

PHILIPPINES

Rural Development Sector Strategic Priorities



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East Asia and the Pacific Region
Rural Development and Natural Resources Sector Unit

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Strategic Priorities

STRATEGIC PRIORITIES

The World Bank's (the Bank) Country Assistance Strategy endorses the Philippine Governments' (the Government) medium-term strategy¹ for rural development, which emphasizes economic growth with social inclusion. In line with these goals, the guiding principles of an effective rural development (RD) strategy in the Philippines needs to focus on reducing poverty through maximizing the positive aspects of growth while, at the same time, ensuring that the possible negative costs of attaining it are minimized. The positive streams of growth will come from production, higher factor productivity and greater value addition in the sector, all in which significant gaps still exist. Meanwhile, the negative streams are the costs of using (*mis*-managing) natural resources in attaining growth and the level of negative growth impact brought about by such mismanagement on the environment. The overall balance would also be influenced by how successful the Bank is in working with Government to reduce the imputed costs of the continued distortions in factor markets, principally land, and prices through continued subsidies. These distortions and uncertainties have for long been negatively impacting on investment, which has led to significant resource mis-allocation; significantly eroding the competitiveness base of Philippine agriculture. Clearly, if the benefits from higher growth in the short-term are outweighed by the costs in mismanagement of factors of production, natural resources and the environment in the longer term, then their social and economic impact on society would be significantly compromised or indeed even be negative.

On another level, growth efforts in the Philippines are being considerably compromised by misallocation of public finances as budgets continue to fund unproductive expenditures at the expense of prioritized development spending².

¹ Government Development Strategies for all sectors are outlined in The Medium Term Philippine Development Plan (MTPDP) 2004-2010) and accompanying Medium Term Investment Plan (MTPIP).

² In RD Departments over 90-95% of appropriated budgets are on personnel costs alone, with very little on operations and capital outlay.

The strategic priorities for the Bank, therefore, would be to support medium-term Government goals, outlined in the MTPDP, aimed at enhancing public and private investment in agriculture, enhancing **productivity** and **agribusiness**, completing **asset reform** expediently, **strengthening** responsible **management of natural resources and the environment**, **rationalizing public expenditure and civil service**, and **developing Mindanao** as a key agricultural and export area. The related thrusts are:

A. Support to Investment in Agriculture. In supporting a more conducive investment climate in agriculture, the priorities are: (i) increasing the stock of rural infrastructure, (ii) enhancing productivity and production, (iii) expediting the completion of agrarian (land) reform; and (iv) implementing governance reforms to reduce agricultural policy, price and market distortions.

(i) Rural Infrastructure: Compared to most countries, the Philippines has a comparatively complex and costly transport system, given its island-based economy. The state of infrastructure is also poor due to significant long-term underinvestment. Less than 50 percent of roads is all-weather and many of the feeder roads are in poor condition due to substandard construction and inadequate maintenance. In rural areas, primary economic growth will be highly dependent on reliable road and water transport, which links producers with markets and irrigation, which reduces risks and raises productivity. In rural infrastructure development, the investment priorities are: (i) increased investments in linking production areas to major markets through the construction of farm-to-market roads, expansion of shipping services, and use of roll-on/roll-off facilities; (ii) encouraging construction and repair of post-harvest facilities by the private sector; and (iii) construction of regional and municipal fish port complexes.

(ii) Productivity, Production and Agri Business. Both land and labor productivity in the Philippines

is lower compared to most countries in the region. Moreover, over the last two decades, the country has steadily been losing competitiveness in agriculture, the share of which in gross domestic product (GDP) has declined appreciably. In recognition of these trends, the Government has highlighted the following interventions in the medium term: (a) expansion of agricultural areas and transformation of idle lands; (b) raising of factor productivity; and (c) development of Mindanao as the country's main agro-fishery export zone. The related focus would be on: (a) promoting high value and export crops; (b) expanding market services; (c) enhancing public/private partnership to make the public sector more responsive to enterprise; and (d) promoting off- and non-farm enterprises.

(iii) Land Reform. Coupled with capital and labor, land is the third crucial factor of production in rural growth. It is also the principal asset in rural areas. The regulations, principles, and signals that govern land use ultimately determine investor confidence, and land's productivity and contribution to growth. The longer distortions and uncertainties in asset valuation, property rights and efficient land markets are allowed to persist, the higher the cost to the economy in terms of competitiveness and growth forgone, as investors shy away. The key challenges facing the Government in addressing land reform are: (a) the substantial funding gap for completing and consolidating land reform; (b) the decline in public lands for future re-distribution; (c) the slow resolution of existing land disputes, coupled with the lack of property rights involving multiple fake and bad land titles; (d) cumbersome property and land valuation processes involving multiple methods and differing, non standardized systems with little coordination; (e) legislative obstacles that deter the use of distributed land as collateral; and (f) poor delivery of support services to complement land distribution. In the medium-term plan the Government has prioritized the following: (a) completing land distribution; (b) fast tracking support services to agrarian reform beneficiaries, particularly in high potential agricultural areas; (c) expediting the passage of the Farmland as Collateral bill; (d) fast tracking mediation and resolution of land disputes;

and (v) improving land tenure security through improved titling processes.

(iv) Governance Reforms: Significant price and market distortions persist in agricultural commodities due to continued government intervention in licensing and regulating in the industry and subsidizing inputs to producers. The impact of such interventions has led to higher prices for consumers, upward pressures on wages, and significant misallocation of resources. Various studies show that rice protection keeps the price higher than in other countries and that the government spends at least 20 percent of its agricultural allocation on rice price stabilization, despite it only benefiting 3 percent of rice farmers. This protectionism, in turn, exerts upward pressure on wages and reduces the country's competitiveness in labour. In addition, high prices of corn and sugar act as a disincentive to the animal feed, livestock rearing and sugar based industries. Generally, protection limits diversification as investments are misallocated to less-profitable protected commodities rather than those that have higher market potential. A number of recommendations are advocated to improve competition and reduce the negative impact of protectionism, including: (i) further liberalization on agricultural commodities - rice, sugar, corn; (ii) the removal of quantitative restrictions on rice imports, the tariffication of rice, and further liberalization of the rice import market involving the private sector; (iv) reduction of government's role in commodity markets; and (v) phasing out of input subsidies under various commodity programs.

B. Support to Environment and Natural Resource Management. Inadequate regard for the implementation of sound environment and natural resource (ENR) measures and for safeguarding the economy from excessive environmental costs has already eroded resource inventories and can seriously compromise short-term economic growth by larger, longer-term costs. In addition to direct resource costs, in the form of degraded resource base, this mismanagement of ENR will result in a lag in investor confidence, as pollution health and congestion costs increase and negatively impact sectors such as tourism. The cost of cleaning up after irresponsible industries will also fall on Government. Consequently, continued ENR mismanagement constitutes

a major cost impediment to long-term sustainable growth.

Past failures in ENR management include an open access policy encouraging over-exploitation, weak property rights and NR management authority, slow devolution toward community and local responsibility for ENR management (ENRM), weak transparency and accountability in ENRM and relatively low priority given to ENR in overall public expenditure. To redress these failures, the Bank needs to partner with the Government in: (i) establishing a sound and efficient institutional basis for ENRM based on a watershed and ecosystem approach, including a management and institutional review and overhaul of the Department of Environment and Natural Resources (DENR) to improve service delivery, rationalize expenditures and prioritize functions; (ii) supporting the DENR to more effectively devolve local responsibility for ENRM to local governments and other partners; and (iii) streamlining the policy and legal framework for ENRM to improve efficiency. The Bank will also need to support priority thrusts in the Medium-Term Philippine Development Plan (MTPDP), including: (i) the promotion of responsible mining³; (ii) protection of vulnerable and ecologically fragile areas; (iii) pollution control; and (iv) disaster risk management.

C. Support to Public Sector Management for Growth. Public resource availability to finance public expenditure in the medium term is saddled with critical constraints that will have to be addressed if the volume, allocative efficiency, and management of public financing is to be improved meaningfully to underpin effective public/private partnerships. These constraints include: (i) a weak fiscal climate; (ii) poor efficiency in public expenditure management; and (iii) poor linkage among public sector policy, planning and budgeting. In most agencies, this deterioration in public finances has led to significant declines in real budgets, allocative efficiencies and service delivery. Critically, public expenditure on items that create and sustain growth, those on operations and capital outlay,

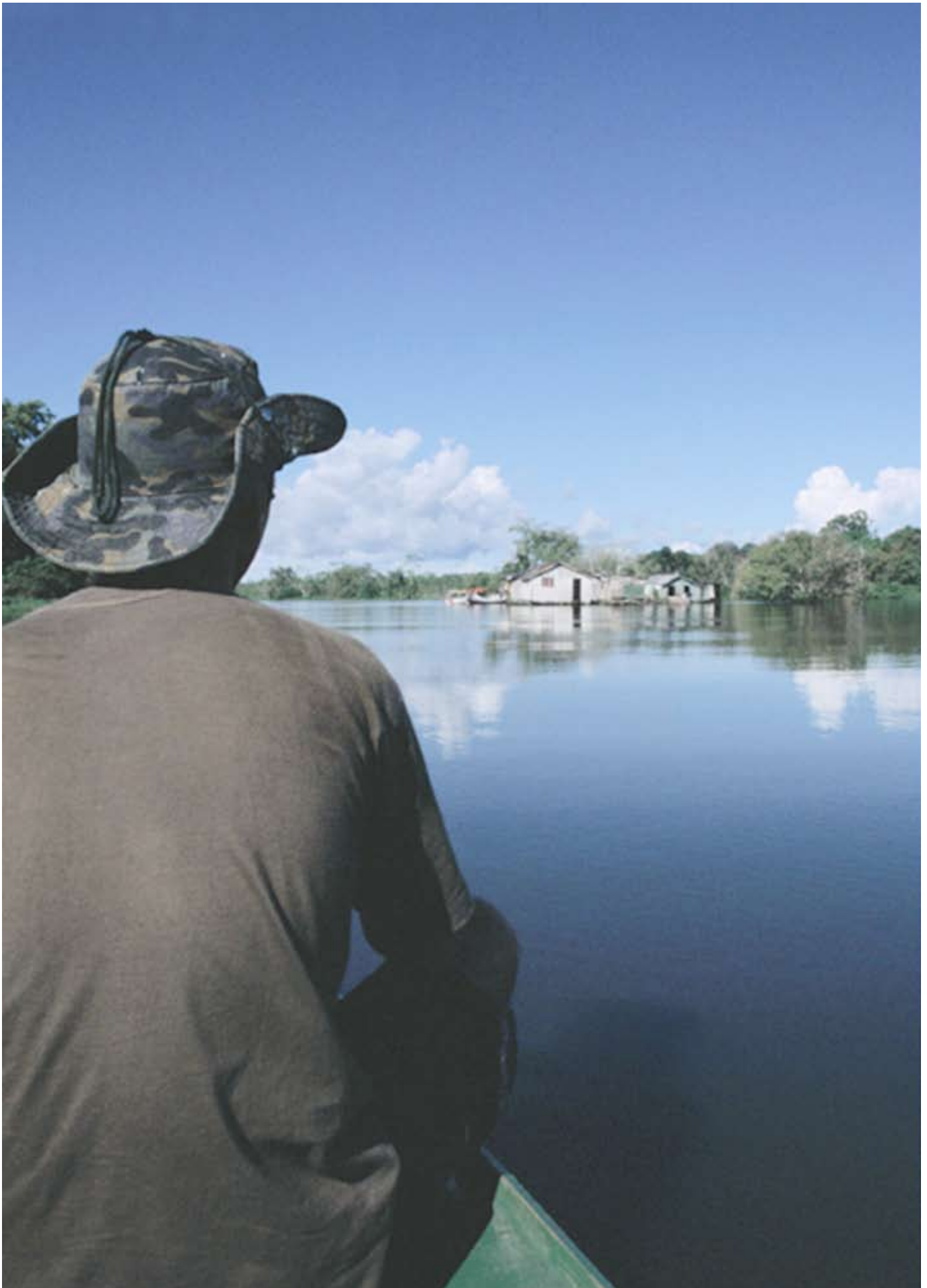
³ Given the potential economic importance of mining, Government has set a high priority to the sector in future growth.

falls far short of needs, as well as that spent on personnel. To address these weaknesses in public finance, Government will need to focus on providing strategic public goods in line with recognized priorities and on reducing the public sector wage bill through rationalization to increase the share of non-wage expenditure. In agriculture, public expenditure needs to be more narrowly focused on growth-enhancing public goods and services and on phasing out non-growth-enhancing expenditure, i.e. rice price stabilization and input subsidies. Moreover, challenges remain in the implementation of the Local Government Code (LGC), which was intended to give implementation responsibility for most of the activities important for RD to local government units (LGUs) through decentralization. Despite the passage of the law, a large budget for these activities is still allocated to National Government Agencies such as the Department of Agriculture (DA). There is therefore a need for bringing greater synergy and partnership between national and local governments. This is at the core of Bank-supported DA programs, the Mindanao Rural Development Project (MRDP) and the Diversified Farm Income and Market Development Project (DFIMDP). Expenditure management and service delivery also needs vast improvement and coordination between planning and budgeting by moving towards functional budgets and away from the commodity-based structure, to enhance the convergence of resources in RD institutions and eliminate functional duplication. In the short-term, the actions that are required toward these ends comprise strengthening the linkage between planning and budgeting within each agency in line with major final outputs (MFOs) and the further simplification of reporting systems. In the medium-term, budget control needs to be decentralized away from agencies to LGUs, as capacity and accountability improve. Ways must also be found to make levels of LGU financing proportionate to devolved responsibilities. In the longer term, a holistic public investment plan would require that sector representation would participate in the budget setting process. The MTPDP thrusts for expenditure rationalization include: (i) rationalizing expenditure in scope and function; (ii) prioritizing expenditure on high-impact areas; (iii) reversing the decline in public investment for capital stock; (iv)

prioritizing capital expenditures for infrastructure and agribusiness; (v) rationalizing National Government spending for devolved services; (vi) strengthening planning and budgeting in RD; and (v) implementing critical governance reforms to reduce policy and price distortions.

D. Support to Development in Mindanao. Rural development in Mindanao suffers the same sector issues as the rest of the country, with the additional constraint of an unstable peace and order situation in some parts of the island. Mindanao has a high poverty incidence, a predominantly rural phenomenon with a rural poverty incidence of 37 percent compared to an urban poverty incidence of 12 percent in 2000. The Bank's poverty assessment in 2000

concluded that the underlying causes of poverty on the island are still the heavy dependence on agriculture, the lack of adequate social safety net, and the lack of educational achievement. This situation has changed little and rural poverty remains significant, with agricultural yields and benefits remaining low, despite the recognized potential of the region for agricultural production. Food security is still an issue, and basic rural infrastructure to open up markets for improved access for products and production inputs are still very limited. Land tenure security remains an issue, which has led to limited investments on the land. The challenge to sustainable rural development for Mindanao will therefore be to generate enough equitable growth that would add to stabilizing the peace and order situation.





Opportunities for Further Analytical Work

OPPORTUNITIES FOR FURTHER ANALYTICAL WORK

The Philippines has a rich source of analytical work in rural development in key areas of agricultural production/productivity and competitiveness, environment and natural resource governance and management, land and asset reform, and public expenditure management. Therefore, moving beyond strategy development toward the operationalization of recommendations in rural development will not necessarily require additional major studies. It does, however, require that more effort is expended in rendering operational recommendations in existing studies, while supporting the Government in taking difficult policy and legal decisions to improve growth with equity. In addition, good lessons need to be adequately captured for replication, as well as to increase implemen-

tation success in selected priority areas. Any future analytical activities in the sector need to start from the premise that relatively limited analysis is needed over that already existing. Instead, these analyses need to find the incomplete areas, work to complete these, and then include the results from the studies in the Line Agency's Annual Implementation Plans. This requires that analytical work be carefully aligned with the MTPDP, and most importantly, the MFOs of the Line Agencies. The recently-concluded Growth and Development Revisited Summary Report is an example of such a strategic "action oriented" paper. In it, the recommendations are compiled in the form of a matrix; "ready" for inclusion in line agency development implementation plans.





Options for Engagement

OPTIONS FOR ENGAGEMENT

Overview. In determining options for Bank engagement, an important driver in recent years has been the difficult fiscal position of Government and the demand from oversight agencies, especially the Department of Budget Management (DBM), for budget support type assistance from the Bank to fill anticipated budget gaps. An additional push from both the DBM and the National Economic Development Authority (NEDA) has been the potential use of Official Development Assistance (ODA) to introduce institutional-led reforms to support Government public service rationalization and improve service delivery at the agency level. This impetus has resulted in the Bank focusing on lending through the Sector Investment and Maintenance (SIM) facility, which is viewed in country as budget support.

There are emerging challenges for the Bank in terms of engagement and especially in using the SIM. The most important is the limited understanding on the utility of a SIM to a traditional Sector Investment Loan (SIL); which presently is perceived as merely the provision of additional budget to the agency by smoothing funds flows. Its other important features, such as the flexibility of the instrument in permitting a programmatic, long term, sector wide and integrated approach, are still to be fully captured. A further consideration has been the high turnover in administrations and senior management, which has required repeated efforts to maintain buy-in and momentum of operations in the pipeline.

Bank engagement by Department and priority area are as follows:

A. The Department of Agriculture: The main thrust in the Department of Agriculture is to support national objectives in production, productivity, product diversification, and value addition through improved marketing. In addition, greater synergy and partnership between the national government and the LGUs is supported. The MRDP and DFIMDP projects are designed to drive a process of institutional reform toward these ends, while providing needed infrastructure to enhance rural development.

The **Diversified Farm Income and Market Development Project (DFIMDP)**, which addresses issues of agricultural competitiveness and private sector involvement in the sector, is designed to help leverage a change in the way the DA does its business, in accordance with its core functions, particularly in the delivery of market-oriented services and within the framework of the Agriculture and Fisheries Modernization Act (AFMA). The challenge in implementing this project is to ensure it does bring about the much needed institutional reforms in the DA. More specifically, it will require strong management oversight and commitment to tackle the tough institutional issues facing the DA and the sector at large.

Mindanao Rural Development Project II (MRDP II). MRDP II is the second phase of a long-term Adaptable Program Loan (APL) which is under preparation and is being designed as a targeted poverty reduction program for the rural poor and indigenous communities of Mindanao. The program specifically aims to improve incomes and food security in the targeted rural communities within the 24 provinces of Mindanao by improving productivity, food security, access to livelihood opportunities, and agriculture and fisheries service delivery in targeted rural communities and LGUs in Mindanao. It will seek to replicate the successes of MRDP I in an expanded geographical scope, in the process deepening the level of engagement among the DA, the LGUs and the communities on planning and prioritizing local investments, local resource generation and mobilization, and micro enterprise development; de-concentrating national resources allocated for devolved activities and investments; improving agriculture service delivery; and greater responsiveness to community needs, all within the framework of devolution and improved LGU transparency and governance.

In addition, a **Participatory Irrigation Development Project** is planned for FY07. The project would take a comprehensive approach to the problems of the irrigation sector, and utilize the lessons learnt from previous projects. At the center of the project would be the

streamlining of the National Irrigation Administration (NIA). NIA streamlining would determine the success of the IMT program, facilitate the reduction in operating costs of NIA leading to the removal of subsidies and the reduction of the GOP's budgetary burden, and help with the establishment of a sustainable mechanism for the rehabilitation and improvement of national irrigation systems (NIS), while providing for a self-sustaining system for communal irrigation systems.

B. The Department of Environment and Natural Resources. In the DENR, the major challenges include improving the agency's credibility and transparency, in the process enhancing public confidence in the DENR, away from a perception of it being just a regulator to being an effective and respected conservator. The challenges also include rationalizing structures, functions and expenditures to promote a sound and efficient institutional basis for ENR management based on a watershed and ecosystem approach. There is also a need to improve ENRM standards, for example, speeding-up the presently slow procedures in securing tenure instruments and issuance of resource-use permits. Land administration is also a major focus in the DENR's mandates. Land administration system in the Philippines is one of the most inefficient in the world. Consequences are multiple, fake, and bad titles. To address these issues, four key areas of reform are identified: institutional reform, legal reform, property land valuation and taxation reform, and improvement of service standards in land administration.

Planned and implemented projects with DENR include:

National Program Support to Environment and Natural Resources Management (NPS-ENRM) is presently under preparation as a targeted expenditure activity. It aims to assist government in following a development path that adequately addresses the implementation of growth and poverty reduction policies and practices to ensure that the environment and natural resources are managed and utilized in a responsible and sustainable manner. The program would have, as its main objective, the institution of the first phase of a long-term environment and natural resources man-

agement program. In doing so, it would ensure that ENRM is viewed as a critical driver of economic growth. The program's principal outcomes are envisaged to be a strengthened enabling institutional environment to mainstream Environment and Natural Resource Management issues in the economic growth, development and poverty reduction processes in the Philippines; while also assisting the GOP in enhancing ecosystem services for additional global and local benefits.

The second Land Administration Management Project (LAMP2) became effective in CY 2005. The project has an overall program objective of poverty alleviation while enhancing economic growth by improving land tenure security and fostering the development of efficient land markets in rural and urban areas, through the development of an efficient system of land titling and administration, which is based on clear, transparent, coherent and consistent policies and laws, and is supported by an appropriate institutional structure.

C. In the Department of Agrarian Reform (DAR), the strategy is to try to reduce the overall cost of prolonged uncertainties and distortions in agricultural land distribution by providing resources to speed up the land distribution process; while also increasing investments on the said lands, thereby increasing agricultural productivity. Under preparation is the:

National Program Support for Agrarian Reform (NP-SAR), which aims to support the Government meet major development goals related to growth, equity, and poverty reduction by completing essential processes in agrarian reform as efficiently as possible. Doing so would reduce the economic and social cost of prolonged uncertainties and distortions in the agriculture sector which currently hampers investment and hence, the sector's performance, competitiveness and responsiveness to changing global trends.

D. In the current work with the Land Bank of the Philippines (LBP), the overall objective is to further develop the capacity of the rural finance system in Philippines by providing long-term financing to the rural banking system and building up the capacity of the

LBP and other participating financial institutions (PFIs) lending in rural areas. Presently, there are ongoing explorations on possible further support.

E. Cross-Departmental Activities Programs supported under the global environment facility (GEF); and those proposed to support natural disaster risk management, are necessarily implemented by several Departments. The main focus of GEF support is to develop a program where partnerships are strengthened for better outcomes and impact. In the case of disaster risk management, present focus is on enhancing pro-activity in a system which is primarily reactionary. The thrusts are on:

Biodiversity Conservation and Management is being achieved through a number of different activities, particularly through a programmatic approach. The activities programmed through the National Program Support to the Environment and Natural Resources would assist the GOP in enhancing ecosystem services for global and additional local benefits. This would be achieved by establishing and implementing integrated and effective systems for ENR protection and management in select priority areas of global significance. More specifically, the blending of GEF assistance into the Environment and Natural Resources Program should help to ensure increased effectiveness and efficiency in GEF funding and other donor operations in the Philippines. Such a strategic approach would be geared towards: (i) improving country-level performance in the management of the ENR portfolio; (ii) applying lessons learned and replicating successful activities; (iii) avoiding stand-alone project-type operations; (iv) better mainstreaming GEF support through the integration of global environment issues into regular development programs; (v) strengthening institutional arrangements at the national and local levels; and (vi) projecting outcomes and impacts with clear indicators that measure performance (M&E).

Another GEF supported program is also being developed for the Mindanao region - also as an integrated project. The global environment objective of GEF assistance for MRDP II will be to conserve coastal and marine biodiversity of global significance through

the co-management of critical marine habitats and through the introduction of improved, upstream land management practices that would arrest land degradation, enhance the integrity of important ecosystems, and benefit landholders who are mostly poor farmers, fisherfolk, and/or indigenous people. The concept is based on the precept and the experiences that show that integrated upland and marine management can simultaneously conserve and protect biodiversity and increase fisheries productivity as well as improve the economic efficiency and productivity of land use practices.

The GEF is also supporting a number of climate change mitigation activities in the country, primarily in the form of bio-carbon funding arrangements. The portfolio for these activities is sizeable, although little has been done with regards to climate change adaptation. GEF is interested in pursuing the use of adaptation funds and is financing a stock-taking exercise to determine how best to incorporate climate change concerns into the development agenda, in particular focusing on mainstreaming and integrating the concern into the Government's development agenda.

Natural Hazard Risk Management: Natural disasters continue to be a key development issue in the Philippines, and the Bank will continue to work with the key agencies to determine how best the Bank can be of assistance. Recently, an operational manual, aimed at increasing Government's ability to quickly access funding needed for post-disaster rehabilitation, as well as carry out activities that reduce the risk from natural hazards was prepared with Bank assistance. The manual has full ownership of the Government and has already been presented to the Investment Coordinating Committee, a high level body that approves ODA in the Philippines. In addition, the World Bank Institute has also been formulating training modules on hazard risk reduction and management and the courses are being prepared and offered in conjunction with the Natural Disaster Coordinating Council. These efforts together form a solid basis on which further assistance can be built for the benefit of the Government and all concerned stakeholders.

F. Mindanao ARMM Social Fund Project (ongoing): The project aims to foster sustainable development and supporting mechanisms for the promotion of a peaceful and safe environment in the conflict-affected areas in the Autonomous Region of Muslim Mindanao (ARMM). The project supports the GOPs “peace and development” strategy to overcome continuing armed conflict in Mindanao between Government forces and Muslim separatist groups, namely, the Moro National Liberation Front and the Moro Islamic Liberation

Front. The project aims to support the government in implementing arrangements that are “Mindanao-driven”. Many of the targeted provinces have the lowest levels of public services, particularly in ARMM and in Regions 9 and 12. Overall, disparities between Mindanao and the rest of the Government are deepening. Through capacity building given to LGUs, local non-government organizations and affected communities in ARMM, the provision of emergency services, as well general services should be enhanced.



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