ICR Review
Operations Evaluation Department

Report Number : ICRR11138

1. Project Data:		Date Posted :	05/02/2002	
PROJ ID :	P056524		Appraisal	Actual
Project Name :	Bank'g Sys Ref (fsal	Project Costs (US$M)	600	200
Country :	Philippines	Loan/Credit (US$M)	300	100
Sector(s):	Board: FSP - Banking (75%), Central government administration (7%), General finance sector (7%), Other industry (7%), Crops (4%)	Cofinancing (US$M)	300	100
L/C Number :	L4412			
		Board Approval (FY)		99
Partners involved :		Closing Date	06/30/2000	06/30/2001

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2. Project Objectives and Components

a. Objectives

The two main purposes of this loan were to improve confidence in the uncertain external financing environment following the 1997 Asian crisis and to strengthen the financial sector . Thus, the loan was designed to support the balance-of-payment and a medium-term reform program to strengthen the banking system and enable it to better withstand current difficulties and future shocks . In addition to (i) maintaining a sound macroeconomic framework (Sched. 3 of the Loan Agreement), the BSRL had the following specific objectives, reflected in the matrix of conditionalities: (ii) improve on an ongoing basis the incentives for supervisors, bank owners, and the market for prudent banking; (iii) enhance the framework and the authorities' preparedness for early intervention and resolution of troubled banks; (iv) strengthen the poorly performing Philippines National Bank (PNB was the second largest bank and 46% government-owned) towards the standards maintained by the top tier banks in the country; (v) reduce the incentives for regulatory and tax arbitrage across financial institutions and between the peso and foreign currencies . To achieve (ii) and (iii) new legislation was required.

b. Components

All funds were for budget support. Implementation measures related to the specific objectives listed in the previous section were to be taken by the banking authorities and by Congress . Capacity building for the regulatory and supervisory institutions in the banking and capital markets was funded under ongoing technical assistance and a parallel PHRD grant approved by Japan.

c. Comments on Project Cost, Financing and Dates

At the time of project approval in December 1998, the Philippine economy had been dealt a severe blow by the 1997 regional financial crisis, but it had also proved more resilient and performed better than most market economies in East Asia, partly thanks to successful reform efforts of the financial system (with Bank assistance) in the early 1990s and partly to past lessons learned from dealing with external shocks (see the March 1998 CAE by OED and the May 1999 CAS by the Region). The project had not been rushed, as it had been under discussion with the outgoing government at least since end-1997 and as the negotiations were finalized after the election in mid-1998 of the Estrada administration. It was structured in three tranches, to be disbursed between December 1998 and June 2000. Only the first tranche of $200 million (half financed by IDA and half by JBIC-Japan) was disbursed, as both the second and third tranches were held up due to the nonfulfillment of agreed conditions of disbursements . Following the Estrada administration's ouster in January 2001 and on the basis of the new government's professed commitment to the BSRL's objectives, the Bank considered a project restructuring . However, the new government concluded that it could not fulfill the remaining conditions of the project within a few months and chose to cancel in April 2001 the undisbursed balance of $400 million ((half committed by IDA and half by Japan Bank for International Cooperation or JBIC-Japan).

3. Achievement of Relevant Objectives:

The achievement of relevant objectives was mixed, with failures in critical areas undermining the effectiveness of the reforms taken in others. (i) A satisfactory macroeconomic framework was maintained through April 2000, but slippages in fiscal and reserve targets, the subsequent slide of the peso, and the loss of investors' confidence following allegations of corruption involving President Estrada derailed the IMF program . (ii) Administrative steps to reform the prudential framework were taken on schedule and mostly before the loan's approval . (iii) The government also took all the administrative steps envisaged to put in place a satisfactory strategy for intervention and resolution of troubled banks. (iv) In spite of announced intentions, the government failed to strengthen and fully privatize PNB (its poor financial performance and corporate governance remain unresolved issues) and instead allowed a close business associate of President Estrada to increase his control over the bank . (v) The authorities implemented fully the agreed reserve, liquidity, interest, and tax policy measures to reduce regulatory arbitrage and intermediation costs. (vi) On the crucial legislative front, a General Banking Law (GBL) passed in May 2000 with some important provisions. Congress left out, however, key provisions that the government had proposed to strengthen the supervisory, intervention and resolution functions of the banking authorities (protection of supervisory officials from litigation arising from the performance of their responsibilities and limitation to legal challenges to penalties and bank closings, among others).

4. Significant Outcomes/Impacts:

See (ii), (iii) and (v) above, which were insufficient to overcome the negative impact of the shortcomings noted in the next section. According to a recent Bank study, capital adequacy ratios as of end -2001 were well above Basle standards and the liquidity position of banks had improved sharply .

5. Significant Shortcomings (including non-compliance with safeguard policies):

See (i), (iv), and (vi) above, which taken together undermined the positive outcome noted in the previous section . According to a recent Bank study, bank portfolios through end -2001 had continued to weaken due to a combination of rising non-performing loans and little new lending.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Unsatisfactory	Unsatisfactory	
Institutional Dev .:	Modest	Modest	
Sustainability :	Unlikely	Unlikely	
Bank Performance :	Satisfactory	Satisfactory	The Bank could have been more pro-active in interacting with Congress, as the ICR recognizes.
Borrower Perf .:	Unsatisfactory	Unsatisfactory	All technical measures were fully implemented by the banking authorities. However, the political leadership in both the administration and in Congress failed to implement crucial agreed measures under this project.
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

When a critical number of specific objectives (such as i, iv, and vi in Section 3) depends on the commitment of politicians and not simply on the leadership of the counterpart technical government agencies, the Bank should carefully identify political risk, be up front about it in the Board documents, and pro -active in addressing them.

8. Assessment Recommended? ● Yes ○ No

Why? An impact evaluation is recommended, as it could feed into a future update of the CAE and of a Bankwide financial sector evaluation and it would track possible delayed results of this project once sufficient time has passed for the new government to act on its professed commitment to reform in the sector .

9. Comments on Quality of ICR:

The ICR has very little analysis of (and scattered references to) the political background that undermined the project's outcome. It covers macroeconomic performance only superficially and with no supporting data . Its picture of the state of the banking system is also sketchy and scattered, although it is readily available in a Bank report under preparation (draft DPR, dated February 1, 2002). While the ICR explains why the loan was cancelled, it doesn't explain why the new government's professed commitment to the BSRL objectives has not yet been translated in concrete action (in 11 months). Absolute and percentage data on the project's actual /latest cost (disbursements) in Annex 2 are wrong. The satisfactory rating of achievement of institutional development objective in Annex 5 is at odds with the modest rating explicitly shown in Section 2 and implicitly discussed in Section 4.5 of the ICR. Finally, the government's comments do not provide either the evidence or explicit corroboration for many of the Region's interpretations, judgments, and ratings. The ICR is nevertheless rated satisfactory (although only marginally so) due mainly to the convincing evidence presented on the achievements and shortcomings of the project, its internal consistency, the identification of the main lesson summarized above, and coverage of future plans .