects. Looking at the transportation share in ODA loans, which supposed to be increased due to underinvestment in public expenditure, has been declining from 50.6% to 42.2% between 2004 and 2006 (Table 4-3). Likewise, the education and manpower development share in the ODA recorded only an average 4.5 % between 2004 and 2006. This has contributed to the Philippines' education quality being ranked 50th among 133 countries.[46]

Table. 4-3 Distribution of total ODA loans

Sector/Sub-sector	2004	2005	2006
Agriculture, Agrian Reform, and Natural Resources	17	17.2	18.3
Industry and service(Tourism, Trade)	5.1	7.6	11
Infrastructure	69.4	65.2	57.5
Transportation	50.6	50.1	42.2
Other Infrastructure	18.8	15.1	15.3
Social Reform and Com. Dev. (Human Development)	8.5	9.9	13
Education and Manpower Development	3.8	3.9	5.8
Health, Population and Nutrition	0.6	3	3.78

[44] http://dbm.maryland.gov

[45] Filep M. medulla, Raul V, Fabella, Emmaneul S, de Dios,(2007), p15

[46] The global competiveness report 2009-2010, Klaus Schwab, World Economic Forum, 2009

Other Social Reform and Com. Dev	4.1	3	3.42
Governance and Institutions Development		0.2	0.23
Total	**100**	**100**	**100**

Source: ODA Portfolio review

4.3 Technical and Managerial constraints

4.3.1 Inadequate estimation of EIRRs

At least 7 in 10 projects funded by ODA loans have failed to deliver their expected benefits and target results, according to a six-month study of the project documents (see Table 4.3) conducted by the Philippine Center for Investigative Journalism.[47] The EIRR is one indicator of economic feasibility of proposed investment projects. The general rule is that a project is economically justifiable and should be endorsed to the NEDA-ICC and NEDA Board approval if its EIRR is 15 percent or higher. If the EIRR is less than 15 percent, the project is considered economically unjustifiable as the rate of return is less than the opportunity cost of capital.

Table 4-4. ODA Projects with EIRR

	DURING APPRAISAL	AFTER COMPLETION
Number of projects with EIRR estimates	62	87
No. of projects with EIRR below 15%	7	29
No. of projects with EIRR equal to or above 15%	55	58
% of projects with EIRR below 15%	11%	33%
% of projects with EIRR equal to or above 15%	89%	67%
No. of projects where change in EIRR after completion is indicated		71
No. of projects with lower EIRR at completion		52
No. of projects with same or higher EIRR at completion		19
% lower		73%
% same or higher		27%

Source: Landingin (2008)

[47] "7 in 10 ODA projects fail to deliver touted benefits", Olongapo City SubicBayNews, 13,02, 2008.

Among the 87 completed projects, only 58 projects or 67 per cent yielded an EIRR of 15 percent or more. In other words, 33 percent did not generate the expected benefit in terms of economic rate of return after completion. In addition, the estimated EIRR of 71 projects was changed between project appraisal and completion. Former NEDA Director General Felipe Medalla explained that in many cases, the estimated benefits were not realized.[48] This suggests either an overestimation of benefits or an underestimation of costs or a combination of both. In some cases, the proponent agencies submit feasibility studies with excessively optimistic estimates of EIRR to justify approval of the project. It is in these cases that the objective and technical evaluation by the NEDA Secretariat of the benefits and costs of a project becomes critically important.

4.3.2 Lack of capacity of Local Government Units (LGUs)

Technical and managerial bottlenecks were encountered by the LGUs in the implementation of projects supported by ODA. A case in point is the Agrarian Reform Communities Development Project of the Department of Agrarian Reform (DAR).

In 2004, only one out of the five approved subprojects was implemented because concerned LGUs were unable to comply with the minimum 50% counterpart contribution.[49] Five LGUs officially withdrew their application. According to the 2008 ODA portfolio review[50], the Pasig river environmental management and rehabilitation sector development program suffered a glitch in the implementation as the concerned LGUs could not commit to provide the required operation and maintenance funds.

The Department of Health reported delays on the part of the LGUs in preparing the equipment specifications and civil work technical requirements, especially for detailed architectural and engineering designs. This is an indication of the need to build LGU capacity for project implementation for timely attainment of project targets. In this connection, many regional offices were reportedly unable to comply with the modified national monitoring and evaluation (M&E) system of NEDA.[51]

[48] Interview with Felipe Medalla, 5. 26, 10:00 am.
[49] NEDA, (2004).
[50] NEDA, (2008), p.27.
[51] ADB (1999).

4.4 Donor's motivation of foreign aid

Although OECD/DAC encourages donors to use ODA for humanitarian purposes, many donor countries see ODA as an instrument for strengthening its "soft power" The term "soft power" is suggested by Harvard Professor Joseph Nye. It is defined as "the ability to shape the preferences of others…. with intangible assets such as an attractive personality, culture, political values and institutions, and policies that are seen as legitimate or having moral authority"[52] Below we examine the three major donor countries' - China, Japan and Korea - motivation of foreign aid to the Philippines.

4.4.1 China

Infrastructure-Driven ODA

China became one of the largest ODA donors in the Philippines, with the acceleration of the Philippines-China economic relations. China disbursed $10 million in grants and $301 million in loans to the Philippines between 2003 and 2008. China's export to the Philippines increased from US$ 1.5 billion to US$ 9.4 billion between 2000 and 2008, while its imports from the Philippines steadily increased from US$ 1.7 billion in 2000 to US$ 23.4 billion in 2008 (Table 4-4).

Table 4-5. China's trade with the Philippines (in million U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Exports to the Philippines	1464	1622	2042	3094	4269	4689	5738	7505	9375
Imports from the Philippines	1677	1945	3217	6306	9059	12870	17676	23129	23363

Source: IMF

In terms of development assistance, the Chinese government provided loans to six projects between 2003 and 2008, accounting for 97 percent of total the Chinese aid, as follows:
(1) the Banaoang Pump Irrigation Project worth US$ 35 million; (2) the General Santos Fish Port Complex Expansion/Improvement Project worth US$25 million; (3) the North rail project, Phase I, Section 1 (Caloocan-Malolos) worth 400 million; (4) the Non-Intrusive Container Inspection System, Phrase I worth US$ 50 million, (5)the Non-Intrusive Container

[52] Nye, (1990).

Inspection System, Phase II; and (6) the North Rail Project, Phase I, Section 2 (Malolos-Clark) worth US$ 500 million. 86 percent of total capital of Chinese loan goes to infrastructure projects.

The most controversial infrastructure project funded by China is the North Rail Project. It aims to provide mass transport services between Metro Manila and Central and Northern Luzon. Commuters travel lanes of the north rail less than 40 minutes. This is the first time that such a mass transport system will be built in the country. The US$ 400 million loans for the North Rail Project Phase 1 Section 1 aims to reconstruct and to convert the existing 32.2 km single track line into a double track between Caloocan City up to Malolos City in Bulacan. The North Rail Project Phase 1 Section 2, on the other hand, is a 48-km, double track line between Malolos City to Clark, Pampanga. In terms of financing side, 79 percent of Section 1 was financed by China and remaining is from commercial borrowings. The attractive conditions of the lending terms are the unprecedented 3 % annual interest rate, the five-year grace period, and the 20-year maturity. However, critics insisted that the North Railway Phase 1 Section 1, which costs $503 million is overpriced excluding resettlement cost of dwellers living along with railroad. According to PCIJ's report,[53] there are 40,000 families which are twice the population of San Juan, Metro Manila living around the rail road. The relocation cost of these families is expected to be at least P6.6 billion ($11.8 billion) and the $503 million cost of the railway will probably be the most expensive railway in the world.

The North Luzon Railway Corporation manages this project while the China National Machinery and Equipment Corporation Group (CNMEG) is the main contractor from China. Critics argued that CNMEG was chosen without competitive public bidding which violates Philippines laws, particularly the Republic Act No. 9184 - Government Procurement Reform Act[54] Critics also noticed that in the case of the North Railway project, the required feasibility study which is usually conducted by NEDA was done by CNMEG. Consequently, the North Rail officials had agreed on a supply agreement with CNMEG that lacked detailed technical specifications and a bill of quantities.[55] In addition, a Chinese firm has the power to determine requirements for the project which involves request like asking for unnecessary funds to the government.

[53]Nightmare at North Rail", Philippines Center for Investigative Journalism, 2005.
[54] Tadem, (2007) p41.
[55] Landingin, (2010) p89.

Natural Resources

China's assistance is viewed as an approach to access natural resources from the recipient countries in Southeast Asia. In Myanmar, China has been the largest source of economic assistance which includes the $1.4 billion to $2 billion worth of weaponry to the ruling junta since 1988 and with pledges of nearly $5 billion in loans, plants and equipment, hydro power and oil and gas production.[56] China's huge aid becomes vital to Myanmar especially after the US trade sanctions in 2003. In 2007, Asia Times reported that a construction of the China-Myanmar oil pipeline is expected to begin. The pipeline would be used as an alternative route for China's crude-oil imports from the Middle East and Africa. Myanmar, in return, will get a loan of $83 million from the Chinese government to tap its oil resources.[57]

During 2004, the Philippines and China had signed the Joint Marine Seismic Undertaking (JMSU) agreement. A year later, Vietnam joined the agreement to conduct research on potential petroleum resource as a pre-exploration research. According to the JMSU agreement, representative state-owned oil company can conduct research for three years covering 142,886 square kilometers in South China Sea including the Spratlys. The Spratlys is a disputed area where the Philippines, China, Vietnam, Malaysia, Taiwan and Brunei claim whole or part of the Spratlys are theirs. To ease tensions among those conflicted countries surrounding the Spratlys, ASEAN-China agreed on the Declaration on the Conduct of Parties in the South China Sea in 2002.

The JMSU covered area is 80 percent of the Kalayaan group of islands which is being claimed by the Philippines, including Spratly Islands, just 700 kilometers off Palawan.[58] South China Sea including the Spratly Islands is estimated to have abundant oil and gas. As part of the JMSU, the Philippines is allowing China or any other country to explore the Philippines' territorial waters and resources. According to the ABS-CBN News (2008) the JMSU deal was signed in Beijing during President Arroyo's state visit on September 2004.[59] During her visit, the supplemental memorandum of understanding between North Luzon Railways Cooperation was also signed. After these understandings

[56] Lum, Morrison, Vaughn (2008), p6.
[57] "China-Myanmar pipeline projects on track "Asia Times, Apr 24, 2007.
[58] "Stirrings over Spratlys Alecks P. Pabico", the DAILY PIIJ ,March 10, 2008.
[59] a policy of betrayal (second of threeparts) ABS-CNN NEWS, 17, Mar, 08.

between the Philippines and the China, the Philippines news agency suspects that JMSU could be a "*quid pro quo*", exchange between investment in Philippines projects and JMSU.[60]

4.4.2 Japan

Strengthening Security

Japan disburses a portion of its development assistance to enhance its security matters. The Article 9 of the Japanese constitution stipulates that Japan "renounces war as a sovereign right of the nation and the use of force as means of settling international disputes". The constitutional limitation on military spending allows ODA as a useful tool for international diplomacy. The Cold War placed Japan under the pressure of the United States to increase more aid to third countries in order to mobilize more ODA support to Third World countries needing to defend themselves from the Communist bloc.[61] Japan committed itself to assist Pakistan and Egypt, which were old allies of the United States. Japanese government was willing to cooperate with the United States in increasing the share of burden for economic recovery of the Philippines.[62] The reason is a sense of guilt for the damages caused by Japanese military during World War II. Therefore, in this case Japanese ODA was driven by political motivation to security interest.

A new 2003 ODA charter[63] shows how Japan reflects its security priority on ODA policies. The new charter states that the objectives of Japanese ODA are to contribute to the peace and development of the international community and to help ensure Japan's own security and prosperity first. Japan's Prime Minister Koizumi announced an initiative for nation-building and consolidation of peace as new orientation for Japanese aid policies and diplomacy in 2002 at a policy speech in Sydney.[64] The Japanese Self-Defense Forces dispatched for humanitarian and reconstruction assistance in Iraq reflects Japan's new security agenda. Notable current movement of the Japanese ODA is that Japan has increased its ODA allotment to conflict resolution programs, and has supported security and humanitarian assistance in several countries including East Timor, Aceh, Sri Lanka,

[60] "Arroyo hit on spratlys deals", Inquirer Head lines, 2008,03,07, "stirrings over spratlys ", the daily pcij , 2008 3.10, "A policy of betrayal" abc-cbn news.
[61] Sunaga, (2004), p9.
[62] Takahashi, (1990), p14.
[63] An ODA charter was formulated in 1992 to suggest principle of aid and it is renewed in 2003.
[64] See: Speech by Prime Minister Junichiro Koizumi (2002).

Afghanistan, Mindanao in the Philippines and Iraq.[65] Japanese assistance for Mindanao started since the 1996 peace agreement. Japan has implemented 137 projects totaling 270 billion yen (approximately 2.5 billion dollars) to Mindanao in all the provinces in Mindanao.[66] Reflecting the revised ODA charter, Japan actually makes an effort to support peace building. Japan regards its ODA to Mindanao as prevention to potential conflicts and as a support to consolidate peace not only in the Philippines, but also in Asia.

Mercantilism

Japan was the largest donor in the Philippines between 2003 and 2008 as it disbursed US$ 4051 million of loans. The share of loans disbursement is 99.8 percent while the grant takes only 0.2 percent. The large loan component in Japan's ODA is criticized by DAC donor countries. Critics argue that Japan focuses more on its economic interest rather than on the development of its recipient country. Katada (2005) explained that Japan's business interests clearly dominated Japanese foreign aid. Also, Katada noted that the Japanese government advanced its own interests in terms of asking for contracts to include Japan's companies and to give Japan access to the recipients' export markets and natural resources. Meanwhile, in times of recession, Japanese required its ODA to be in line with its national interest. According to a poll conducted by Japan's cabinet office in 2003,[67] the percentage of people having a positive attitude toward ODA dropped from 43.2% in 1990 to 19.0%, while those who favored a reduction in ODA increased from 10.7% to 25.5 %. As an explanation, 74.4% of those who responded negatively to ODA referred to Japan's sluggish economic conditions.[68] The public perception on Japan's ODA is that its ODA is only implemented toward national interest. Principal contractors under Japan's ODA loan confirms that Japanese companies benefited from its assistance to its recipient countries (Table 4-5).

[65] Palanovics, (2006), p376.
[66] http://www.ph.emb-japan.go.jp/bilateral/oda/mindanao.htm.
[67] Cabinet office, "Gaiko ni kansuru seronnchousa"(Public opinion survey on diplomacy) http://www.cao.go.jp.
[68] Kazuo Sunaga, 2004, p4.

Table 4-6. Principal contractors under ODA Loans

Project Name	Year of approval	In Million ¥	Goods and Services
Metro Cebu development project(III) (Cebu south coastal road)	1995	4,487	Japan
Northern Negros geothermal project	1997	7,086	Japan
Second Mandaue-Mactan Bridge and Metro Cebu road project	1997	1,953	Japan
Selected airports development project(phase I)	1998	9,193	Japan
Kmanaba area flood control & drainage system improvement project	2000	8,027	Japan
Mindanao container terminal project	2000	7,045	Japan
Subic Bay port development project	2000	11,251	Japan
LRT Line1 capacity expansion project (Phase II)	2000	19,781	Japan
Second Magsaysay Bridge and Butuan city bypass road construction project	2000	3,846	Japan
New lloilo airport development project	2000	14,353	Japan
The Laoag river basin flood control and sabo project	2001	4,046	Japan
Subic Clark Tarlac expressway project	2001	28,861	Japan
Urgent bridge construction project for rural development	2002	11,711	Japan
Total contracted (13)		131,640	
Metro Manila strategiec mass rail transit development project (II),(III)	1997	21,823	Japan, ROK
Luzon grid transmission project associated with private power project	1997	3,767	Japan, France
Metro Manila flood control project-west of mangahan	1997	7,222	Japan, ROK
Lower Agusan development project	1997	3,132	China, Japan
Agno River flood control project (Phase II)	1998	2,694	ROK, Japan, RP
Arterial road link development project (Phase III)	1998	11,493	RP, Japan, ROK
Metro Manila interchange construction project (Phase IV)	1998	3,559	China, Japan
Batangas Port Development Project	1998	6,507	RP, Japan
Central Luzon irrigation project	1998	4,921	Japan, China
Bohol irrigation project (Phase II)	1999	4,439	Japan, ROK
Arterial road link development project(Phase IV)	1999	11,252	China, Thailand,

			RP, japan, ROK
Metro Manila interchange construction project (Phase V)	2001	1,026	RP, Japan
Arterial road links development project (Phase VI)	2002	7,573	Japan, China, RP
Jointly contracted (13)		89,408	
Rural road network development project (II)	1995	3,398	ROK, China
Philippine-Japan friendship highway Mindanao section rehabilitation project (I)	1997	2,798	RP
Leyte-Bohol interconnection project	1997	1,696	China
Metro Irrigation regional infrastructure development project	1998	2,047	ROK
Pinatubo hazard urgent mitigation project (Phase II)	1999	2,017	China
Rehabilitation and Maintenance of bridge project (Phase IV)	1999	18,230	ROK
Philippine-Japan friendship highway Mindanao (Phase II)	1999	7,087	ROK, China
Cordillera Road Improvement Project	1999	4,376	China, RP
Sustainable environmental management project in Northern Palawan	2001	1,718	RP
Arterial road links development project (Phase V)	2001	5,669	Thailand, China
Agno river flood control project (Phase II-B)	2001	1,816	RP
Rural road network development project (Phase III)	2001	1,659	ROK
Help for catubig agricultural advancement project	2001	2,034	ROK
Bago river irrigation system rehab and improv project	2002	1,459	China
Iloilo flood control project(II)	2002	3,455	RP, China
Totally other country contracted (15)		59,459	
Total project: 41		280.507	

Source of basic data: Japan Bank for International Cooperation

Table 4-6 shows that out of 41 Japan ODA-funded projects from 1995 to 2002, 13 (32 percent) were totally contracted by Japanese firms, 13 (32 percent) were jointly contracted with Japanese and other countries firms, and 15 (36 percent) were totally contracted by other country's firms. In terms of loan amounts which totaled to ￥million 280507, ￥131640 million (47 percent) was totally contracted by Japan, ￥89408 million (32 percent) was jointly contracted with Japan, and only ￥59459 million (21 percent) was

totally contracted by other country's contractor. Japanese businesses are actively involved in Japanese funded ODA that is why critics state that Japan's ODA is closely related in increasing its economic performance.

Table 4-7. Summary of contractions of JBIC loans to Philippines, 1995-2002

Status	No. of project	%share	Loan amount	% share
Totally Japan contracted	13	32	131,640	47
Jointly Japan contracted	13	32	89,408	32
Totally other country' contracted	15	36	59,459	21
Total	41	100	280,507	100

4.3.3 Korea

Korea is one of the few countries which transformed from being a recipient country to a donor country successfully. Korea is an emerging donor country that joined the OECD/DAC in 2010. As Korea's commitment to ODA increases rapidly, Korea recognizes the need to reform its ODA as a member of DAC. In terms of aid type, Korean bilateral aid is higher than its multilateral aid. Bilateral aid takes almost 70 percent of the total ODA of the recipient countries (Table 4-7). In the Philippines, Korea already disbursed $41million loans with 80 percent of total aid given between 2003 and 2008. This shows that Korea tries to highlight its 'Korean commitment' to ODA rather than supporting aid through multilateral aid only. Korea wants to 'fly the flag' or 'show face' through its aid assistance.[69]

Table 4-8. Korea's net ODA disbursement, current prices (in million U.S. dollars)

	2003	2004	2005	2006	2007	2008
Bilateral ODA	245	331	463	376	491	539
Multilateral ODA	121	93	289	79	206	263
TOTAL ODA	**366**	**423**	**752**	**455**	**696**	**802**

Source: OECD/DAC

[69] Kawai et al (2001).

Korea favors giving aid to trade partners or potential Korean market where Korea's business interests' lies rather than giving aid to least developed countries (source?). This is evident from the fact that the top aid receiving countries are also the top trading partners of Korea, and not the least develop countries. It is clear that Korea's official loans are targeted more towards countries such as Indonesia, Sri Lanka, Vietnam, and the Philippines, which are Korea's biggest trade partners (Table 4-10).

Table 4-9. Economic Development Cooperation Fund Disbursement (KRW millions)

	2003	2004	2005	2006	2007	2008	Total
China	155,447	179,819	197,101	203,465	209,873	217,186	1,162,891
Indonesia	133,179	145,799	152,225	153,229	166,880	180,554	931,866
Sri Lanka	108,384	115,631	133,517	152,227	176,485	194,194	880,438
Vietnam	106,455	132,499	139,090	140,825	142,726	193,198	854,793
Bangladesh	48,517	73,392	104,846	122,393	124,598	125,024	598,770
Romania	80,884	80,884	80,884	80,884	80,884	80,884	485,304
Cambodia	35,563	58,385	69,817	76,008	98,903	122,497	461,173
Myanmar	62,186	64,047	70,336	76,839	76,839	12,399	362,646
Ghana	29,653	46,843	60,597	60,597	60,597	60,597	318,884
Uzbekistan	50,931	50,931	50,931	50,979	50,979	50,979	305,730
Poland	38,173	38,173	38,173	38,173	38,173	38,173	229,038
Mongolia	35,839	35,839	35,839	35,839	39,252	40,393	223,001
Philippines	22,534	24,971	28,420	28,979	48,249	66,673	219,826

Source: Korea Exim Bank

Also, it is apparent in Table 4-9, that these same trade partner countries (Indonesia, Vietnam, Sri Lanka and Philippines) are the top grant recipients of Korea International Cooperation Agency (KOICA), with the exception of Iraq and Afghanistan . In terms of trade balance value from 2003 to 2008 Indonesia ranked 11^{th,} the Philippines ranked 22nd, and Vietnam ranked 26th. The Korean ODA increases as trade volume among the three countries namely Indonesia, Vietnam and the Philippines increases (Table 4-10). Therefore, Korean

'economic cooperation' dominates ODA policy rather than 'development cooperation'.[70]

Table 4-10. KOICA'S Top 10 recipient countries in ODA (KRW millions)

	2003	2004	2005	2006	2007	2008	Total
Iraq	48,351	68,776	75,624	46,057	43,333	7,147	289,288
Indonesia	3,114	7,491	9,531	16,865	10,893	10,518	58,412
Afghanistan	25,140	19,892	3,393	2,013	2,419	4,233	57,090
Vietnam	4,189	11,205	9,515	7,523	11,060	11,061	54,553
Sri Lanka	1,719	1,919	12,576	6,533	12,626	10,690	46,063
Cambodia	2,789	3,824	5,955	6,047	8,075	14,556	41,246
Philippines	7,108	7,286	5,182	6,348	5,358	9,939	41,221
Peru	2,475	3,385	2,790	4,152	9,503	10,013	32,318
Laos	2,417	3,867	2,170	4,054	6,567	9,393	28,468
Mongolia	2,069	2,058	2,850	2,911	5,546	12,865	28,299

Source: KOICA

Table 4-11. Trade balance value of Korea's major trade partner (in million U.S. dollars)

	2003	2004	2005	2006	2007	2008
Indonesia	8,590	10,046	13,230	13,722	14,884	19,254
Vietnam	3,072	3,929	4,126	4,852	7,152	9,842
Philippines	4,939	5,499	5,536	6,117	6,859	8,116

Source: Korea International Trade Association

Korea's Economic Development Cooperation Fund (EDCF) strategic plan for 2006-2009[71] includes strengthening of Korea's economic cooperation with Asian countries that are members of Korea-ASEAN Free Trade Agreement like Vietnam, Indonesia, and the Philippines. Also, Korea should assist emerging markets and low income resource rich country to maximize aid efficiency based on limited budget. Korea sees ODA as a tool to support Korean business expansion to recipient country within economic cooperation relationship.

[70] Hyuk Sang Sohn, Jeongho Choi (2008), p 161.
[71] Ministry of Strategy and Finance (2006), p9.

As Korean ODA's purpose mentions,[72] Korea should implement ODA for poverty reduction and sustainable development in international community utilizing Korea's own development experience which is one of Korea's outstanding assets.

5. Summary of research findings

The Philippines has been availing itself of ODA for over five decades. ODA had played a pivotal role in the recovery of the economy following the Second World War. It has been and continues to be an important source of development finance, with a low interest rate and long term repayment period compared to private sources. Indeed, it has played a key role in closing the domestic resource gap and the foreign exchange gap.

Data has shown that the Philippine economy has increasingly been relying on factor (particularly labor) income from abroad, more widely known as OFW remittances, in closing the domestic resource and foreign exchange gap. It seems that the traditional role of ODA of reducing the resource gap and the foreign exchange gap has been replaced by OFW remittances.

In this paper, we have evaluated the Philippines absorptive capacity for aid for the period 2003-2008. We have also identified the constraints to Philippines aid absorption.

The Philippines continues to suffer from lack of infrastructure facilities partly due to allocation of budgetary resources based on political considerations. As ODA proceeds become part of total budgetary resources in practice, any misallocation of the latter effectively becomes a misallocation of the former. Despite a need for essential infrastructure projects, e.g. national level mass transportation, considerable budgetary resources are allocated based on project preferences of politicians in their respective districts rather than on needs from a national perspective.

These political considerations in the allocation of budgetary resources, which includes ODA proceeds, have affected the country's capacity for aid absorption. The Philippines' absorptive capacity for foreign aid declined from the period 1986 to 1988 to the period 2003 to 2008. During the latter period, the Philippines disbursed only 16.7 percent of committed ODA and 81.7 percent of the scheduled disbursement. The Philippines ability to meet scheduled disbursements of ODA has been decreasing.

The problems associated with aid absorption arise from both the recipient and the

[72] www.odakorea.go.kr.

donor community. A huge debt burden, including ODA loan repayments, has diverted financial resources that would otherwise be available for critically important infrastructure and social services projects. Every year, the Philippines spends 8 to 10 percent of GDP for debt service.

Based on the highly publicized National Broadband Network project to be funded by a Chinese ODA loan, there is evidence of corruption even at the project preparation stage. Additional project cost arising from pay-offs can be minimized by introducing more transparent procedures in the project preparation and evaluation process.

In many cases, estimated benefits from projects funded by ODA were not realized even as they suffered cost overruns. A weak point in the project preparation process is overestimation of benefits and underestimation of costs.

Donor's motivation in giving aid is another main determinant of aid absorptive capacity. Some donors expect direct and short-term political and economic benefits from ODA rather than long-term development of the recipient country. Donor's desire to protect its security, commercial and natural resource interests can be cited.

China has become one of the largest donors providing concessional loans to the Philippines. Designating Chinese company as a contractor without public bidding made the North Rail project the most expensive rail project in the world.

The Philippines traditional largest donor, Japan, has used ODA to promote Japanese business in recipient countries. Japanese companies gain benefits from ODA project by participating as main contractors. More recently, Japanese ODA is used to support conflict resolution and peace consolidation project for Japans' security in line with a new ODA charter.

Korea is an emerging donor joining OECD/DAC in 2010. Korea's priority recipients are its major trading partners like Indonesia, Vietnam, and the Philippines. Korea's ODA policy is to support recipient country's social welfare and economic development.

5.1. Policy implications and concluding comments

The Paris Declaration stresses that partnership between recipient and donor should be strengthened to increase aid effectiveness. As a recipient country, it is recommended that the Philippines prepare and implement a country-owned strategic plan for ODA. Priority

ODA agenda should be in the context of Medium-Term Philippines Development Plan (MTPDP) and Medium-Term Philippine Investment Program (MTPIP). A national mass transportation system and Conditional Cash Transfer (CCT) enabling poor families to send their children to school, with adequate budgetary allocation, would be good example of ODA projects.

The Philippines should actively participate in consultative meetings with major donors to discuss programming of ODA from different bilateral and multilateral sources. In turn, donors should be sensitive to "real development needs" of the Philippines during those meetings. The Philippines and the donor community should share and establish a common aid strategy at joint meetings or pledging conferences in the context of the Philippine Development Forum (PDF).

The Philippines should endeavor to combat corruption and establish more transparent ODA programming, evaluation and approval procedures. In response, donors should reorient their motivation towards sustainable and equitable development of the recipient country. Increasing ODA absorptive capacity can be attained only through joint action by both recipient and donor.

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