



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform the Congress of our plan to negotiate a Millennium Challenge Compact with the Government of the Republic of the Philippines.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of the Philippines, please contact Ellona Fritschie (for the Senate) or Erin Kolodjeski (for the House of Representatives) at (202) 521-3850. This notification is being sent to the Congress on January 12, 2010, and negotiations with the Government of the Republic of the Philippines may be started on or after January 26, 2010.

Sincerely,

James Mazarella
Vice President (Acting)
Congressional and Public Affairs

Enclosure:

As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

January 12, 2009

Pursuant to the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010 (Pub. L. 111-117, Division F), and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification is (1) to advise you that the Millennium Challenge Corporation intends to start negotiations with the Government of the Republic of the Philippines for a Millennium Challenge Compact and (2) to initiate the 15-day consultation period before the start of negotiations.

Attached please find a summary of the objectives and mechanisms to be used for the negotiations of this Compact

SUPPLEMENTAL INFORMATION

MCC COMPACT DEVELOPMENT WITH THE REPUBLIC OF THE PHILIPPINES

January 12, 2010

Overview

MCC first selected the Philippines as eligible for MCC compact assistance in March 2008. MCC and the Government of the Republic of the Philippines (GRP) analyzed several project proposals first submitted to MCC in January 2009. The GRP and MCC then selected a subset of these proposals based on the results of detailed studies underway, estimated project budgets, estimated economic returns, impact on poor beneficiaries, and implementation risks. The three project proposals outlined below aim to address the Philippines' lack of fiscal space for productive expenditure, its poor quality of basic infrastructure, and poor delivery of essential social services at the local level, all of which were identified as binding constraints to economic growth. These project proposals also benefitted from feedback from civil society, government agencies, other donors, and the private sector.

After an intensive compact development process, MCC anticipates entering into compact negotiations with the Government of the Republic of the Philippines (GRP).

Program Overview and Budget

Following several months of development and refinement, the GRP submitted project concept documents focusing on five key proposals in late January 2009. MCC conducted an internal and external peer review—drawing upon expertise of other donors (including USAID) and the private sector—following which the list of project concepts was reduced to four based on the analysis of the economic returns and beneficiaries, as well as the technical challenges presented by each concept, including project risk, possible risk mitigation measures, and viability. In May 2009, MCC and the GRP agreed to cut the projects under development to three. The three remaining project concepts, with a preliminary estimated investment cost of up to \$445 million include: (i) an expansion and improvement of community development project, Kalahi-CIDSS¹; (ii) reforms and investments to modernize the Bureau of Internal Revenue (BIR) to increase fiscal space for public good investments and social spending and reduce opportunities for corruption in tax administration; and (iii) construction of one, and rehabilitation of two contiguous secondary national roads. MCC and the GRP agreed to consider these project concepts because they align closely with the Philippines constraints to growth analysis and other GRP development plans; directly support MCC's mission to promote poverty reduction through economic growth; likely have an economic rate of return (ERR) in excess of 12.4% (MCC's hurdle rate); have identifiable beneficiaries; are technically, environmentally and socially sound; and can be completed within five years.

¹ Kapit bisig Laban sa Kahirapan (“Linking Arms Against Poverty”) – Comprehensive Integrated Delivery of Social Services

To ensure that these projects are ready for implementation, MCC and the GRP have invested substantial resources in project development, including technical and economic feasibility studies, environmental and social impact assessments, and the establishment of implementation structures. Advancing this work will enable the Philippines to break ground more quickly, reduce the risk of cost escalations, and improve the speed and predictability of disbursements. These studies are nearing completion and will inform the final scope and costs of the compact proposal submitted for MCC management and Board approval.

The following table outlines estimated costs and benefits of the proposed program by project, and administrative costs. Information in this memorandum is expressed in terms of maximum possible project size. It is subject to further verification and revision.

Proposed Compact Components	Preliminary Cost Estimates (millions of US\$)	Preliminary Estimated Economic Rates of Return	Preliminary Estimated Number of Beneficiaries²
Kapit-Bisig Laban sa Kahirapan-Comprehensive and Integrated Delivery of Social Services (Kalahi-CIDSS)	\$120	13%	7.0 million
Revenue Administration Reform Project	\$60	40%	125 million (projection for 2030)
Secondary National Roads Development Project	\$265	14%	0.54 million
Administration: MCA-Philippines, Monitoring and Evaluation, Audit Services	\$40	N/A	N/A
Proposed Compact Total (up to):	\$485		N/A

Kalahi-CIDSS

Project Rationale and Description

The community-driven development project, KALAHI-CIDSS (or KC), aims to increase incomes in rural areas through small-scale, community driven development projects. The KC project does so through direct provision of infrastructure and services associated with community-selected and managed “subprojects,” strengthened community participation in development and governance activities at the village and municipal level, and improved responsiveness of local government to community needs. The project will build on and support the application of the participatory planning, implementation, and evaluation methodology

² As of year 5 of Compact implementation (except as noted). These beneficiary estimates are not additive; many people may benefit from more than one MCC project activity.

developed by the Philippine Government's Department of Social Welfare and Development (DSWD).

The project concept prioritizes (a) empowering communities to participate fully in the development of their communities, and to manage assets in a sustainable way, (b) improving how communities link their priorities to other development programs of the state, and (c) using investments from the project as a platform to promote greater accountability and to reduce poverty. The grants provided by the project are overseen by local communities, who are responsible for the project selection, the procurement of goods and services for their project, and in many cases the operations and maintenance of the physical assets. The DSWD would implement the project, overseen by a National Steering Committee that includes representatives of other government departments and NGOs, and in collaboration with local governments.

While MCC will take advantage of the many lessons learned during the implementation of the World Bank funded first phase of KC (KC 1) and consequent project refinements, MCC's own KC program will include a much deeper emphasis on improving gender equity and the participation of women in the project. An impact evaluation of the program will expand upon and enhance the data collection and evaluation efforts undertaken during the first phase of KC, and is expected to exploit a more robust, rigorous methodological approach than evaluations of comparable programs around the world have done. MCC is also developing a sliding scale of oversight based on a categorization of projects and their attendant risks, which would be an innovation to the current KC model. The MCC funded version of KC will be complementary in most aspects to the second phase of the World Bank's program, which will be implemented in an overlapping timeframe. This coordinated effort will lay the groundwork for a national expansion of the program by building the capacity of DSWD and demonstrating the agency's ability to coordinate multiple funding sources.

Preliminary evaluations of the KC 1 indicate that most subproject types have superior cost effectiveness compared to traditional infrastructure projects implemented by the central government. Integral to the effectiveness and the sustainability of the project to date is the project's participatory model, which builds social capital by catalyzing an intensive engagement with communities (*barangays* in the national language), their leaders, and municipalities. The model is based on a methodology that emphasizes empowerment through strengthened participation at the *barangay* level, transparent decision making and reporting in planning, implementation, and evaluation. By providing tangible, functional examples of effective service provision, the project also encourages rural constituents to hold their *barangays* and municipalities accountable for good governance that delivers public value. A study conducted in 2006 found that 82% of subproject costs were in the following major categories of investments: domestic water supply (pump and gravity), roads construction and improvement, elementary school buildings, *barangay* health centers and day care centers.

Revenue Administration Reform Project

Project Rationale and Description

The Revenue Administration Reform Project (RARP) addresses a key constraint to economic growth in the Philippines: the lack of fiscal space³ for growth-enhancing investments in public goods such as infrastructure and social services (e.g., education and health), while reducing opportunities for corruption in revenue administration. The project will increase the efficiency of revenue collection through a redesign and computerization of business processes with a focus on the Bureau of Internal Revenue (BIR) within the Department of Finance (DOF). The overall objective is to address the problems of tax evasion and corruption while raising tax revenues. Some of these activities are extensions of Philippines Threshold Program activities that concluded in May 2009.

The project will reduce public sector administrative costs for the Philippine revenue agencies, allowing these resources to be diverted to more productive uses. This occurs through process improvements and automation aimed at enhancing agency effectiveness and minimizing opportunities for corruption, while increasing the likelihood of detecting corruption and tax evasion. Over the longer term, these efforts will increase the revenue raised through tax administration and enforcement. There is a direct link between perceptions of inadequate control of corruption, an often unfavorable investment climate, and the persistently low level of private investment. The current enabling environment makes it difficult to realize profits from investments of any size – as a result, poor people choose to consume more than invest, and wealthy people send their savings overseas where they can more reliably receive higher returns. While improved tax revenue administration constitutes only one element of the enabling environment, the project's contribution to increased transparency and level of automation will narrow the gap between potential and actual collections, improve the predictability and impartiality with which revenue laws and regulations are enforced, and reduce opportunities for tax evasion and corruption.

Secondary National Roads Development Project

Project Rationale and Description

The Secondary National Roads Development Project (SNRDP) will reduce transportation costs through the construction of one, and rehabilitation of two contiguous, existing road segments. These reduced costs will facilitate increased commerce in and between the provinces of Samar and Eastern Samar and around the city of Iloilo, increasing incomes through both decreased vehicle operating costs and time savings for both passengers and goods, and reduced maintenance costs borne by the public sector.

Inadequate infrastructure is consistently named by rural dwellers as a significant constraint on economic activity and development. People in these communities view roads as essential infrastructure, and ranked by them among the most important improvements that could be made in their villages.

³ The severity of the constraint is underscored by levels of public sector infrastructure investment and government development expenditures (as a percentage of GDP) which are among the lowest in Southeast Asia.

For farmers, fishers, traders, and those in the tourism industry—the primary economic activities in these regions—secondary roads constitute a critical connection to markets. Improved roads, moreover, facilitate productive diversification—including transport itself and transport-reliant services such as logistics and shipping—labor mobility for skilled and unskilled workers alike, and reduced travel times (and potentially increased travel frequency) to social services such as education and health.

Partnership Strategy

MCC has worked closely with established donors and multilateral organizations, including the World Bank, the Asian Development Bank (ADB), the International Monetary Fund (IMF), and the Japan Bank for International Cooperation (JBIC), alongside the GRP in the development and planning of the proposed compact projects. The GRP is developing the second phase of Kalahi-CIDSS with the World Bank and MCC. MCC has partnered with the World Bank and IMF in their work with the DOF, and MCC will arrange to have the IMF provide technical oversight for the MCC-funded project in tax administration. MCC will continue collaborating with the road sector “donor group,” (comprised of the World Bank, ADB, JBIC, and the Australian Agency for International Development) which has partnered with the GRP to promote transparency and accountability in road sector procurements as well as provide sufficient and sustainable levels of dedicated funding for road maintenance in the Philippines.